Slaughter and May Podcast
Tax News Highlights: February 2022

Zoe Andrews	Welcome to the February 2022 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 look at the increasing interest in the link between tax and climate action, the proposed new Public Interest Business Protection Tax, the revised draft Uncertain Tax Treatment guidance and the consultation on the UK's implementation of Pillar Two. We will also cover the European Commission's Unshell proposal, the OECD's updated transfer pricing guidelines and the Court of Appeal's decision in the *Embiricos* case. This podcast was recorded on the 8th of February 2022 and reflects the law and guidance on that date. So, tax policy in the context of net zero has increasingly come under scrutiny.
Zoe Andrews	Indeed, a number of reports were issued last year in advance of COP26. The IMF and OECD co-authored a report on "Tax Policy and Climate Change" which noted that carbon prices – whether explicit through carbon taxes or emissions trading systems, or implicit for example through taxes on energy use – are well below the level required to drive the necessary decarbonisation to comply with the Paris Agreement and effectively called on the G20 Finance Ministers to take further action. Alongside the UK Government's "Build Back Greener" net zero strategy, the Treasury published its "Net Zero Review", but this included significantly more detail on the expected structural impact of decarbonisation on the tax system – as carbon tax revenues will decrease as we move to net zero – than on the tax measures to support net zero. The Institute for Government, a cross-party think tank, had meanwhile issued a report calling for a commitment by the Treasury to undertake an audit of the tax system as a whole to ensure that overall tax policy supports the transition to net zero and the Institute for Fiscal Studies, which describes itself as "Britain's leading independent microeconomic research institute", had noted that the implicit taxation of carbon in the UK is such that "tax rates on emissions vary wildly" which gives rise to "highly uneven" incentives to cut emissions.
Tanja Velling	And this is not a UK-specific issue. In a report published on the 31st of January, the European Court of Auditors reiterated that, under the current

	Energy Taxation Directive, tax levels vary widely and more polluting energy sources may have a tax advantage over less polluting ones – which is something the European Commission is seeking to address through a recast Energy Taxation Directive. The Commission's proposal was published last year and is subject to the consultation procedure which means that it would be adopted by the Council, taking into account an opinion from the European Parliament (but without being bound by it). We are still awaiting the adoption of this opinion by the European Parliament.
Zoe Andrews	Going back to the UK, more recently, the conservative think tank Centre for Policy Studies added its voice to the debate in the form of a report on "Levelling Up and Zeroing In" which called, amongst others, for a carbon border tax despite the Net Zero Review indicating the Treasury's preference for international cooperation on emissions reductions goals over a CBAM. But perhaps the think tank's report will lead the Chancellor to reconsider.
Tanja Velling	Be that as it may, another interesting development is that the debate is not limited to the executive and legislative branches. The High Court recently delivered its judgment in the judicial review proceedings of *Cox and others v The Oil and Gas Authority*. The claimants, three environmental campaigners, sought to challenge the OGA's strategy on the basis that it should have taken into account the tax position of operators when considering the economic recovery of UK petroleum – where operators are net tax negative, their activity cannot be said to be "economic" in the context of the UK as a whole. The High Court essentially decided the case on the basis that the legislation gave the OGA discretion to determine the best method of economic assessment which it had properly exercised (in the sense that the OGA had not acted irrationally as had been contended by the claimants). But the High Court also made an *obiter* observation which I think is worth quoting in full: "*The complaint is essentially this: that I should conclude that the approach to the Strategy is wrong because it is possible there may in individual cases be net payments to particular companies in particular years because of the way in which the taking over of particular concessions is organised. So, while the tax position over the life of the concession is at worst neutral, because A may be the incumbent in years 1-18 with net positive tax position but B is the incumbent in years 19-20 with net negative tax position, the whole strategy needs to be changed. This is, frankly, a strained and nonsensical approach*." As the tax position of perceived polluters is likely to continue to come under scrutiny – whether as part of climate-action-based judicial review proceedings, which I would also expect to increase, or in the court of public opinion – this quote encapsulates an important lesson: the narrative is key. As framed by the High Court, the complaint does sound strained and nonsensical; as expressed by the claimants, it did not. And businesses will

	need to find new ways to take and keep control of their narrative on tax and ESG. But what else is new in the UK?
Zoe Andrews	Well, the publication of some additional legislation for inclusion in the Finance Bill on the 28th of January came as a bit of a surprise. It consisted of an additional clause and schedule, introducing a new Public Interest Business Protection Tax which is essentially aimed at ensuring that the value of assets which had been held for the purposes of a failing public interest business is not transferred to shareholders. The tax would be charged at a rate of 75% of the adjusted value of the asset. Public interest business would be defined as an energy supply business, meaning a business which needs a gas or electricity supply licence, but the legislation permits the definition to be extended by regulation to cover other types of business subject to a special administration regime. The tax is quite clearly borne out of the current energy crisis and includes a sunset clause. It responds to a particular Government concern in relation to energy business structures and I can't help but wonder whether we will also see a regulatory (meaning a non-tax) response to address such structures going forward beyond the lifetime of the tax.
Tanja Velling	In a somewhat less surprising turn of events, HMRC published revised draft guidance in relation to the Uncertain Tax Treatment (**UTT**) notification. Since our last podcast, a consultation began and ended on revised guidance on UTT which takes into account the current legislation and feedback on the earlier draft guidance published in August 2021. Final guidance is promised by the end of February. By way of reminder, the rules apply to large businesses, meaning those with a turnover above £200m per annum and/or a UK balance sheet total over £2bn. Such businesses are required to notify HMRC of a UTT in respect of any amounts in corporation tax, VAT, PAYE and income tax self-assessment returns which have filing dates on or after the 1st of April 2022 unless an exclusion or exemption applies. Things have moved on considerably since the August draft guidance haven't they, Zoe?
Zoe Andrews	Yes. For a start, the scope of the rules has been narrowed since the original proposals with the legislation in Finance Bill 2022 now having just two triggers for an amount to be an uncertain amount. The revised guidance is a significant improvement on the first draft and goes some way to easing the concerns of business in complying with the new rules. There is an emphasis on what is referred to as the "general exemption" – basically, you do not have to notify under the UTT rules if HMRC already

	has the information available to it pursuant to another regulatory requirement or in dealings with HMRC. There is a list in the legislation of disclosure regimes which constitute regulatory requirements. The revised guidance elaborates on the meaning of “dealings with HMRC” which includes clearance applications and discussions with HMRC.
Tanja Velling	The revised guidance helpfully provides that where a taxpayer (or their agent) approaches HMRC via the Customer Compliance Manager, if they have one, or through the MSB Customer Support Team for those without, to provide information and discuss an uncertain tax issue, HMRC will confirm whether the general exemption is met. As a matter of good practice, taxpayers should make clear that the discussion is to avoid the requirement to notify and the discussion should be documented. If there are any changes to the transaction or to the tax treatment of it after this discussion, they must be notified to HMRC because such changes would invalidate the exemption.
Zoe Andrews	That sounds helpful. But what if the general exemption does not apply and the taxpayer needs to determine if one of the triggers applies? The provision in the accounts trigger is an easy one to spot but has the revised guidance provided more clarity on how to determine what HMRC’s “known position” is for the second trigger?
Tanja Velling	Yes it has. One significant change from the earlier draft guidance is that explanatory notes and technical notes relating to legislation have moved from the “not to be considered” column to the “contains HMRC’s known position” column. This is a sensible and welcome development. There’s a lot of information out there though. How much is a taxpayer expected to do to ascertain HMRC’s known position?
Zoe Andrews	HMRC recognises that there is a large volume of published material and the revised guidance states that the UTT regime is not intended to “act as a series of tripwires” leading to penalties where a business took a reasonable approach to establishing HMRC’s position. So what is a reasonable approach?
Tanja Velling	Business is expected to have a level of familiarity with HMRC’s published material and factors to be considered to show whether a business took a reasonable approach include whether the guidance is easy to find, for example by being in a relevant HMRC Manual; whether HMRC’s published view pops up if a search is done using relevant search terms on the issue; and whether the tax issue is novel, contentious, high-value or high-risk such that a careful examination of HMRC’s view is warranted. In practice, this might mean a greater emphasis on capturing information on the searches conducted and materials reviewed in trying to establish HMRC's view.

Zoe Andrews	January was a busy month! HM Treasury also launched a consultation (open until 4 April) on the UK's implementation of Pillar Two, the global minimum tax rules. What happened to the two Pillars being part of a package then?
Tanja Velling	Well, it is still supposed to be a package, it's just that Pillar Two is moving at a faster pace and the UK understands it needs to consult with business now in order to meet the ambitious implementation timetable and smooth out and, where possible, ease the administrative burden on business. The downside of consulting early on this, though, is that there are still many moving parts which will have to be fed into the process, such as the safe harbours and simplifications which many MNEs will be hoping will save them from the compliance burden (once these have been agreed). The UK intends to introduce the Income Inclusion Rule (similar to a traditional CFC rule but broader in scope) and the backstop rule referred to in the Model Rules as the Undertaxed Payments Rule. The UK consultation refers to this as the Undertaxed Profits Rule but it is the same thing and seeks to ensure that top-up tax is paid in respect of a low-taxed entity when the parent entity is located in a territory which does not impose an Income Inclusion Rule.
Zoe Andrews	An aspect of the consultation that got me scratching my head, though, is that the UK is also considering introducing a domestic minimum tax (**DMT**) which would kick in if the ETR in the UK were below 15%. Our current rate of corporation tax is 19%, rising to 25% in 2023 so you might wonder how the ETR could drop low enough for a DMT to apply. The key to understanding this is that the ETR does not use the same tax base as domestic tax rules because these vary from jurisdiction to jurisdiction. A uniform set of rules has been agreed to establish the GloBE tax base and the way that adjustments are made, for example for deferred tax, can result in a lower ETR than 15%, which means that even if an MNE is paying actual corporation tax in the UK at a rate of more than 15%, the ETR calculation may drop below 15%. The DMT will ensure that, in situations where another jurisdiction would otherwise have the right to apply a top up tax, it will be the UK, and not the other jurisdiction, which gets to collect the tax.
Tanja Velling	The consultation invites comments as to whether a DMT would really help reduce compliance costs as envisaged by the government, and whether it should apply to all groups which meet the Pillar Two revenue threshold or only to UK-headed groups. So once the new rules are implemented, do you think some of the UK's existing anti base-erosion measures will be removed?

Zoe Andrews	The government's view is that the BEPS measures address risks to the UK's tax base which are not directly addressed by the GloBE rules, and so the BEPS measures continue to play an important role in protecting the UK's tax base for the wider population – not just those MNEs with over €750m global revenue. There is a glimmer of hope for eventual consolidation of measures, however, as the consultation suggests this may be revisited once Pillar Two is fully implemented and it becomes clear what level of protection it provides for the UK tax base.
Tanja Velling	Another international topic I want to mention briefly is the European Commission's Unshell Directive proposal which is also sometimes referred to as ATAD3. If an entity resident in an EU Member State meets certain gateway tests, a rebuttable presumption that the entity lacks substance will be triggered. If the entity is then unable to provide sufficient evidence to rebut the presumption, certain tax consequences would follow. But how could this be relevant to the UK? Following Brexit, the UK would obviously not be required to implement the directive, but, for example, treaty benefits in respect of payment flows from the UK to an EU shell company could be affected. Under the directive, Member States would be required to deny shell entities' requests for a certificate of tax residence (or issue a qualified one), and it is hard to see that HMRC would grant treaty benefits in respect of a payment where the recipient was unable to provide such a certificate. How HMRC would respond to a certificate that is qualified by reference to the Unshell Directive is an open question, but I would not want to bet on a favourable response. The explanatory memorandum also indicates that, in this situation, the third country source jurisdiction could decide to instead apply any double tax treaty that it has entered into with the jurisdiction in which the shareholder of the shell entity is resident. This would, presumably, have to be based on the argument that the shareholder rather than the shell entity is the beneficial owner of the payment that was made to the shell.
Zoe Andrews	Another point worth noting is that, while the application of Unshell would be limited to entities resident in the EU, the Questions and Answers document published alongside the draft Directive indicates that the Commission is also planning to present "a new initiative to respond to the challenges linked to non-EU shell entities" during the course of this year. We will have to wait and see what that will look like and how it would affect the UK.
Tanja Velling	On the 20th of January, the OECD released its new, 2022 edition of the "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" which consolidates into a single document the changes made to the 2017 edition resulting from the revised guidance on the transaction profit-split method released in 2018, the guidance on hard-to-

	value intangibles which was also released in 2018 and the guidance on financial transactions released in 2020. In the UK, the 2017 edition has applied for corporation tax accounting periods starting from April 2018 onwards, and will continue to do so until the new edition is designated by Treasury Order pursuant to section 164 of the Taxation (International and Other Provisions) Act 2010. Considering that the 2017 edition was published in July of that year and the designating Treasury Order was made in March 2018, and it has been reported that HMRC are looking to provide supplementary guidance setting out HMRC's view of certain concepts used by the OECD in the 2022 edition, it seems unlikely that the 2022 edition would be brought into force within the next two months in time for the start of the 2022/2023 tax year.
Zoe Andrews	In respect of that supplementary guidance (if any is indeed published), it will be interesting to see whether HMRC will take the same approach as with previous updates, namely that, as per the International Manual, "in the vast majority of cases the application of any version should result in the same outcome", which seems to have meant in practice that arguments based on differences in wording between the 2017 and earlier editions may have little traction with HMRC in relation to transfer pricing questions in respect of pre-2018 periods. And last, but not least, shall we look at another recent case?
Tanja Velling	Yes. There is one I would like to mention. We spoke about the Upper Tribunal's decision in the *Embiricos* case on the scope of partial closure notices (**PCNs**) just over a year ago. 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 incurring significant cost in providing this information. 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. Although the First-tier Tribunal concluded that domicile could be treated as a separate matter from the amount of tax, the Upper Tribunal disagreed. So what did the Court of Appeal decide?
Zoe Andrews	The Court of Appeal recently confirmed the decision of the Upper Tribunal that HMRC cannot issue a PCN dealing with the question of domicile without stating the tax due to give effect to HMRC's conclusion. The Court of Appeal did emphasise, though, that a PCN might not always have to specify tax payable in order to give effect to HMRC's conclusion. It will depend on the matter in issue and the nature and effect of HMRC's conclusion. For example, if the conclusion is the disallowance of a loss

	carry forward, there is no additional tax due for the return in which the loss is claimed. So what is the point of the PCN regime?
Tanja Velling	The Court of Appeal concluded that the primary target of the regime is discrete areas of dispute in multiple open enquiries, rather than as here, separate constituent elements of a single enquiry. This is bad news for Mr Embiricos and for other taxpayers as in many cases it limits the taxpayer's ability to force a judicial determination of a preliminary legal issue, such as the domicile question. A preliminary judicial determination could only be achieved through a joint reference to which HMRC would need to agree. What have we got coming up over the next month?
Zoe Andrews	• The consultations on business rates review and corporation tax: response to accounting changes for insurance contracts close on the 22nd of February. • Final guidance on the Uncertain Tax Treatment notification is expected by the 28th of February. • And the OECD's website states that "a public consultation document on the implementation framework [for Pillar Two] will be issued in February".
Tanja Velling	And 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.