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The summary of responses to the consultation on VAT treatment of fund management services indicates that very little will change. In *Euromoney*, the Court of Appeal concludes that, when applying the purpose test in s137 TCGA, the whole of the taxpayer's scheme or arrangements must be considered, and not just a select part of them. Recent developments on Pillar Two include revised draft guidance from HMRC and a further tranche of agreed administrative guidance from the Inclusive Framework. The latest report on the tax contribution of the banking sector estimates the total tax contribution for 2022/2023 to be £41bn but shows that London is looking less attractive from a tax perspective than some other major finance centres.

VAT treatment of fund management services review: summary of responses

Last January we wrote about the consultation on a proposal to codify current UK policy for the VAT treatment of fund management services (based on UK law, retained EU law, general principles, guidance and a body of case law) into UK law. The intention of the consultation was stated to provide certainty and clarity, simplify the process considerably, reduce the scope for differing interpretations of law and case law and ultimately achieve a reduction in the amount of litigation which takes place in this area.

The summary of responses, published on 14 December 2023, announced that the principles-based approach to defining the criteria for a Special Investment Fund (SIF) outlined in the consultation will not be followed. The government has concluded, in response to feedback, that existing UK VAT legislation covers 'the vast majority of fund types for which management services should be exempt' and that the list-based approach of VATA 1994, Schedule 9, Group 5, Items 9 and 10 provides sufficient legal certainty. This 'whitelist' can be extended as new fund types emerge. There is no suggestion in the response document, however, of any particular changes to be made to Items 9 and 10 to ensure it covers all the fund types for which management services should be exempt or which ones are currently missing or in what timescale any required changes would be made.

Despite the 'almost universal' calls by respondents to the consultation and in discussions with stakeholders for the government to legislate for a definition of 'management' of a fund, the government concluded that the position established by settled case law provides sufficient legal certainty, so there will not be a definition. However, in the review of current guidance, consideration will be given to providing additional clarity on the current legal position. One aspect highlighted by respondents as requiring clarification is how outsourcing of various parts of fund management to third parties should be taxed - particularly where outsourced services are partially automated or IT-enabled.

As expected, the government confirmed it is not taking forward the calls for zero-rating of fund management services to UK domiciled funds to increase UK competitiveness in terms of fund domicile by putting UK funds on the same footing as non-UK domiciled funds. A couple of times in the response document, however, to ease disappointment this is tempered with the line 'the government keeps all taxes under review', hinting that nothing is permanently off the table.

Euromoney: purpose test in TCGA 1992 s137

The Court of Appeal found in favour of the taxpayer in *Delinian (formerly Euromoney) v HMRC* [2023] EWCA Civ 1281 on the application of the purpose test in TCGA 1992 s137. The case involved a third-party acquisition where the substantial shareholding exemption (SSE) was unavailable to the seller. After a cash and share deal had been agreed on, the tax director on the seller side advised that the cash element be replaced with a redeemable preference share issue. The intention was to prevent the tax charge that would have arisen on the cash element, relying instead on reorganisation treatment on the sale and waiting for SSE to become available before redemption or disposal of the preference shares.

HMRC challenged this under s137 on the basis that the share-for-share exchange formed part of a scheme or arrangements a main purpose of which was the avoidance of a liability to corporation tax. For the purpose of identifying the relevant scheme or arrangements to which the purpose test would be applied, HMRC zoomed in on the part of the arrangements that involved the exchange of target shares for redeemable preference shares in the purchaser.

The parties agreed that the 'exchange' for these purposes was the whole deal: both the originally agreed share consideration and the preference share issue that replaced the cash element. This meant that if Euromoney had lost the case reorganisation treatment would have been denied for the entire exchange, costing Euromoney £7.7 million in tax instead of saving £2.8 million as intended.

Fortunately for Euromoney, the Court of Appeal dismissed HMRC's appeal and held that s137 did not apply. The Court of Appeal concluded that the 'scheme or arrangements' of which the share exchange formed part was the whole scheme or arrangements and not just the part related to the preference shares. This conclusion was reached on both a literal and purposive construction of s137. The FTT was therefore correct to apply the motive test to the whole of the scheme or arrangements undertaken of which the exchange formed part.

The FTT had found as a fact that looking at the scheme or arrangements as a whole, tax avoidance was not the main purpose or one of the main purposes of the scheme or arrangements. This finding was based on a number of factors including that: the transaction would have gone ahead anyway with or without the tax saving; the preference shares were a relatively small portion of the overall consideration; the taxpayer would have proceeded with the cash deal if the purchaser had refused the request for redeemable preference shares; limited resources were devoted to the tax aspects of the transaction; and, although an application to HMRC for clearance was made under s138, the exchange was completed without waiting for the response.

Euromoney had cross-appealed on the basis that taking advantage of the SSE, a legitimate freedom from tax, was not tax avoidance and so s137 was not engaged in the first place but the Court of Appeal swiftly dismissed this argument. The Court of Appeal concluded that utilising the SSE counts as tax avoidance for the purpose of s137. What saved the taxpayer in this case, however, was the finding of fact of the FTT that the avoidance of tax was not the, or a, main purpose.

Pillar Two: changes to UK legislation and further guidance

Anyone wishing for some Christmas reading material might not have had Pillar Two in mind but shortly before the 31 December 2023 commencement date for the GloBE rules in the UK and in a number of other jurisdictions implementing on time, HMRC published revised draft guidance on the multinational top-up tax (MTT) and the domestic top-up tax (DTT), and the Inclusive Framework released its third tranche of agreed administrative guidance. The current Finance Bill going through Parliament also proposes a number of changes to the MTT and DTT legislation.

Administrative guidance: anti-avoidance measures add complexity to CBCR safe harbour

Some aspects of the administrative guidance make compliance easier for taxpayers, but the latest guidance also includes measures to tackle transactions taking advantage of differences in tax and accounting treatment to get within the country-by-country reporting (CBCR) safe harbour. This safe harbour allows companies to use their CBCR information to calculate tax rates in each jurisdiction if they meet certain criteria. This is much simpler than the full complex calculations in order to determine if they are subject to the minimum tax rules. Three identified hybrid arbitrage arrangements now have to be excluded from this safe harbour calculation which could cause some groups to lose the benefit of the safe harbour.

This anti-avoidance provision has been met with criticism from business for adding a last-minute layer of complexity to what is intended to be a simplification measure. There may be more anti-avoidance measures to come as the Inclusive Framework is also looking at hybrid arbitrage arrangements more generally, and further administrative guidance will be provided to address hybrid arbitrage arrangements that may otherwise affect the application of the GloBE rules outside the context of the CBCR safe harbour.

UK revised draft guidance

Interestingly, some of the latest administrative guidance had already been included in the changes proposed in the Finance Bill and were covered in the revised draft HMRC guidance. This includes a change to permit a multinational group which is not required to submit country-by-country (CBC) reports to nevertheless qualify for the transitional CBCR safe harbour if the conditions are met on the basis of the figures that would have been included in a CBC report if one had been required. The Finance Bill includes an amendment to permit this kind of anticipatory change so we are likely to see more changes in the future which 'the Treasury consider necessary to secure the effective operation' of MTT/DTT where the provision does not, at the time made, reflect the Pillar Two rules, but it is reasonable for the Treasury to believe changes will be made to the rules consistent with or similar to the provision.

Securitisations

A significant practical point on DTT and MTT risk in securitisations is being fixed in the Finance Bill. There was a concern that a DTT charge might be imposed on a securitisation vehicle, or if the securitisation vehicle is part of a group, that a group payment notice might be imposed in relation to MTT or DTT in respect of a primary liability of another entity in that group. These issues cannot be remedied through an indemnity from the originator because this would expose the securitisation vehicle to credit risk that runs counter to the securitisation structure.

The Finance Bill deals with this by making a securitisation company that is not a member of a group for DTT purposes an excluded entity for DTT purposes. A securitisation vehicle that is a member of a group for DTT purposes will not be treated as being part of a group for any DTT purpose other than determining the group revenue threshold. Furthermore, there will be a change to the provision for group payment notices to provide that certain types of entity (including a securitisation company) cannot be issued with a group payment notice.

Latest report on tax contribution of UK banking sector

UK Finance has published the report it commissioned on the 2023 total tax contribution of the UK banking sector. A record number of 43 banks provided data for the study. The report estimates a total tax contribution of the UK banking sector for 2022/2023 of £41bn, which is the highest amount since the study started in 2014 and represents an increase of £2.2bn compared with 2021/22. The increase is driven by corporation tax (including bank surcharge) and employment taxes. The UK banking sector contribution represents 4.6% of total government receipts.

But London is looking less attractive from a tax perspective than other major finance centres. A comparison of the total tax rate of a model bank operating in London with those in New York, Frankfurt, Amsterdam and Dublin shows that the total tax rate of a London bank was 45.5% for 2023, remaining comparable with Frankfurt and Amsterdam but 17.6 percentage points higher than New York. According to the projected model analysis for 2024, the total tax rate in London could be 7 percentage points higher than in Frankfurt and the highest of the comparison cities once contributions to the European Single Resolution Fund decrease significantly or are no longer required.

There is uncertainty as to the legislative agenda in the UK due to the forthcoming election but whoever wins the election would be wise to think carefully about how to increase the UK's competitiveness to continue to enjoy the significant tax contribution of the UK banking sector.

What to look out for:

- **The new UK/Luxembourg double tax treaty has effect from 1 January for withholding taxes and for other Luxembourg taxes and from 1/6 April for UK taxes except withholding taxes.**
- **The Court of Appeal is scheduled to hear the appeal in *Clipperton v HMRC* on 16 or 17 January on whether payments under a dividend replacement scheme are taxable on the shareholders as a dividend.**
- **On 23 or 24 January, the Court of Appeal is scheduled to hear the appeal in *Prudential Assurance Company Ltd v HMRC* on whether the effect of the time of supply rules is that intra-group supplies invoiced after the supplier left the VAT group took place at the time of invoicing and so are subject to VAT.**
- **On 25 January, the Upper Tribunal is scheduled to hear the appeal in *Gould v HMRC* on whether an interim dividend is not due and payable until paid, even if another shareholder of the same class has already received their interim dividend payment.**

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