TAX AND THE CITY

The majority of the Court of Appeal in Prudential decides in favour of HMRC that the investment management services are treated as supplied when invoiced (which was after the supplier left the VAT group) rather than when actually made (when part of the VAT group). According to the First-tier Tribunal in *Barclays Bank Plc*, the accounting treatment giving rise to a discount is not GAAP compliant and, even if it were GAAP compliant, the provision in the accounts does not 'fairly represent' a loss arising to the taxpayer from the debt instruments. The Upper Tribunal decides in *Beard* that payments from the share premium of a non-UK company to a UK shareholder are dividends of an income nature and so subject to income tax. The UK government announces that it will legislate in a future finance bill for the global minimum tax country-by-country safe harbour anti-avoidance provision, which will have effect from 14 March.

Prudential: interaction of VAT grouping and time of supply rules

Prudential v HMRC [2024] EWCA Civ 300 is about the interaction of the VAT grouping rules (VATA 1994, s 43) and the time of supply rules for continuous services (VAT Regulations 1995, SI 1995/2518, regulation 90). The majority of the Court of Appeal (Lord Justice Newey and Lord Justice Underhill) dismissed the taxpayer's appeal but there was a dissenting judgment by Lord Justice Nugee which may encourage a further appeal.

Silverfleet provided investment management services to Prudential whilst both were members of Prudential's VAT group. Following a management buy-out, Silverfleet later ceased to be a member of the VAT group. As part of the consideration for the investment management services was based on the performance of the managed funds over several years, there were invoices raised, and payments made, after Silverfleet left the VAT group. The question was whether these payments made after Silverfleet left the VAT group, in respect of supplies of services rendered when part of the VAT group, were subject to VAT.

The VAT grouping rules in s43 provide that a supply by one member of a VAT group to another is to be disregarded and any business carried on by a member shall be treated as carried on by the representative member. Regulation 90 provides for continuous supplies of services to be treated as supplied at the time of the invoice or payment, rather than at the time the services are supplied 'in the real-world'. Which rule comes first? Both rules have deeming provisions that look to something other than the 'real-world' situation. The First-tier Tribunal (FTT) decided the VAT grouping rules applied first and, as the services were supplied within the group, they were outside the scope of VAT. The Upper Tribunal (UT) and the majority of the Court of Appeal agreed with HMRC that you look at the time of supply rules first which provide that the time of supply of the services for which the performance fees were paid was when they were invoiced or paid. As the parties were no longer in a VAT group at that time, VAT was due.

There was much discussion at all three levels of the Court of Appeal's judgment in the *B J Rice* case [1996] STC 851. Mr Rice had done work for a client and invoiced for it when he was not registered for VAT. The client did not make payment until 4 years later by which time Mr Rice was registered for VAT and HMRC argued the supply was to be treated as made when payment was received which meant that VAT was due. The Court of Appeal held by a majority (again there was a dissenting judgment) that no VAT was payable on the basis that the time of supply rules determine 'when, but not whether,' VAT is chargeable, and the existence of a chargeable transaction is to be determined 'at a time when the supply is actually made'. In *Prudential*, counsel for the taxpayer relied on *B J Rice* to argue the deeming of the supply to occur after Silverfleet left the VAT group cannot go so far as to create a tax charge where there would not otherwise be one.

The judges disagreed on whether *B J Rice* is binding and if so, whether the *ratio* can be distinguished. *B J Rice* has not been expressly overruled by a higher court so it is open to interpretation whether there is anything in the subsequent House of Lords decisions referring to it which means it can no longer stand. The FTT found it binding and not distinguishable, but the UT found the FTT had erred in regarding it as binding. The majority of the Court of Appeal found that *B J Rice* cannot stand in light of the later House of Lords decisions but Lord Justice Nugee in his dissent found it is binding and not distinguishable.

Lord Justice Nugee accepted that caselaw has moved on since *B J Rice* and that regulation 90 can affect not only the time of supply but also the nature of supply. He acknowledged this means the blanket statement in *B J Rice* that the time of supply rules are concerned with 'when, not whether' can no longer be regarded as authoritative but he was not persuaded this meant *B J Rice* is no longer binding on the Court of Appeal. Lord Justice Nugee considered the court was obliged to apply the *B J Rice ratio* to the effect that 'if a supply is not a chargeable transaction at the time of supply it does not become one later through the operation of the time of supply rules (subject to the exception in the case of exempt supplies)'. In his view, it follows that Silverfleet's supply of services to Prudential, being at the time of actual supply an intra-group supply and not chargeable, has not become chargeable through the operation of regulation 90.

A Supreme Court decision would be welcome to provide clarity in this murky area of intersection of the two deeming rules. In the meantime, before a supplier of continuous services leaves a VAT group it would be good practice, where possible, to ensure outstanding amounts for services supplied whilst in the VAT group are invoiced and paid. In the case of performance fees spanning several years, such as in the *Prudential* case, it may not be possible to pay the performance fees before the supplier leaves the group in which case the additional VAT cost to the group should be borne in mind when making the commercial decision for the supplier to leave the group.

Barclays Bank PLC: debit denied for loan relationship discount

The FTT in *Barclays Bank Plc v HMRC* [2024] UKFTT 246 decided this loan relationship discount case in HMRC's favour. The taxpayer had claimed losses under the loan relationship rules in relation to an accruing discount shown in the accounts for the debt instruments it issued. In brief, Barclays Bank Plc (BB Plc) issued debt instruments with a face value of £3bn, and its listed parent company, Barclays Plc (B Plc), issued share warrants, to Qatar during the financial crisis in 2008. Under the documents, BB Plc received £3bn for issuing the debt and B Plc received £1.52 for issuing the warrants. The accounting treatment, however, differed from this. The IFRS accounts of BB Plc (audited by PWC) recognised the debt instruments at £2.2bn (being £3bn received less £800m being Barclays' estimate of the fair value of the warrants) and accreted them to par over the terms of the instruments. There was an £800m credit to equity, treated as a capital contribution to BB Plc by B Plc.

HMRC challenged the deduction of the debit for the discount on two grounds. Firstly, that the accounting treatment (recognising the debt instruments at £2.2bn and accreting them to par) was not GAAP (IFRS) compliant. HMRC was successful in this argument with the FTT finding the debt instruments should have been recognised at £3bn. Second, HMRC argued that even if the accounting treatment were correct, the discount did not 'fairly represent' a loss arising to BB Plc from the debt instruments given that it received £3bn and did not itself issue the warrants. The FTT also agreed with this argument which was based on section 84(1)(a) FA 1996 which applied at the relevant time, although we no longer have an equivalent of the 'fairly represents' rule in the current legislation (it was replaced by the regime anti-avoidance rule in CTA 2009 ss 455B – 455D).

The FTT seemed to prefer the technical analysis of Barclay's expert to HMRC's expert as to how to apply IAS 39 (use the transaction price agreed by the parties not a fair value derived from valuation techniques). However, the FTT disagreed with the way the Barclay's expert applied this to the facts to give his view that the £3bn transaction price was paid for the debt instruments and the warrants together. The FTT concluded, as a matter of fact, that the £3bn was paid for the debt instruments alone and the value in the warrants was given away by the Barclays shareholders. The FTT noted the absence of an expert from PWC, as auditor, to defend the position in the accounts.

The conclusion on 'fairly represents' is unsurprising. Both parties accepted, as was established by the Court of Appeal in *GDF Suez* [2018] EWCA Civ 2075, that 'fairly represents' is a statutory override in the sense that it allows you to ignore the accounts if they do not fairly represent a real profit/loss from a debt instrument. The taxpayer failed to show the debit does represent a real economic loss suffered by BB Plc. On the FTT's analysis, BB Plc received £3bn for issuing an instrument with face value £3bn, carrying an arm's length coupon, and ultimately repaid for £3bn, so the £800m is not an economic loss for BB Plc but is rather a loss suffered by B Plc (or arguably B Plc's shareholders) agreeing to issue warrants worth that much for £1.52.

Although the 'fairly represents' point is now of historical interest only, this case is a good reminder that in cases where HMRC think an accounts based deduction should be denied it is not uncommon for them to seek to do so on the basis that even Big 4 audited accounts are not GAAP compliant, in addition to any tax technical challenges they may have, and for such an approach to be successful.

Beard: tax treatment of distributions from non-UK resident company

The UT in *Alexander Beard v HMRC* [2024] UKUT 73 had to determine the UK tax treatment of distributions from the share premium of Glencore, a Jersey company, to a UK resident shareholder. The taxpayer's argument was that the payments he received were distributions of a capital nature and so subject to capital gains tax, rather than income tax, in the UK.

The UT dismissed the taxpayer's appeal on the basis that the FTT's conclusion that the distributions constituted dividends within ITTOIA 2005, s 402 is 'impeccable' and they are not 'dividends of a capital nature' for the purposes of s 402(4) 'for reasons which are for the most part similar to those set out in the impressive judgment of the FTT'.

In this case, the taxpayer and HMRC both took on the reverse positions to those argued in the *First Nationwide* case where the taxpayer had argued the payment by a Cayman company out of share premium account was a dividend of an income nature and HMRC argued the dividend was capital in nature and so not within the corporate dividend exemption. In *First Nationwide*, the FTT, UT and Court of Appeal agreed it was a dividend and was income in nature in the hands of the recipient.

It is reassuring that the UT has agreed with the conclusion of the FTT rather than re-introducing the uncertainty that HMRC's approach in *First Nationwide* had caused until the Court of Appeal's decision [2012] EWCA Civ 278 became final. For income tax purposes there is a distinction between payments received from UK-resident and non-UK resident companies. UK income taxpayers are subject to income tax on any distribution (whether or not capital in nature) from a UK resident company but only on dividends not of a capital nature, or other income received, from a non-UK resident company. Advisers drafting shareholder documents for any of the London-listed non-UK resident companies are often required to ascertain how a particular payment to UK individual shareholders should be classified.

Pillar two: anti-avoidance rule ministerial statement

In our Tax and the City review for January (Tax Journal, *January 2024*), we mentioned concerns about the breadth of the anti-avoidance provision preventing exploitation of the country-by-country reporting (CBCR) safe harbour which was included in the third set of administrative guidance agreed by the OECD/G20 Inclusive Framework in December 2023. The CBCR safe harbour allows companies to use their CBCR information to calculate tax rates in each jurisdiction if they meet certain criteria and is a much simpler method for determining if they are subject to the minimum tax rules. The anti-avoidance provision tackles transactions taking advantage of differences in tax and accounting treatment to get within the CBCR safe harbour. The administrative guidance identified three hybrid arbitrage arrangements to be excluded from this safe harbour calculation which could cause groups to lose the benefit of the safe harbour.

The UK government announced that it will legislate for this anti-avoidance provision in a future Finance Bill to prevent a loss of UK tax, with effect from the date of the announcement, 14 March. It is hoped that concerns about the breadth of the provision in the administrative guidance will be addressed as the government intends to consult with stakeholders on how the provisions are legislated to ensure the legislation operates as envisaged without unintended outcomes.

What to look out for:

- The Court of Appeal is scheduled to hear the appeal in *Hotel La Tour v HMRC* (VAT on professional fees connected to a share sale) on 10 April.
- On 16 or 17 April, the Court of Appeal is scheduled to hear the appeal in *KWIK-Fit Group Limited v HMRC* (unallowable purpose test in loan relationship rules).
- Tax Administration and Maintenance Day is 18 April when announcements of new tax measures, together with an update on current consultations, are expected.
- 9 May 2024 is the closing date for responses to the HMRC consultation on HMRC's enquiry and assessment powers, penalties and safeguards.

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