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Slaughter and May Podcast
Tax News Highlights: January 2023

Zoe Andrews	Welcome to the January 2023 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 Court of Appeal's decision in *Urenco Chemplants* and certain updates provided by the UK government in December, including on the VAT treatment of fund management services, the next Budget, the final OTS report as well as draft legislation for the Electricity Generator Levy and the transfer pricing documentation requirement. In terms of international developments, we will discuss the OECD's consultations on Pillars One and Two as well as the EU's Pillar Two Directive and CBAM agreement. This podcast was recorded on the 10th of January 2023 and reflects the law and guidance on that date. Let's start with the Court of Appeal decision.
Zoe Andrews	*Urenco Chemplants* concerned the availability of capital allowances for expenditure on the construction of a specialised facility for the treatment and management of highly toxic and radioactive waste in the civil nuclear industry. Admittedly, this is a rather niche topic, but I think the case is of more general interest for the Court of Appeal's approach to correcting what it perceived to be a drafting error in the Capital Allowances Act 2001. Let's start with the drafting error. We're looking at capital allowances for expenditure on plant and machinery. Sections 21 and 22 provide that certain expenditure is **not expenditure on** plant and machinery for these purposes. But section 23 then provides that sections 21 and 22 "do not affect the question whether expenditure on any item described in list C is…**expenditure on the provision of** plant or machinery." List C is rather long and its precise contents are immaterial for our purposes. What is, however, noteworthy is that, only from item 23 onwards, the items are prefaced with "the provision of". These prefatory words are irrelevant to item 22. But what does their omission mean in relation to the first 21 items? Does it mean that expenditure "on the provision of" those items cannot qualify, although expenditure "on" them would?
Tanja Velling	The Court of Appeal concluded that the omission of "the provision of" in the first 21 items was a drafting error. In doing so, it went behind the Capital

	Allowances Act 2001 to look at the predecessor legislation and how it had been translated into the CAA 2001. The Court of Appeal concluded that *Farrell v Alexander* (which it described as “the leading case on the construction of consolidating statutes” that must “apply with at least equal force to a Tax Rewrite statute such as the CAA 2001”) permitted recourse to antecedent statutes in the case of a significant ambiguity that other methods of construction cannot resolve. Having established that there was a drafting error, the Court of Appeal referred to two options for resolving this. The preferable route was to read the words “on any item” in the part of section 23 which Zoe quoted as equivalent in meaning, in this context, to “on the provision of any item”. Alternatively, the court could use its power to correct a clear drafting error by reading “the provisions of” either into section 23 or into each of the first 21 items in List C.
Zoe Andrews	What else has been happening in the UK?
Tanja Velling	In early December, the Treasury published another follow-on from the review of the UK’s funds regime which had been announced as part of the March 2020 Budget. The latest instalment is a technical consultation on the VAT treatment of fund management services. Unfortunately, there is no policy change and the proposal is merely to codify in UK legislation the existing exemption for fund management services provided to “special investment funds” which is currently found in a patchwork of UK law, retained EU law, general principles, guidance and a body of case law. Although moving towards zero rating would have had a bigger impact on increasing the competitiveness of the UK fund management industry, the Government made it clear early in 2022 that this would not be possible in the current fiscal environment. However, there are expected benefits to the codification of the existing exemption, including greater certainty and less litigation about the exemption and lower administrative cost for relying on the exemption.
Zoe Andrews	HMRC also published a plan for the evaluation of the uncertain tax treatment notification requirement. This was introduced in the Finance Act 2022 and requires large businesses to notify HMRC if they adopt a tax position that is contrary to HMRC’s known position or requires an uncertain tax provision to be made in the accounts and certain threshold conditions are met. The evaluation will use a range of information including customer research (such as the annual survey of large businesses) and HMRC’s administrative data to assess in particular the effectiveness of the policy in reducing the legal interpretation portion of the tax gap.

	We should not hold our breath for the evaluation report, though – this is not expected for another three years or more. For HMRC to be able to conduct a thorough evaluation, the notification requirement must have been in place for several financial years.
Tanja Velling	But going back to what else *has* been happening in the UK – in particular the week before Christmas was incredibly busy. On the 19th of December, the Chancellor announced the 15th of March 2023 as the date of the next Budget. I would assume that the Spring Finance Bill should also be published around that date. The Autumn Finance Bill did manage to pass all the stages in the Commons and Lords before Christmas, but Royal Assent was given today meaning that it is now the Finance Act 2023 – rather than the Finance (No.2) Act 2022 as I had expected.
Zoe Andrews	Also on the 19th of December, regulations were made to extend the "investment transaction" definition for the investment management exemption to include cryptoassets. This followed on from the consultation in Summer 2022 on extending the definition to provide tax certainty to UK investment managers seeking to include types of cryptoassets within their investors' portfolios and reflects the government's desire to maintain and enhance the UK's position as a global leader in both investment management and cryptoasset activity and business.
Tanja Velling	On the 20th of December, HMRC published draft guidance on the changes to be made to the UK's research and development relief regime in the Spring Finance Bill. It discusses the new territorial requirements and categories of qualifying expenditure with examples, and details what information HMRC would expect to be provided. Comments can be submitted until the 28th of February 2023.
Zoe Andrews	Also on the 20th of December, the Office of Tax Simplification published its report on hybrid working which is also its final report. The closure of the OTS, which was announced in September 2022, will take effect when the Spring Finance Bill receives Royal Assent. Clearly, hybrid working is here to stay. Many employers also regard the ability to allow employees to work abroad for short periods as important for attracting and retaining staff (even if the take-up of this offer was reported to have been minimal). There is also an increase in individuals requesting (and employers permitting) more long-term working abroad for personal reasons. Employee income tax implications of this appear to be generally well understood. Social security is more complex and employers called for the

	UK to expand its network of social security agreements and provide clear guidance on the position where no agreement is in place.
Tanja Velling	As regards corporate tax, there would be an opportunity for the UK to lead by example (in addition to pushing for a solution at the OECD level) to provide more clarity on the interaction between cross-border working and permanent establishment and transfer pricing questions. Respondents called for further guidance on questions such as: • How would HMRC assess different fact patterns – such as working temporarily from a family member's home – for the purposes of determining whether there was a permanent establishment? • How would policies designed to ensure that employees working in the UK temporarily for personal reasons don't create a permanent establishment interact with the avoided permanent establishment trigger for the diverted profits tax? • Could there be a default approach to, or a transfer pricing safe harbour for, re-charging the services provided to the UK business by an individual employed by a connected company in their overseas home jurisdiction?
Zoe Andrews	The interaction between working from home and the traditional permanent establishment test is going to be a difficult nut to crack. The temptation is to say that there isn't a PE if the employee is using his or her own premises and the employer has no infrastructure in the jurisdiction concerned. That will seem a bit arbitrary because many people use facilities in local company offices rather than working from home. There are also other tax points to consider in relation to working from home in the UK – like eligibility for the principal private residence relief from capital gains tax – that may need to be picked up as part of this exercise. Planning regulations and the question whether council tax or business rates should be paid may also come into view. Domestically, the rise of hybrid working might further be taken as an opportunity for the government to review and modernise tax reliefs for employees, beyond instances where existing incentive schemes may need amendment to continue to incentivise behaviour as intended. One example would be the cycle to work scheme and its requirement to use the bike mainly for journeys between the home and the workplace which was eased during the pandemic, but applies as before since April 2022.
Tanja Velling	Yet another thing that was published on the 20th of December was the draft legislation for the Electricity Generator Levy which took effect from the 1st of January, although it will be included in the Spring Finance Bill. It has understandably not been received well by those renewable energy suppliers affected by the levy. Indeed, it is reported that Community

	Windpower, a wind farm operator, is considering a legal challenge over the new levy claiming it is "unfairly disproportionate, discriminatory and adverse to the government's [2050] net zero [emissions] strategy". It is understood that a key issue is that even with the £75/MWh starting point for the levy it would effectively block new onshore wind projects because many developers have witnessed a big jump in their financing costs following recent turmoil in UK financial markets, and rising turbine prices because of supply chain inflation. There is no equivalent of the investment allowance which eases the equivalent levy chargeable on oil and gas companies. But the oil and gas companies are not happy either about the changes made to the Energy Profits Levy in the latest Finance Act increasing the levy from 25% to 35%, and extending it to the end of March 2028, are they?
Zoe Andrews	No - obviously they had expected the levy to end in 2025 or sooner if more "normal" levels of oil pricing were reached in the meantime. In response to the changes some oil and gas companies are finding banks are cutting loans to those with credit facilities linked to the value of their reserves. The EU's windfall tax on oil companies is also in the news with a large US oil company reportedly challenging the authority of the EU to impose such a levy.
Tanja Velling	In this context, it's also worth mentioning a change to the UK's Public Interest Business Protection Tax, another temporary, special purpose tax. Introduced in the Finance Act 2022, it broadly applies where an energy supply business undertakes steps to realise an asset, thereby precipitating or exacerbating its collapse, and is charged at a rate of 75% on the adjusted value of that asset. The initial sunset date for the PIBPT was the 28th of January 2023. This has now been extended until the 30th of April 2024, and the relevant primary legislation would allow for a further extension to late January 2025.
Zoe Andrews	On the 21st of December, HMRC published draft regulations to require multinational enterprises to keep a master and UK local file in accordance with the OECD's transfer pricing guidelines. For corporation tax purposes, this requirement will apply from April 2023. The draft regulations do not yet include the summary audit trail requirement, which – based on the consultation response published in November 2021 – is intended to be "a short, concise document summarising the work already undertaken by the customer in arriving at the conclusions in their transfer pricing documentation." They would empower HMRC to introduce this requirement by way of published notice at a later date, which the

	government would intend to happen following a separate public consultation in 2023. But now, moving away from the UK, the OECD delivered on its promise of some Christmas presents, didn't it?
Tanja Velling	It did indeed! On the 20th of December, the OECD published draft Multilateral Convention provisions on digital services taxes and other relevant similar measures under Amount A of Pillar One and an implementation package relating to Pillar Two Global Anti-Base Erosion (GloBE) Rules, made up of guidance on Safe Harbours and Penalty Relief and consultations on the GloBE Information Return and Tax Certainty for the GloBE Rules. I have already shared my thoughts on the draft MLC provisions in a post on the European Tax Blog. Unfortunately, the list of digital services taxes and equivalent measures that countries would have to remove was not included in the consultation. But, on reflection, that is not particularly surprising, given that this is likely to be a controversial political issue to be negotiated within the Inclusive Framework, rather than a technical question where public comments could contribute to a resolution. Zoe, what did you make of the Pillar Two implementation package?
Zoe Andrews	We do not have time to go into any detail here but it is worth noting 4 aspects of the implementation package for Pillar Two. First, safe harbours are an important part of the workability of the GloBE rules. It is inevitable that compliance will be challenging until everyone knows what the rules are and has processes in place to apply them. In particular, there are concerns that the rules could impose a disproportionate compliance burden on certain MNEs in respect of their operations in high-tax and other low-risk jurisdictions in the initial years. To address this there will be a transitional country-by-country reporting safe harbour rule that removes the obligation to calculate the GloBE effective tax rate for an MNE's operations in lower-risk jurisdictions in the initial years (which means fiscal years ending on or before the 30th of June 2028). A permanent safe harbour will be developed which will require simplified income and tax calculations. The Inclusive Framework is also working on a Qualified Domestic Minimum Top-up Tax (QDMTT) safe harbour that would provide compliance simplifications for MNEs operating in jurisdictions that have adopted a QDMTT. A QDMTT Safe Harbour would eliminate the need for an MNE to perform an additional GloBE calculation in addition to the QDMTT calculation required under local law. This will be considered as part of the Administrative Guidance on the QDMTT. Second, in order to give the GloBE rules a "soft landing" when first introduced, where an MNE has taken reasonable measures to ensure the

	correct application of the GloBE rules the Transitional Penalty Relief Regime will require a jurisdiction to give careful consideration as to the appropriateness of applying penalties or sanctions. Third, on the more practical side, the consultation on the standardised GloBE information return seeks input on the information required to apply the GloBE rules and possible simplifications. At the end of the day the GloBE rules are all about the data! Finally, one of the main concerns about the GloBE rules being implemented by way of the common approach is how to achieve tax certainty by preventing disputes about the interpretation and application of the rules and providing mechanisms for resolving them where divergent outcomes arise. The public consultation on this topic sets out a number of possible mechanisms to achieve tax certainty. Administrative guidance is a key part of ensuring consistency in the application of the rules. We are expecting the Inclusive Framework to release administrative guidance on the interpretation and administration of the GloBE rules on a rolling basis with the first tranche to be released early 2023.
Tanja Velling	In other international tax reform news, there has also been a pre-Christmas breakthrough on Pillar Two at the EU level. You will recall that the implementing directive had to be approved unanimously in the Council and Hungary was the final member state whose agreement had still been outstanding. Then, on the 12th of December, it was announced that the member states had reached agreement in principle to implement the global minimum tax under Pillar Two. The agreement was reached in conjunction with the adoption of decisions on aid to Ukraine and the approval of the Hungary Covid-19 recovery and resilience plan. The final version of the Directive was published in the Official Journal of the European Union on the 22nd of December. As envisaged in the Commission's original draft published just before Christmas 2021, the Directive applies the OECD's GloBE rules to large domestic groups as well as multinationals. The amended, final version reflects developments at the OECD level over the last year (such as taking into account internationally agreed safe harbours) and the outcome of negotiations between the member states. You may recall that Poland in particular had been in favour of linking the implementation of the two Pillars, and the directive now requires the Commission to report on the implementation of Pillar One by mid-2023 and, if appropriate, propose alternative legislation in the absence of such implementation.
Zoe Andrews	Member states must implement the Pillar Two Directive – i.e. the Income Inclusion Rule and the Undertaxed Profits Rule – by the end of 2023. Subject to a temporary exclusion for domestic groups and multinational

	groups in the initial phase of international expansion, the IIR must generally be applied effectively from 2024 and the UTPR from 2025. But member states where no more than twelve parent entitles of in-scope groups are located have the option to delay the application of the IIR and the UTPR effectively until 2030. If a member state wishes to make use of this option, it must notify the Commission before the end of 2023 and the application of the UTPR in other member states in respect of the profits of groups headquartered in the opted-out state will be brought forward to the date from which the IIR would otherwise have been applicable.
Tanja Velling	The Directive's timeline for the application of the IIR in the EU is in line with the UK's proposed timeline for its multinational top-up tax – and makes it likely that the UK will go ahead as planned (rather than heeding calls for a delay). It would also seem to make it likely that the UK would introduce a UTPR from the same date as the EU. In the Autumn Statement, it was confirmed that the UK's intention was to introduce such a rule, but with effect no earlier than accounting periods beginning on or after the 31st of December 2024. The Autumn Statement had also brought the news that the UK would introduce a qualified domestic minimum top-up tax at the same time as the multinational top-up tax. The Pillar Two Directive similarly allows member states to introduce a domestic top-up tax. An election to introduce this would have to be notified to the Commission within four months of the adoption of the relevant national rules and it would seem to commit the member state to apply the tax for at least three years. After each three-year period, the election would then renew automatically for another three years unless it is revoked. Were there any other EU developments that we should mention?
Zoe Andrews	On the 13th of December, negotiators representing the European Parliament and Council also agreed the terms on which to implement a Carbon Border Adjustment Mechanism or CBAM, for short. The CBAM will mirror and complement the EU Emissions Trading Scheme. It aims to reduce the risk of carbon leakage and will cover imports of specific emissions-intensive products into the EU customs territory, as well as some downstream products and indirect emissions. Our colleagues have written in more detail about the CBAM and the potential trade tensions it could trigger on the European Tax Blog. And now, what can we look forward to?
Tanja Velling	Let's hope for a more stable year for Chancellors and tax policy! I suspect (or one might say hope) that we won't see a continuation of the publication

	bonanza of the week before Christmas. Rather January 2023 looks like the time to respond to the various consultations that we have mentioned. The closing date for comment on HMRC's draft transfer pricing documentation regulations is the 31st of January 2023. Comments on the draft MLC provisions on digital services taxes and other relevant similar measures under Amount A of Pillar One can be submitted until the 20th of January, and on the design elements of Amount B of Pillar One until the 25th of January. The consultations on the GloBE Information Return and the Tax Certainty for the GloBE Rules run for slightly longer, until the 3rd of February.
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.