Slaughter and May Podcast
Tax News: April 2024

Zoe Andrews	Welcome to the April 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 the Court of Appeal's decision in *Prudential* and the Upper Tribunal's decisions in *Beard* and *Sehgal*. We will also touch on the Spring Finance Bill, the UK's proposal to introduce a CBAM, HMRC's updated guidance on aspects of the new R&D relief regime and the statement of intent to introduce an anti-abuse rule to prevent the exploitation of the CbCR transitional safe harbour. And we will finish off with some other international tax news and exciting things to look forward to which will – spoiler alert – include our upcoming special podcast series on tax disputes. The podcast was recorded on the 9th of April 2024 and reflects the law and guidance on that date.
Zoe Andrews	Let's start with *Prudential*, a case which illustrates the uncertainty that can be caused at the intersection of two deeming rules in the VAT legislation. The facts are quite simple: fund management services were provided by Silverfleet to Prudential at a time when Silverfleet was a member of Prudential's VAT group. But part of the payment for those services was dependant on how well the managed funds performed. At the time Silverfleet invoiced for these performance fees and received those payments, it was no longer part of the VAT group. Taking the VAT grouping rules first, at the time of the actual supply of the management services, the supplier was in the VAT group. Section 43 of the Value Added Tax Act 1994 tells us that supplies between members of a VAT group are to be disregarded and any business carried on by a member of the group shall be treated as carried on by the representative member. So you might think, as the taxpayer argued, that section 43 should be the start and the end of the analysis – the services themselves were outside the scope of VAT and so the later invoicing and payment of fees for those services should not be subject to VAT.
Tanja Velling	But, there is another deeming provision to consider here. That's the supply of continuous services rule in regulation 90 of the VAT Regulations 1995. This provides that such services are to be treated as supplied at the time of the invoice or payment, not when they were actually supplied. Here the invoices were issued after Silverfleet had left Prudential's VAT group. So, if you apply the continuous services deeming rule first, the services are treated as supplied when the entities were not grouped and therefore can't be disregarded under the grouping rules. That is the view that the Upper

	Tribunal and then the majority of the Court of Appeal took – the time to look at whether the supplies were made within a VAT group was at the time they were treated by regulation 90 as being supplied, not the actual time of the supply. So the performance fees are paid for management services supplied outside the VAT group and therefore were subject to VAT. What did the dissenting judgment say?
Zoe Andrews	Lord Justice Nugee reached a different conclusion to the majority on the interpretation and application of caselaw. In particular, Lord Justice Nugee considered that the Court of Appeal is bound by a previous Court of Appeal decision in a case called *BJ Rice* and this case could not be distinguished on the facts and it had to be applied here. In *BJ Rice,* services were provided by Mr Rice at a time when he was not registered for VAT but were not paid until 4 years later, when he was registered for VAT. HMRC had argued the services were supplied at the time they were paid, at which point they should have been subject to VAT. But the Court of Appeal determined that the time of supply rules cannot take a non-chargeable supply and make it chargeable. The majority of the Court of Appeal in *Prudential* thought that *BJ Rice* is no longer good law (in light of subsequent House of Lords decisions) and so not binding. We do not have time here to go into the analysis of *BJ Rice* and whether it can still stand but it raises some interesting issues.
Tanja Velling	So perhaps an interesting one for the Supreme Court to sort out if the taxpayer appeals – and the fact that there is a dissenting judgment (which is unusual these days) may encourage the taxpayer to do so! In the meantime, this case is a good reason for ensuring a clean break, where possible, when a supplier leaves a VAT group, rather than payments being made afterwards. Or in the case of performance fees which are, of necessity, due at points in the future, the additional VAT costs of such payments being made outside the VAT group should be taken into account when considering the implications of the supplier leaving the VAT group.
Zoe Andrews	Before we move on to the *Beard* case, to set the scene I want to remind you that, for income tax purposes, there is still 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. *Beard* is a case about whether distributions from the share premium of a Jersey company were taxable as income or capital in the hands of the UK-resident recipient. The Upper Tribunal had to consider two questions. Were the distributions dividends? If they were dividends, were they dividends of a capital nature for the purposes of section 402(4) of the

	Income Tax (Trading and Other Income) Act 2005 which we'll refer to as ITTOIA?
Tanja Velling **06:44-07:13**	HMRC assessed Mr Beard to income tax on the distributions, he appealed to the First-tier Tribunal which held that they were not dividends of a capital nature. The Upper Tribunal agreed, with much praise to the FTT judge (Rachel Short) for her "impressive judgment". The leading case on the question whether a dividend is in the nature of income or capital is *First Nationwide* and it is quite interesting that the arguments of the taxpayer and HMRC in *Beard* are the opposite to the respective positions taken in *First Nationwide*. In *First Nationwide* the taxpayer successfully argued that the payment out of share premium of a Cayman company was a dividend of an income nature whereas HMRC had argued it was of a capital nature and so outside the corporate dividend exemption. Counsel for the taxpayer in *Beard* sought to distinguish *First Nationwide* as irrelevant to section 402 of ITTOIA because it was decided on earlier UK legislation contained in Income and Corporation Taxes Act 1988. But the FTT and UT concluded that the *First Nationwide* analysis of what is a dividend and what is income and capital does not depend on reference to any prior statutory provisions.
Zoe Andrews	Following the test laid down in *First Nationwide* the FTT had concluded that the distributions from the Jersey company fell within the meaning of dividend as a matter of ordinary usage for English law purposes and were paid out of the share premium account by the same mechanism as would be used for paying a dividend out of trading profits. It is a relief to advisers and taxpayers for the *First Nationwide* analysis to be confirmed equally applicable to the ITTOIA legislation.
Tanja Velling	Let's now turn to the Upper Tribunal's decision in *Sehgal*. At its heart is a set of rules that both the government and the opposition want to abolish. These are, of course, the remittance basis rules, popularly known as the non-dom rules. Pursuant to these rules, individuals who are resident, but not domiciled, in the UK may be taxed on their foreign income and gains only to the extent that they have brought (or "remitted") these to the UK.
Zoe Andrews	But we should probably start with the facts of the case which I'll simplify slightly. Two individuals owned certain companies. One of the companies, which we shall call "IR", owed around £6 million to another of the companies. That other company was Visage Ltd. The individuals sold Visage's parent to an unrelated third-party group, and the SPA provided for an indemnity in case IR failed to repay the debt due to Visage.

	Lo and behold, IR failed to repay the debt, so the purchaser could have claimed under the indemnity. But the purchaser group became concerned about the financial reporting effects of an indemnity payment, and an alternative transaction was agreed. The individuals put IR's parent in funds to purchase goods from a member of the purchaser's group. The goods were worth around €200,000 (and they were ultimately donated to charity), but IR's parent paid roughly €6.8 million for them. In this way, the indemnity payment was replaced by a sale of goods at an overvalue. This was accompanied by a side letter releasing the individuals from the SPA indemnity and confirming that IR's debt was reduced by the amount paid for the goods.
Tanja Velling	And that amount, HMRC then claimed, should be subject to tax in the hands of the individuals. Very broadly, HMRC's view was that the amount represented chargeable gains realised on the sale of Visage's parent and the alternative compensatory transaction amounted to a remittance of these gains to the UK. The taxpayers won both before the First-tier Tribunal and now before Upper Tribunal, but for different reasons. Before the First-tier Tribunal, they ultimately won on the basis that there was no chargeable gain that could have been remitted. In contrast, the Upper Tribunal considered that there was a chargeable gain capable of remittance, but nothing was actually remitted. I propose that we focus on the chargeable gains point and make one more general observation, leaving the remittance question to one side.
Zoe Andrews	So, onto chargeable gains. The FTT considered that the term refers to gains as calculated for capital gains tax purposes and, for those purposes, the amount of a gain that is taxable on a share sale is reduced if there is an indemnity payment under the SPA. So, to the extent of the indemnity payment, the chargeable gain effectively disappears. Consequently, saying that an indemnity is paid out of chargeable gains realised on the transaction to which it relates would be a nonsense. In the FTT's words: "adopting HMRC's approach and suggesting that funds paid in order to reduce the proceeds of a share sale should be treated as generating a taxable gain in the UK has something of Alice in Wonderland about it." I would agree, and the Upper Tribunal also agreed (although its discussion of the point was *obiter*). But there remained a problem. In this case, there was no indemnity payment, only the different compensatory transaction. The FTT considered that this didn't make a difference; the same reasoning applied to mean that

	the payment for the goods under the compensatory transaction could not have been out of chargeable gains. At the time, I struggled to follow the FTT's reasoning here; it seemed a rather broad-brush substance-over-form approach to me. And now, it looks as if I was vindicated by the Upper Tribunal. Also *obiter*, it considered that the FTT had erred on this point. The compensatory transaction "created rights and obligations which were distinct from the rights and liabilities under the original sale of shares... The whole purpose of the structure adopted was to avoid there being a claim under the Indemnity, and that was its actual effect." The payment under the compensatory transaction did not reduce the chargeable gains (as the indemnity payment would have done), so it can very well be made out of those gains. This makes more sense to me as it means taxing the individuals in accordance with the transaction they actually entered into.
Tanja Velling	I also thought it encouraging that the Upper Tribunal rejected HMRC's argument to the effect that the relevant legislation should be regarded as anti-avoidance provisions (because they were intended to address "loopholes, flaws and anomalies") and therefore given a broader construction informed by the aim of "taxing gains that were not 'genuinely' kept offshore". I would draw a line here back to the Supreme Court's decision in *Fisher* where Lady Rose considered it an "improper argument for HMRC to run" that uncertainty as to the scope of a charging provision can be a positive virtue of the drafting as taxpayers cannot structure around a provision if its scope is unclear. HMRC could then assess them and wait for the taxpayer to convince it that there was no mischief. Lady Rose agreed with Counsel for the taxpayers that "the law cannot be left in some unclear state 'just to scare people'".
Zoe Andrews	It is heartening to see courts drawing a line in the sand against arguments in favour of an overbroad or uncertain reading of the legislation. But what if you had to conclude that this is exactly what Parliament intended? You will recall that, in *Fisher*, a family-owned UK company had transferred its telebetting business to a Gibraltar company owned by the same individuals, and HMRC sought to tax the individuals on the Gibraltar company's profits under the transfer of assets abroad rules on the basis that, as shareholders of the company, they were the "quasi-transferors" of assets transferred by the UK company to the Gibraltar company. The Supreme Court rejected the "quasi-transferor" argument and concluded that the relevant section did not apply to an individual in relation to a transfer made by a company in which they are a shareholder, even if they

	are also a director. As part of the Spring Budget, it was announced that legislation would be introduced to change this.
Tanja Velling	This legislation is included in the Spring Finance Bill which was published on the 13th of March, the day after we recorded the March edition of this podcast. The legislation would bring individuals who are participators in a close company within the scope of the transfer of assets abroad rules in respect of a transfer made by that company. This is subject to two conditions and both conditions have to be met for the TOAA rules to bite. The first condition is that the individual must have been involved in the company, but this may give little comfort. The individual will be treated as being involved unless they can satisfy HMRC that they had no direct or indirect involvement in the decision making of the company. It is unclear what level of involvement would be required and over which period this would be tested. For instance, how would you treat someone who used to manage the company but had stepped back, for example with a view to retiring? So, perhaps taxpayers may end up relying more on the second condition. That's the avoidance condition. It is failed (so that the TOAA rules don't apply) if the individual objected to the transfer. But this would have to be a genuine objection – objecting only for the purpose of failing the condition wouldn't cut it because this condition (as well as the involvement one) is backed up by an anti-avoidance clause pursuant to which arrangements with a main purpose of securing that the relevant condition is failed are ignored. Overall, to me, this starts to look like legislation intended to scare people with an "assess and let them try to convince HMRC that there is no mischief" approach.
Zoe Andrews	We'll have to see whether any changes are made to clarify the scope of the provisions as the Bill goes through Parliament, but I wouldn't hold my breath.
Tanja Velling	It's also worth mentioning the commencement date. The amended rules apply in respect of income arising on or after the 6th of April – that is in respect of existing as well as new structures. So, if the Fishers' business was still run through the same arrangement, they could probably now be subject to tax under the TOAA rules.
Zoe Andrews	The Spring Budget also confirmed that the introduction of a new fund type, the Reserved Investor Fund (Contractual Scheme) or "RIF", will go forward. HMRC has now published draft regulations for consultation until the 14th of May. The enabling legislation for these regulations is included in the Spring Finance Bill.

	That Bill also includes legislation for the energy security investment mechanism which would lead to an early termination of the Energy (Oil and Gas) Profits Levy, if oil and gas prices fall below the relevant thresholds.
Tanja Velling	In other news, HMRC and HM Treasury launched a consultation on the design and administration of the proposed UK carbon border adjustment mechanism (or "CBAM"). It is envisaged that, from the start of 2027, a charge would be imposed on emissions embodied in certain imported products including cement, fertiliser, glass and hydrogen. The tax point would be when the products are subject to customs control or, if they are not subject to such controls, when they first enter the UK. The consultation runs until the 13th of June.
Zoe Andrews	Pursuant to the Finance Act 2024, rules for research and development reliefs have changed for periods beginning on or after the 1st of April of this year. The changes include a restriction on relief where the R&D is carried out overseas and new rules for contracted-out R&D. On the 27th of March, HMRC published updated guidance on these two aspects. Draft guidance had been made available for comments back in February. I'll limit myself to highlighting a few points. The guidance reiterates that there are no specific record-keeping requirements for the purpose of claiming R&D reliefs, but it helpfully details the level of evidence HMRC may expect to see in respect of the location of the R&D under the general requirement to keep and preserve records. It is said that this would "be pragmatic and proportionate to the risk". In the case of a small contractor with a UK trading address, evidence of the address would be sufficient. Where a business relies on an exception to claim for overseas expenditure, it is advisable to retain minutes of meetings, plans and other evidence showing that it was necessary to carry out the work overseas. Later on, the guidance states that "HMRC would expect that in managing the R&D project plans and proposals would consider and identify what activity is needed and where, and these would be the starting point."
Tanja Velling	I also thought it somewhat amusing that, in discussing which factors would indicate that R&D is carried out in the UK, HMRC felt the need to clarify that all of England, Scotland, Northern Ireland and Wales count as the UK for these purposes.
Zoe Andrews	The guidance around the exception for overseas expenditure has also been expanded, including to confirm that expenditure could be apportioned as qualifying or non-qualifying where some parts of a project, but not others meet the conditions for the exception. In this respect, the updated guidance expands an example involving a pharmaceutical company testing foreign plants for their suitability as medicines as follows: "If due to differences such as stability of the samples, some need to be analysed quickly while others

	do not, then the cost of doing the former overseas could qualify, but not the latter. In these circumstances an apportionment might be appropriate.”
Tanja Velling	Turning to contracted-out R&D, one requirement for the customer to be able to claim relief for contracted-out R&D is that it’s reasonable to assume that the customer “intended or contemplated” that the relevant sort of R&D would be undertaken. If the customer merely contracts for an end-product and the supplier undertakes R&D in delivering that product, the contractor could claim for the R&D. The distinction will often be clear. But borderline cases will likely turn on the meaning of “intended or contemplated”. The guidance acknowledges that neither term is defined in the legislation and resorts to the first edition of Collins English Dictionary to elucidate their meaning. What a court would make of this is unclear. Only in January, the Court of Appeal, in *Dolphin Drilling*, indicated that “one should be wary of trying to lay down a definition of ordinary words; the meaning of an ordinary word is to be found not so much in a dictionary but in how it is in fact ordinarily used”. But now – no podcast is ever complete these days without mention of the global minimum tax under Pillar Two. What do you have for us this month?
Zoe Andrews	This month’s Pillar Two development is that the UK will enact legislation to implement anti-avoidance provisions concerning the country-by-country reporting (CbCR) safe harbour. The CbCR safe harbour is a simplification mechanism that allows companies to use their CbCR information to calculate tax rates in each jurisdiction if they meet certain criteria. The UK legislation will be enacted in a future Finance Bill but will have effect from the 14th of March 2024, the date of the ministerial statement announcing it. The legislation will implement the provisions contained in the Inclusive Framework’s agreed administrative guidance released in December 2023 to tackle transactions taking advantage of differences in tax and accounting treatment to get within the CbCR safe harbour. When the administrative guidance came out in December, there was concern about the breadth of the provision causing “innocent” transactions to be caught. The UK government seems to be alert to the need to address these concerns as it was announced there will be a consultation with stakeholders on how the provisions are legislated to ensure the legislation operates as envisaged without unintended outcomes.
Tanja Velling	And speaking of the two pillars, it appears that the OECD missed its own deadline of the end of March for finalising the text of the Multilateral Convention on Amount A of Pillar One, the new taxing right. I’d say that this probably makes a signing ceremony by the end of June less likely and may ultimately buoy the UN’s work towards a framework convention on international tax cooperation.

	Meanwhile, the OECD published the sixth peer review report on the Prevention of Tax Treaty Abuse. This looks at progress towards implementing the minimum standard developed under BEPS Action 6. This requires the inclusion of a statement on non-taxation and provisions to address treaty shopping in double tax treaties.
Zoe Andrews	On the 31st of May 2023, more than half of the 2,504 bilateral agreements between members of the Inclusive Framework were compliant with the minimum standard. This is a significant achievement, having started with just 13 compliant agreements on the 30th of June 2018, the reference date for the first peer review report which was published in February 2019. The biggest driver for this increase in the number of compliant agreements is the modification of existing agreements through the multilateral instrument. It is therefore unsurprising that the recommendations in the latest peer review report urge countries that have signed the MLI to take steps to bring it into effect. And what is there to look out for?
Tanja Velling	In the UK, we'll be following the passage of the Spring Finance Bill through Parliament and we also have the Tax Administration and Maintenance Day on the 18th of April to look forward to. The consultation on the Tax Administration Framework Review that we discussed in the March edition of this podcast closes on the 9th of May. And one other thing to look forward to is the release of our first ever special podcast series. Together with our Tax and Disputes Partners, Zoe and I went on a six-stage journey to talk to local experts in Brazil, the US, Australia, India, Nigeria and France about tax disputes. The first episode is due to be released later this month, so keep your eyes (or perhaps more accurately: keep your ears) peeled!
Zoe Andrews	And 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. And you can also follow us on Twitter – @SlaughterMayTax.