Proskauer

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In this month's edition we cover significant developments in the UK's implementation of the "DAC 6" European cross-border transaction disclosure regime as well as a case decision reminding us of the breadth of the employment income taxing regime.

UK General Tax Developments

Date set for next UK Budget

The first Budget of the new Conservative government will be held on Wednesday 11 March. There has been significant speculation that there will be a major overhaul (or even abolition) of entrepreneurs' relief in this Budget following the Chancellor's statement that the government would "review and reform" the regime and the Prime Minister's recent statement that the Treasury is concerned about the lack of focus on real entrepreneurship of the regime. Our Tax Talks blog of 22 January has more details. You can read more about this here.

Brexit

The European Union (Withdrawal Agreement) Bill 2019-20 received Royal Assent on 23 January and has been approved by the European Parliament and Council, so the UK will leave the EU on 31 January.

DAC6 developments

So-called DAC6 is the latest amendment to the European Directive on Administrative Cooperation in Direct Taxes which entered into force 25 June 2018. Under DAC6 EU Member States must introduce legislation to require specified persons to disclose certain cross-border arrangements to their home tax administration, with the first disclosures due in August 2020.

The UK government have always said that they intended to implement DAC6 into UK law despite Brexit and revised regulations to do so, which will come into force on 1 July this year, were laid before the House of Commons on 13 January (the Regulations).

The rules apply to "intermediaries" and to taxpayers, requiring disclosure of certain cross border tax arrangements to their local tax administration. Information will be collected by tax administrations and automatically shared between them. These rules are additional to existing UK disclosure of tax avoidance scheme (DOTAS) rules which already apply to transactions generating certain UK tax advantages.

The Regulations replace those issued in draft in 2019 and, in certain respects, reflect the body of consultation responses received by HMRC in relation to those draft regulations and guidance.

One of the more important changes from the draft is provisions that mitigate penalties for failure to report in certain circumstances. The default position will be a one-off penalty of up to £5,000, with daily penalties only applying in more serious cases. HMRC summarised the changes as follows:

- amending the penalty regime to ensure it is proportionate and is flexible enough to deter non-compliance, while not unduly penalising those who make genuine mistakes;
- limiting the scope of 'tax advantage' to only taxes covered by DAC6, addressing a particular concern raised by a number of stakeholders around ensuring the rules are proportionate;
- amending the rules to ensure that the same intermediary does not have an obligation to report in multiple jurisdictions;
- ensuring that the scope of the rules is limited to UK intermediaries and does not apply to those without a UK connection, as intended by DAC6; and
- ensuring that the rules are compatible with legal professional privilege (LPP). HMRC will work with stakeholders on the guidance to ensure it does not inadvertently risk impacting on LPP.

Notwithstanding these changes, the rules are still likely to impose significant compliance obligations on affected intermediaries and taxpayers. Those subject to the rules should make sure that they are prepared for the first reporting requirement in August, particularly since at that point transactions entered into since the end of June 2018 which come within the scope of the rules must be reported.

Government to consult on changes to implementation of the private sector IR35 legislation

As reported in our Tax Talks blog on 8 January 2020, the government is launching a review into the implementation of the changes to the IR35 rules for private sector workers which are scheduled to be introduced on 6 April. The review will conclude by mid-February in order to allow any changes or improved assistance that is identified to be put in place for April and its stated purpose is to ensure a "smooth and successful implementation" of the rules. This might involve providing additional support to affected businesses and further improving HMRC's online CEST tool. You can read more about this here.

On 22 January HMRC also issued revised draft legislation and a new consultation document detailing HMRC's ability to collect any tax due under these new private sector off payroll worker rules from the worker's end client in circumstances where there is a chain of entities between the client and the worker's intermediary entity. The consultation period closes on 19 February. The changes proposed include HMRC first seeking to recover any unpaid tax liabilities from the agency the client contracts with where this agency is UK-based. Where HMRC are of the view that there is no realistic prospect of recovering the outstanding income tax from that agency, HMRC will then seek to recover unpaid liabilities from the client.

Disguised remuneration loan charge

Following the review into the much criticised disguised remuneration loan charge that we reported on in our last UK Tax Round Up, HMRC has published draft legislation to amend the loan charge in certain respects.

The scope of the charge in prior periods has been narrowed and can be reduced in relation to more recent tax years provided full disclosure was made. In addition, the charge will apply only to loans made on or after 9 December 2010 instead of the current date of 6 April 1999. People who have already paid the charge in respect of earlier loans will be able to make reclaims. This narrowing of the application of the charge is to be welcomed.

Revised HMRC guidance on procedures for preparing and filing partnership tax returns

As reported in our Tax Talks blog on 17 January 2020, HMRC has published updated guidance on the new requirements for filing partnership tax returns for 2018/19 and beyond following the changes made in Finance Act 2018.

Various relieving measures have been introduced, some relating to the need to prepare tax computations on multiple bases for tiered partnerships with non-UK resident indirect partners (such as funds of funds). In addition, HMRC has provided updated unique taxpayer reference (UTR) numbers for use by non-resident partners where a partnership is not required to report on them under CRS for various reasons.

UK Case Law Developments

VAT recovery for general partner of a UK investment fund

In *Melford Capital General Partner Ltd v HMRC,* the FTT has held that a general partner of an English limited partnership structured investment fund that was VAT grouped with the fund's adviser was entitled to recover its input VAT costs on establishment of the fund because the adviser provided VATable services to the fund's portfolio companies. The appellant company (GP) was the general partner of an English limited partnership investment fund (the Fund) and the subsidiary of a UK limited liability partnership (LLP) which provided advisory and management services to the Fund and its portfolio companies. The Fund held shares in an Isle of Man holding company (HPH) which, in turn, held a series of corporate special purpose vehicles (SPVs) that owned investment assets including commercial property. The LLP supplied property management services direct to HPH and the SPVs for consideration. The GP and the LLP were members of a VAT group. HPH and the SPVs were not part of that VAT group. It is a well-accepted VAT principle that a limited partnership is recognised as being its general partner for VAT purposes, so that the activities of the Fund were included in the VAT group.

The Fund (acting through the GP) incurred various costs including the costs of setting up the Fund and attracting investors and ongoing operational costs.

The FTT rejected HMRC's refusal of a claim by the GP/LLP VAT group to recover the input VAT on the set-up and operating costs and allowed full VAT recovery. It found that the costs were incurred by the GP (either by itself or as representative member of the VAT group) and were incurred for the purpose of the taxable business of supply of management services by the LLP (and so the VAT group) and that the Fund (and so the VAT group) did not carry on a separate investment business distinct from its activities as an active holding company. The FTT also found a direct and immediate link between the costs (both the operating costs and the set-up costs of the GP/Fund) and the supply of the management services. In particular, it ruled that the set-up costs were incurred for the purpose of subscribing for shares in or providing loans to HPH and the SPVs with the intention of providing taxable advisory services to them.

This is a very helpful case for managers of UK structured investment funds and produces a favourable VAT recovery position in relation to investment fund VAT expenses. It applies the recently developed ECJ case law on VAT recovery for so-called "active" holding companies in fund structures (where the holding company provides VATable services to its subsidiaries) to the fund structure which has not been the case previously. Given the potential scope of application of the case, an appeal by HMRC seems likely.

Amounts paid on spread betting contracts taxed as employment income

In *Root 2 Tax Ltd v HMRC* the FTT has ruled that a series of arrangements under which a company paid amounts indirectly to its directors (and owners) under some call spread options with a third party, with that third party making equivalent payments under spread betting contracts, should be treated as employment income of the directors.

The FTT held that (a) the contracts were linked to employment, (b) amounts paid to the employees by the third party were earnings subject to PAYE and (c) if wrong on that, the amounts would be taxable as "disguised remuneration" under Part 7A ITEPA.

The FTT applied the *Ramsay* line of general anti-avoidance cases and, in particular, that "commercially irrelevant contingencies" contained in arrangements could be ignored in determining that the possibility under the arrangements that the directors might "lose" their bets could be ignored since, in that case, it was expected that the company would make an equivalent profit that it could then pay to the directors.

Given the heavily structured nature of this arrangement and the terms of some of the advice underlying it, this is not a surprising decision and highlights again that HMRC and the courts are likely to look unfavourably on contrived arrangements designed to avoid employment income tax.

Upper Tribunal rules on breadth of "arrangements" in consortium relief case

HMRC v Eastern Power Networks plc considered whether certain changes made to the articles of association of certain companies amounted to "arrangements" for the purposes of a provision of the consortium relief rules. The companies in question had entered into a series of detailed changes to their articles of association, dealing in particular with amendments to the thresholds for passing resolutions and changes to the voting percentages held by members of the consortium and other shareholders. The companies claiming relief involved in this case were trading subsidiaries of UK Power Networks Holdings Limited (UKPNHL).

HMRC argued that anti-avoidance legislation which applies where there are "arrangements" in place for preventing consortium companies from controlling a consortium relief surrendering company operated (or might operate) to restrict the relief available for surrender. The case was not deciding on the point of whether the relevant anti-avoidance provision applied in its entirety but simply on whether the "arrangements" limb of it was satisfied so that HMRC could continue with its enquiry into the purpose of the arrangements. The Upper Tribunal (UT) overturned the First-tier Tribunal's (FTT's) decision that the required arrangements were not in existence. The articles of association of the relevant companies had been changed to require a 75% vote to pass ordinary resolutions (the 75% Voting Threshold). Two companies that were not link companies or consortium members held between them 25.4% of the votes. The UT found that the existence of the 75% Voting Threshold enabled those two companies to prevent the link companies from controlling UKPNHL. Accordingly, the UT held that the arrangements were ones into which HMRC could reasonably continue to enquire.

This is a complex and specific set of facts, but the important point is that the UT was willing to apply the word “arrangements” broadly in the context of anti-avoidance legislation (including considering just a part of, rather than the entirety of, the company's articles of association) to allow HMRC to continue to enquire into whether the relief should be restricted. It reinforces that the term “arrangements” as used in many statutory provisions is broad applying its ordinary meaning.