Slaughter and May Podcast
Tax News Highlights: November 2021

Zoe Andrews	Welcome to the November 2021 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 provide an update on international tax reform and the transition away from digital services taxes, and cover the Health and Social Care Levy Act, a selection of measures announced as part of the Budget or alongside it and the First-tier Tribunal decision in *Europcar*. This podcast was recorded on the 9th of November 2021 and reflects the law and guidance on that date.
Zoe Andrews	During the October edition of our podcast, we already mentioned that, on the 8th of October, the OECD/G20 Inclusive Framework published a statement setting out the agreement reached by 136 jurisdictions on international tax reform. This statement was endorsed by the G20 leaders during their meeting in Rome on the 30th and 31st of October. They "call[ed] on the OECD/G20 Inclusive Framework on BEPS to swiftly develop the model rules and multilateral instruments as agreed in the Detailed Implementation Plan, with a view to ensure that the new rules will come into effect at global level in 2023". It remains to be seen whether this call will provide the necessary momentum to push the reform through.
Tanja Velling	And, for it to go through, a lot of momentum will be needed. There is the small matter that, in order to implement Pillar One, changes to the tax treaty network will be required. The 8th of October statement envisaged a multilateral convention to achieve these changes. But one key State has consistently struggled to ratify new tax treaties or changes to its existing treaties. You will have guessed that I'm referring to the United States who, notably, did not sign up to the multilateral instrument to implement tax treaty related measures of the BEPS project either. The legal press is filled with theories as to how the US might be able to implement Pillar 1. But, if the experience in respect of President Biden's tax plan is anything to go by, it looks likely that this will be an uphill struggle.
Zoe Andrews	Interesting and potentially tricky questions of legal theory could also arise in respect of the implementation of Pillar Two, but this time in the EU. As the income inclusion rule resembles a controlled foreign company rule, the question arises whether its implementation at member State level would be compatible with the EU's freedom of establishment as interpreted in *Cadbury Schweppes*. That Pillar Two will include a

	substance-based carve-out is helpful, but its formulaic nature may not be sufficient to satisfy the *Cadbury Schweppes* principle that only “wholly artificial arrangements” should be in scope. If Pillar Two is, as planned, implemented through a directive at EU level, this could help nudge the CJEU towards concluding that it is compatible with the fundamental freedoms, in particular given that, under current rules, the directive would have to be passed unanimously by the member States. But this is by no means a given. In theory, the CJEU could still find the directive invalid for infringing the freedom of establishment. In theory, it is also possible that a directive could be blocked by the one member State, Cyprus, who is not among the 136 jurisdictions that reached the agreement on international tax reform. So, even among the major proponents of the international tax reform proposals, there seems to be a level of uncertainty around their implementation.
Tanja Velling	Another open question related to digital services taxes. The 8th of October statement envisaged the removal of “all Digital Services Taxes and other relevant similar measures”. But would countries who have enacted digital services taxes actually be willing to give up on the associated tax revenues? At least a partial answer was given by a joint statement from the United Kingdom, Austria, France, Italy, Spain and the United States published on the 21st of October. The five European States are permitted to retain their DSTs until Amount A of Pillar One takes effect, but agree that, to the extent that DST liabilities in the interim period exceed the additional tax liability that would have arisen if Amount A of Pillar One had already been in effect, companies will be permitted to set that excess DST against future tax liabilities resulting from the implementation of Amount A. In return, the US will terminate proposed trade actions relating to the DSTs and commits to not impose further trade actions in respect of the European countries’ DSTs.
Zoe Andrews	Whether similar agreements will be reached in respect of other countries’ DSTs and similar measures remains to be seen. There is also still the possibility that the European Commission may seek to propose a new digital levy and, as part of the Autumn Budget, it was confirmed that the UK would consult on the introduction of an online sales tax the revenues from which would be used to alleviate the burden of business rates. It would seem that the EU’s digital levy and the UK’s online sales tax would be intended to coexist with Pillar One, but it is less than clear how this could be achieved. The question of what counts as a “relevant similar measure” to a DST is likely to be key. It will also be interesting to see what impact the compromise on DSTs and the introduction of Amount A will actually have on the UK’s (and the other European countries’) public finances. It seems to me that, in the UK, this has not yet been factored into the predictions. The figures, calculated by the Office for Budget Responsibility, which were included in the Autumn Budget indicate an increase in predicted DST revenues as

	compared to the March Budget by £0.1 to £0.2 billion per year until and including tax year 2025/26. Assuming that Pillar One is implemented as planned in 2023, DST revenues should, however, have decreased to nil by that point, and one would expect any additional tax revenues resulting from the implementation of Amount A to be shown as an uplift in corporation tax receipts. But, I suppose, more certainty around the implementation of Pillar One and the compromise on DST transition is needed before this can be reflected in the OBR's projections.
Tanja Velling	Now, you've already mentioned the Autumn Budget, but I wanted to first take us back to something which one might say should have been included in it, but was, in fact, announced a good month and a half earlier, namely, the introduction of a health and social care levy and an increase in the rate of dividend taxation.
Zoe Andrews	You are right. We should mention that the health and social care levy has now been enacted. The legislation, which, in tax terms, is remarkably brief, was passed swiftly. The Health and Social Care Levy Bill received Royal Assent on the 20th of October 2021. It was passed as a Money Bill which means that, once it had passed the House of Commons, it had to receive Royal Assent no later than one month after being introduced in the House of Lords. The Lords cannot amend Money Bills and it is irrelevant whether or not the Lords passes them. Nonetheless, in this case, the record of the Lords' debate makes interesting reading.
Tanja Velling	You will remember that when the government announced the levy, which amounts to, broadly speaking, a 1.25 percentage point increase in employer, employee and self-employed national insurance contributions, it said that the revenues would be "ringfenced to fund the investment in health and social care". There are several interesting points to note in this respect. First, as I mentioned, the introduction of the levy is to be accompanied by an increase in dividend tax by 1.25 percentage points which the government stated would "help to fund the health and social care settlement". The draft legislation for the increase in dividend tax is included in clause 4 of the Finance Bill which was published last Thursday, the 4th of November. It would change sections 8 and 9 of the Income Tax Act 2007 to increase the rates of tax applicable to dividend income including the dividend trust rate. It does not, however, include any provision to hypothecate the additional tax take. The intention that it would help finance health and social care had been reiterated in the

	policy paper published alongside the Autumn Budget, but is also absent from the Explanatory Notes to the Finance Bill. The levy itself, on the other hand, is officially hypothecated under section 2 of the Health and Social Care Levy Act. But is this more than “a grudging and perhaps temporary hypothecation”? This was the term used by Lord Eatwell during the Lords’ debate after noting that section 4 “allows the Treasury to use the levy to make different provision for different purposes”. Even though I would not necessarily read it as enabling a removal of the hypothecation, section 4 does give a broad regulation-making power. To my mind, this should, however, rather be seen as indicative of the government’s expectation that, given the rushed passage of the Act, further details will have to be ironed out through secondary legislation. That said, as a matter of principle, an eventual removal of the ringfence does not seem out of the question. The Minister of State, Cabinet Office and the Treasury, Lord Agnew of Oulton said that “I cannot provide the noble Lord, Lord Eatwell, with a cast-iron guarantee that the hypothecation will remain in perpetuity”.
Zoe Andrews	The levy itself, on the other hand, appears to be here to stay. Lord Agnew confirmed that it represents “a permanent increase in taxation for a permanent challenge that we face in a country with aging demographics”, and did not rule out that the levy could be increased in the future. We now await the White Paper on Health and Social Care which should set out the government’s health and social care reform plans in more detail and has been promised before the end of this year. Shall we now look at some measures announced as part of the Autumn Budget, perhaps starting with a selection of three measures included in the Finance Bill?
Tanja Velling	Certainly, but I shall again start by going back in time! As part of the UK’s March 2021 Budget, the Chancellor announced an increase in the corporation tax rate from 19% to 25% to take effect from April 2023 and committed to reviewing the banking surcharge to ensure that, following this increase, the combined level of taxation on banks “does not increase substantially from its current level”. At the Autumn Budget, it was revealed what this meant. From April 2023, the banking surcharge will decrease from 8% to 3%. This is not quite commensurate with the corporation tax increase, so the level of taxation on banks will increase by one percentage point and hit 28% from April 2023. Nonetheless, the move was welcomed by the chief executive of UK Finance as a recognition of “the importance to the UK of an internationally competitive [banking] sector”.

	The Chancellor also announced that the banking surcharge annual allowance will be increased from £25 million to £100 million which will, in particular, help challenger banks which UK Finance commented would "support heathy competition in the sector". The draft legislation for both banking surcharge changes is included in clause 6 of the Finance Bill.
Zoe Andrews	Another welcome development came in the form of a change in the policy paper on the notification of uncertain tax treatment for large businesses which indicated that the third notification trigger would be dropped (at least for now). This is the trigger based on a substantial possibility that a court or tribunal would find the treatment to be incorrect in one or more material respects. And this trigger has indeed been removed from the revised draft legislation included in clause 94 of, and Schedule 15 to, the Finance Bill, although this removal may be only temporary. The policy paper stated that the "government is committed to further consideration of a third trigger". Certain other interesting changes were also made since the publication of the draft legislation in July. I'd like to highlight three. • Some of us had wondered as at which date one assesses whether a tax treatment is uncertain. Paragraph 8(2)(a) of Schedule 15 now indicates that this assessment should be made when the relevant return is delivered. Taxpayers should therefore be particularly mindful of the possibility of changes in HMRC's known position in the period between determining the tax treatment of a particular transaction and the filing of the relevant tax return. • Another point worth noting here is that a notification obligation can be triggered after a return has been submitted – but this applies only in respect of the first trigger, namely where an accounting provision is made after the return has been filed. • And finally, more detailed rules have been included in respect of the calculation of the tax advantage against which the £5 million threshold is to be assessed. The rules provide that group relief shall be ignored in calculating the tax advantage. If the uncertain tax treatment involves the creation of losses, the tax advantage is assessed differently, depending on whether the losses are used in the same year. If not, they are valued at 10% of the loss amount or at nil, if there is no reasonable prospect of the loss being used. I should also note that, if more than one treatment would be wholly in accordance with HMRC's known position, one applies the treatment which produces the least amount of tax advantage.
Tanja Velling	The third Finance Bill measure we wanted to highlight relates to the diverted profits tax and comes in two parts. I'll start with the change which taxpayers seeking to resolve their transfer pricing disputes

	through MAP are likely to welcome. Section 124 of the Taxation (International and Other Provisions) Act 2010 provides that, where HMRC arrive at a solution to a MAP case or reach a mutual agreement, they "are to give effect to the solution or mutual agreement despite anything in any enactment". Clause 27 of the Finance Bill inserts a new section 114A into TIOPA which provides that such a solution or mutual agreement "may include provision related to" DPT and the duty to give effect to it "includes a duty to make any such adjustment as is appropriate in relation to" DPT. The other DPT change which would appear intended to prevent the wider application of the First-tier Tribunal's decision in *Vitol* will be less welcome. Even though the relevant DPT review period had not yet ended, the FTT had directed HMRC to issue closure notices in respect of parallel transfer pricing enquiries. The FTT considered that there was nothing to suggest that the DPT legislation would override the provision of Schedule 18 to the Finance Act 1998 in relation to corporation tax enquiries. Clause 28 of the Finance Bill will change this. It provides that neither a partial nor a final closure notice may be issued under Schedule 18 where a parallel DPT review period has not yet ended. This also means that – and this is made explicit in the draft legislation – a Tribunal's direction to issue a closure notice in respect of the corporation tax enquiry will not take effect until the expiry of the DPT review period. The change will be effective from the 27th of October, but saves tribunal directions where the application for the direction was made before the 27th of September, which is the date of the judgement in *Vitol*. The *Vitol* case shows again that while, as intended in 2015, DPT puts a lot of pressure on taxpayers to proceed quickly in dealing with HMRC enquiries, there appears to be very little leverage in the other direction when, as appeared to be the case in *Vitol*, HMRC have themselves prolonged an enquiry. And now, onto two things in the pipeline?
Zoe Andrews	Actually, it just occurred to me that we should mention something else that was announced alongside the Budget and has already been actioned – the designation of the first freeport tax sites. Regulations coming into force on the 19th of November designate the first such sites within the Teeside, Humber and Thames freeports. Freeport tax sites benefit from additional tax reliefs such as enhanced capital allowances and stamp duty land tax relief. Speaking of reliefs, one of the measures in the pipeline is changes to the tax relief for research and development. The Chancellor announced that these reliefs will be broadened so as to cover data and cloud computing costs, but also narrowed through "refocusing support towards innovation in the UK". It is proposed that the change will be legislated for in next

	year's Finance Bill to take effect from April 2023, with further details and next steps to be published in due course. In relation to the narrowing of the relief, one obvious question will be around the purpose of the relief: is it to incentivise R&D spend by UK taxpayers or to incentivise them to physically locate their R&D activities in the UK? My money would be on the latter!
Tanja Velling	The second thing in the pipeline that we wanted to flag is that the Government is looking at introducing a corporate re-domiciliation regime which would allow non-UK incorporated companies to change their jurisdiction of incorporation to the UK while retaining their existing legal identity – and potentially vice versa, but the consultation is decidedly more lukewarm on outward re-domiciliation. As it is not predominantly a tax measure, the consultation (which closes on the 7th of January 2022) is run jointly by the Treasury, HMRC and the Department for Business, Energy & Industrial Strategy. But it includes a range of thoughtful tax questions, for example, around the impact on company residence, tax losses and base cost, and whether an outward re-domiciliation regime would need to be accompanied by measures to prevent stamp duty avoidance. And there is a non-tax point which I wanted to highlight. In the UK, companies are registered in one of England and Wales, Scotland or Northern Ireland, and cannot currently move their registration to a different nation while retaining their existing legal identity. So, intra-UK re-domiciliations are not currently possible and the consultation states that the government "is not minded at present to change this."
Zoe Andrews	It's also worth noting that any inward re-domiciliation to the UK requires a degree of international co-operation. Only companies incorporated in countries which allow outward re-domiciliation to the UK (which, I believe is not a huge number, but would, for example, include Luxembourg) could benefit from the UK's proposed inward re-domiciliation regime. So, could you just move your company into one of those jurisdictions and then to the UK? That would first depend on the rules that your company's jurisdiction of incorporation has vis-à-vis that jurisdiction which allows a re-domiciliation to the UK – it might, for instance, be possible to re-domicile to Luxembourg from another EU member State where that other State would not allow a re-domiciliation to the UK. The next question is then whether the company could immediately onward-re-domicile to the UK. In this respect, the proposed eligibility criteria could prove troublesome. It is envisaged that the company "must have passed its first financial period end and provide the relevant documentation". This might mean that the company would have to remain established in the intermediate jurisdiction for a non-negligible

	period, unless it was possible to look back to the financial records during the period of incorporation in the first jurisdiction. Hopefully, this will be one of the points that will be flushed out as part of the consultation. Shall we now say a few words about the First-tier Tribunal decision in *Europcar*?
Tanja Velling	Sure. This was an application for the appointment of joint experts against the wishes of one party, namely HMRC. The substance of the dispute concerned certain UK companies' claims for cross-border group relief in respect of the trading losses suffered by a Dutch and a German member of the group. In order to make out the claim for relief, the taxpayers had to prove that there was no possibility of the losses being utilised in the Netherlands or in Germany. So, expert evidence in respect of Dutch and German law was required. The reference to "no possibility" is, of course, a reference to the test laid down by the CJEU in *Marks & Spencer* and, given the mention of cross-border group relief, I can't help but refer back to the Budget. As announced on the 27th of October, clause 24 of, and Schedule 4 to, the Finance Bill provide for the abolition (with effect from the 27th of October) of the more favourable cross-border group relief rules which were applicable in respect of EEA-resident companies. So, in terms of any substantive points (should they ever be litigated), *Europcar* will be of limited relevance going forward.
Zoe Andrews	The decision on the procedural point is, however, all the more noteworthy, in particular given the benefits of instructing joint experts – such as reduced costs and potentially more speedy proceedings. Whilst it is permitted to appoint joint experts in the Tax Chamber, this is unusual. It is more common in the civil courts and has been the direction of travel there over the last 20 years. In deciding whether a joint expert should be instructed, the FTT considered the factors set out in Practice Direction 35 of the Civil Procedure Rules. These include whether it is proportionate to have separate experts having regard to the amount in dispute, its importance to the parties and the complexity of the issue and whether claims to privilege would make it inappropriate to instruct a joint expert. These factors are not, however, considered from a place of neutrality. The FTT noted that the starting point, following case law, is that, unless there is reason for not having a single expert, there should only be a single expert. The FTT found that the factors set out in the Practice Direction were finely balanced in this case, but concluded that HMRC

	had not provided a sufficiently good reason to depart from the starting point of having a joint expert.
Tanja Velling	And now, onto some things to look forward to: • The 2021 Congress of the International Fiscal Association is taking place online from the 29th of November to the 1st of December. • The Autumn Budget promised further information on a number of proposed future measures in addition to the change to R&D tax reliefs and an online sales tax. It was promised that there will be a consultation on the VAT treatment of fund management fees "in the coming months". There will also be further "tax administration and maintenance" announcements later in the autumn – which should presumably give the Chancellor about six weeks given that autumn ends on the 21st of December, at least according to my calendar. • We are also still waiting for the draft rules to replace the slimmed-down DAC6 implementation which we were promised for before the end of this year.
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. And you can also follow us on Twitter – @SlaughterMayTax.