

SLAUGHTER AND MAY

Slaughter and May Podcast

Tax news highlights: August 2020

Zoe Andrews	Welcome to the August 2020 edition of our tax newscast. I am Zoe Andrews, Head of Tax Knowledge.
Tanja Velling	And I am Tanja Velling, Professional Support Lawyer in the Tax department. Zoe and I will provide an update on the OECD's project to address the challenges arising from the digitalisation of the economy. We will also discuss recent cases on tax-related contractual disputes and touch on the UK government's ten year strategy for our tax authority and the proposal to modernise UK stamp taxes on shares. This podcast has been recorded on 18 August 2020 and reflects the law and guidance on that date.
Zoe Andrews	<p>But first one point of follow-up from our last podcast. We mentioned that, on 8 July, Chancellor's announced that stamp duty land tax would be temporarily reduced for purchases of residential property in England and Northern Ireland. At the time we questioned whether Scotland and Wales would follow suit. Sure enough we can confirm that they have. Scotland and Wales have announced temporary reductions to their land transactions taxes such that transfers of residential properties for £250k or less would not attract transaction taxes and these reductions apply until 31 March 2021.</p> <p>So Tanja what did the OECD say in their July webinar about the OECD's project on the tax challenges arising from the digitalisation of the economy?</p>
Tanja Velling	Blueprints for international tax reform are due in October to be presented to the Inclusive Framework meeting on the 8 and 9 October. From news reports we however understand that, in early August, first drafts have been submitted to governments for comment. The OECD's stated aim is still to reach agreement by the end of the year, although it is acknowledged that agreement is unlikely to be reached before the US presidential election in November. At least to me, it is also not quite clear how an agreement could be reached after that election whilst keeping within the end of 2020 deadline - the existing Trump administration has voiced fundamental misgiving with the proposal and a new Biden administration would not be in place until 2021.
Zoe Andrews	<p>I think it is interesting to follow how the terminology and scoping has evolved. The OECD started with exploring lots of possible approaches under the two pillars, and then this got narrowed into the unified proposal and now we await the blueprints of international tax reform. There will then be a consultation on the blueprints and implementing rules will still have to be developed, so even if there is some sort of consensus on the blueprints by the end of the year there is still some way to go next year for the OECD to deliver the solution.</p> <p>In the meantime, economic impact assessments are due to be published after the summer, but it is unclear what level of granularity these will contain. If you remember the interim impact assessment published in February did not reveal any information at the country-level, although it did show that the combined effect of both Pillars is that</p>

	<p>global tax revenue gains could rise by up to 4% of global corporate income tax revenues or USD 100 billion annually, depending on the final reform design.</p> <p>Relatedly, the UK's digital services tax has come into effect with enactment of Finance Act 2020 and HMRC has published a list of countries which impose similar taxes based on the objective of those foreign taxes. France, Italy, Malaysia and Turkey have been listed so far. However, relief is given only for 50% of the similar overseas DST so there will still be an element of double taxation.</p>
Tanja Velling	<p>Somewhat predictably the US response to the UK's inaction of the US' digital service tax has been rather frosty. The Republican Chair of the Senate Finance Committee and a Democrat Ranking Member said that: "Unilaterally imposing a discriminatory tax that unfairly targets U.S. businesses damages efforts to achieve a multilateral solution and unnecessarily complicates the path forward for a U.S.-U.K. trade deal". It remains to be seen whether or where the UK will compromise.</p>
Zoe Andrews	<p>In many ways the boost that the pandemic has given to digital sales must have given added impetus to the global digital tax initiative. I can see the philosophical justification for an access or franchise type tax or fee - but that would obviously need to be accommodated within WTO restrictions and principles on trade taxes or barriers.</p>
Tanja Velling	<p>Double taxation is also a tricky issue. Trying to make any digital tax a tax on profits for tax credit purposes would be difficult. But giving those affected an option to be taxed on the basis of the profits that would arise from a permanent establishment deemed to exist and having certain deemed activities and functions would be a step in the right direction. It would also protect start-ups and other loss makers.</p>
Zoe Andrews	<p>At the end of the day, this is all, of course, heavily dependent on there being the political will to make something happen. Failing that, confusion is likely to reign as individual countries go their own way and the US retaliates.</p> <p>Over the last few years, a fair few disputes around tax-related contractual provisions have come before the courts. The High Court's decisions in two further cases, Axa and Dodika, were published last month. In this podcast, we can do barely more than scratch the surface of three of the issues that were in dispute. Tanja, do you want to take the first?</p>
Tanja Velling	<p>Sure. One of the questions in Axa was what it meant for a loss to be incurred. The judge decided that the word "incur" would bear "its ordinary and natural meaning of "to render oneself liable for". But what does that actually mean? Well in the case it meant that a loss was incurred upon becoming liable to make a payment, not upon actually making the payment. So a loss would be incurred for when one is actually out of pocket but that wasn't all. The judge went even further and confirmed that there would still be a loss, even if the liability would never have to be satisfied, so if one would never actually be out of pocket. On the one hand, this conclusion appears to go somewhat beyond what one might think of as the ordinary and natural meaning of "incurring a</p>

	loss". On the other hand, it made sense, in the context of the contractual drafting at issue. The devil is in the detail.
Zoe Andrews	The interpretation of the gross-up for tax on the receipt of a payment was also at issue in Axa. More specifically, the judge had to choose between two rival interpretations of the phrase "subject to Taxation in the hands of the receiving party". The first option, looking at a theoretical tax liability at the jurisdiction's headline rate, was rejected. The phrase "subject to Taxation" meant "actually taxed". So, the gross-up would compensate the recipient only to the extent that it was subject to an enforceable obligation to pay tax.
Tanja Velling	Moving on to Dodika. The buyer feared that an enquiry by the Slovenian tax authorities into the target's transfer pricing practices would result in additional tax liabilities. So, the buyer notified the seller of its intention to make a claim under the tax indemnity. The notice was clearly made in time. But the sellers argued that it was nonetheless invalid. And the court agreed because the notice failed to "state in reasonable detail the matter which gives rise to [the] Claim". The notice had referred merely to the existence of the Slovenian tax authorities' enquiry where it would have had to set out the subject matter of that enquiry. Whether or not the sellers were already familiar with that subject matter because correspondence with the tax authority had been shared with them was held to be irrelevant. As such, the decision is a reminder that, unless contractual provisions are followed to the t, they may end up cutting across commercial reality – and do that even somewhat harshly.
Zoe Andrews	At 21 July marked one of the highlights in a tax lawyer's year. Legislation day or L-day as some like of us like to call it. The UK government published draft legislation for inclusion in the finance bill to be published later this year which will, eventually, become the Finance Act 2021. As has become the norm, the draft legislation includes further provisions to bear down on tax avoidance. It also envisages that HMRC will be able to request information on a taxpayer's affairs from financial institutions without having first obtained the taxpayer's consent or court approval.
Tanja Velling	Alongside the draft legislation, the UK government published certain other documents, including HMRC's proposed 10 year strategy and a call for evidence on the modernisation of stamp taxes on shares. In our view both documents go hand in hand. But let's start with the 10 year strategy to build "a trusted, modern tax administration system". The strategy has three key elements.
Zoe Andrews	The first element involves a push for more real-time information – although not quite as real time as in countries such as Russia, where it has been reported that data from many checkout terminals feeds directly to the country's Federal Tax Service. HMRC's strategy rather focusses on an extension of their making tax digital or MTD initiative. Broadly, MTD means a requirement to keep digital records and use particular software to submit returns. From April 2022, MTD will apply for VAT for all VAT registered businesses and from April 2023, it will apply for income tax for businesses and landlords with income over £10,000. Later this year, the government also intends to consult on how corporation tax could be made digital.

Tanja Velling	As a result of this first element, HMRC will receive information closer to real-time. So, naturally the next question is whether taxes should also be paid closer to real time. A call for evidence is to be published in due course; the strategy itself indicates that an accelerated payment schedule could be applied – at least initially – on a voluntary basis.
Zoe Andrews	The third element is the reform of the tax administrative framework. Options include a smarter use of data through the pre-population of tax returns. Estonia might be a good model for this. A thought leadership piece published by the Institute of Chartered Accountants in England and Wales in 2019 mentioned that over 94% of Estonian personal tax returns are filed electronically utilising pre-populated data, meaning that the filing process takes less than five minutes on average. The UK government expects that taxpayers would welcome associated efficiency gains.
Tanja Velling	But how does this all relate to stamp taxes on shares? Well, the 10 year strategy explains the need for reform as follows: “While great strides have been made in opening up digital tax services, many of these are built on old technology and manual, paper-based processes that are no longer fit for the 21st century...The current paper based, time lagged system is out-dated and at odds with the world in which we live.” So, in light of this, will we finally get a modern, digital stamp taxes system?
Zoe Andrews	I really hope so. In the call for evidence published on 21 July, HMRC notes its focus on becoming a trusted, modern tax and customs department – collecting tax at minimal cost to customers and the Exchequer – and recognises that the time is right to explore options for fundamental redesign of the stamp duty and SDRT frameworks. Don’t get too excited though – this is a long-term project and will require many rounds of consultation so actual legislative change is a long way off. Options being considered include the modernisation of stamp duty – digitalising the stamp duty process and retiring the stamping machines – and a more fundamental amalgamation of stamp duty with SDRT is back on the agenda. And it did seem like a missed opportunity after the Office of Taxation Simplification review in 2017 when the government rejected the amalgamation option and the main modernisation it approved was replacing the very old stamping machines with nice new ones that did not require manual date changing! As a result of the pandemic however, HMRC has seen that stamp taxes can still be collected without the handling of any physical documents so I am hopeful that this time there will be significant improvements to the stamp taxes regime in the long term.
Tanja Velling	Now looking forward, it seems that, for the rest of the month, we can expect to find almost everyone on holiday. The judicial calendar is empty and we are not expecting any major changes to be announced or consultations published. That said, a crucial group of people will not be allowed to rest – this week will mark the seventh round of negotiations between the UK and the EU on their new partnership, with further meetings and rounds to follow in the coming weeks. So, we will await for any news of what we can expect from 2021 – although we have already had some glimpses. Recently the UK government has published a number of papers on how the trade of goods between Northern Ireland, the rest of the UK and the EU will work following the end of the transition period. The European Commission has proposed to amend the Principal VAT directive to give Northern Ireland its own country code. It remains to be seen how all of this beds down. Also we do have one date for you to highlight in the

	calendar. 15 September is the closing date for comments on draft legislation that was published on L-day.
Zoe Andrews	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 . Or can follow us on Twitter - @SlaughterandMayTax.