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For more information,
please contact:

Stephen Pevsner
Partner
t: +44.20.7280.2041
spevsner@proskauer.com

Robert E. Gaut
Partner
t: +44.20.7280.2064
rgaut@proskauer.com

Catherine Sear
Partner
t: +44.20.7280.2061
csear@proskauer.com

Welcome to December's edition of our UK Tax Round Up, and a happy new year to our readers. From a tax perspective, December was an interesting month which included the announcement of a significant narrowing of the UK DAC 6 reporting obligations, the handing down of the long-awaited verdict in the *Development Securities* tax residence case and the publication of a second stage HMRC consultation with a view to increasing the attractiveness of the UK as an asset holding company jurisdiction.

COVID-19 Developments

Tax exemptions for coronavirus antigen costs

Draft regulations providing for employee and employer national insurance contribution (NIC) exemptions from payments made to employees to cover the cost of a coronavirus antigen test (whether an advance payment or a reimbursement) have been laid before Parliament in respect of tests taken between 25 January 2021 and 5 April 2021 (the end of the 2020-21 tax year).

The NIC regulations follow the income tax exemption legislated for last month in respect of employees being provided with a coronavirus antigen test by their employer, although the income tax exception does not apply to payments made to employees to cover the cost of antigen tests in the way the NIC exemption does.

However, HMRC have confirmed that as an informal matter they will not seek to collect tax or NICs due on any coronavirus antigen payments made in the 2020-2021 tax year.

OECD transfer pricing guidance

The OECD has published specific guidance on the transfer pricing implications of the COVID-19 pandemic, developed and approved by its 137 member states.

The guidance addresses some of the particular challenges that the pandemic has brought about, including in particular (i) how to compare arm's length prices during the pandemic compared to pre-pandemic periods; (ii) loss and cost allocation of COVID-19 specific costs; and (iii) the impact of government assistance programmes.

UK transfer pricing legislation states expressly that they are to be interpreted in light of the OECD transfer pricing guidelines from time to time, so that the OECD's commentary applies directly to businesses subject to UK transfer pricing rules.

UK Case Law Developments

Court of Appeal decides that Jersey companies were UK tax resident

The Court of Appeal (CA) has determined that certain Jersey incorporated subsidiaries of a UK parent were resident in the UK for tax purposes by reason of being centrally managed and controlled in the UK in its long-awaited verdict in *HMRC v Development Securities*.

As with all cases about central management and control, the decision rested on the facts and the message to take away is that the boards of non-UK resident companies taking advice from the UK should consider that advice carefully before concluding on whether or not to take a particular act or enter into a particular transaction.

By way of background, Development Securities plc (DS) wished to implement a tax planning scheme whereby the group would use losses incurred on the acquisition of some of its subsidiaries and properties (the Assets) to offset other gains in the group. DS incorporated three Jersey subsidiaries which then acquired the Assets at a price in excess of their market value. On that basis the acquisitions were not, considered in isolation, in the best interests of the Jersey subsidiaries but, based on advice from DS that the acquisitions were lawful, the Jersey-based directors of the Jersey subsidiaries approved the transactions.

The First-tier Tribunal (FTT) accepted that all board meetings of the Jersey subsidiaries had a Jersey resident majority, the board meetings were held in Jersey and the decisions were actually taken at those board meetings. However, the FTT also found that the Jersey subsidiaries had considered only the Jersey legality of the transactions in question and not the uncommercial nature of them from the perspective of the subsidiaries. On that basis, the FTT held that the central management and control of the Jersey companies was exercised in the UK.

After the Upper Tribunal (UT) had found in favour of DS, the CA has now reinstated the FTT's decision that the Jersey companies were UK tax resident. In particular, the CA noted that the UT had misunderstood the importance of the uncommercial nature of the transactions and the thought that should have gone into deciding to enter into them from the perspective of the Jersey subsidiaries.

The CA found that, in applying the questions of fact of (1) who was making the strategic and management decisions regarding the company's business and (2) where those decisions were made, the Jersey directors were simply acting under instructions or orders from DS in confirming the lawfulness of their decision but, crucially, without considering the merits of the decision. This led to a conclusion that the decision to enter into the relevant transactions was, in fact, taken by DS and not by the directors in Jersey.

This is an important decision in the line of cases considering the tax residence of overseas incorporated companies and acts as a reminder that particular attention should be paid to ensuring that foreign subsidiaries under the control of UK parent companies should actively engage in the decision making process and give sufficient attention to the details of the decision that they are taking rather than simply agree to implement a decision that was already taken by a third party.

For a more detailed discussion on this case please see our blog post here.

Holding company entitled to recover input VAT on contingent consideration

Holding or acquisition vehicles being able to recover their input VAT costs is a significant concern for many clients and the recent case of *Bluejay Mining plc v HMRC* highlights the continued uncertainty in this area.

In this case the FTT held that, contrary to published HMRC guidance, a holding company making supplies for contingent consideration can be engaged in an economic activity for VAT purposes and so be entitled to recover its input VAT costs.

In the UK, input VAT costs can be recovered by VAT registered persons if they incur those costs in the course or furtherance of a business (an economic activity) and those costs are directly and immediately linked to a supply that is itself subject to VAT.

In this case, Bluejay, a UK holding company of a mining group, provided technical services under a services agreement to its subsidiaries. Consideration for the services was paid under the services agreement by adding amounts to the subsidiaries' loan accounts with Bluejay. Those loans were generally written off if the underlying mining project to which the services related did not proceed. HMRC argued that the consideration payable under the service agreement was contingent consideration and, that consistent with its own published guidance, this contingency severed the link between the input VAT cost and the supply, thereby preventing recovery of the input VAT costs.

The FTT rejected HMRC's argument on this point and found that the services were being provided by Bluejay in return for consideration.

More significantly, the FTT found that even if the consideration was contingent on the outcome of the mining projects, because there was a real intention and a real expectation at the time that the services were provided that the invoices would be paid, this was sufficient for there to be a supply for consideration for the purposes of recovering input VAT. The FTT's view was that Bluejay's position could be distinguished from that in *Norseman Gold plc v HMRC*, a key case in the area of contingent consideration, since in Norseman there was only a vague and general intention that consideration might be paid at some point in the future.

The case illustrates the continued uncertainty that taxpayers face in this area, with decisions swinging on finely balanced facts, albeit in this instance those facts fell in the favour of the taxpayer.

Other UK Tax Developments

Narrowing of UK intermediaries' DAC 6 reporting requirements

On 30 December, the UK government laid regulations that will significantly reduce the type of cross-border arrangement that will need to be reported by UK intermediaries under the so-called DAC 6 rules on 31 January 2021 and in the future.

As a reminder, DAC 6 is the wide ranging EU regime for reporting "cross-border tax arrangements" which requires certain "intermediaries" and taxpayers to report to HMRC a wide range of transactions entered into since 25 June 2018 that met a "hallmark" set out in the implementing EU Directive. In the UK the first reports in respect of reportable cross-border tax arrangements are due to be made by 31 January 2021.

As a result of finalising the UK-EU Trade and Cooperation Agreement (TCA) under which the UK and the EU have agreed how they will interact following the end of the Brexit transition period, the

UK's obligation is solely to "not weaken or reduce the level of protection … below the level provided for by the standards and rules which have been agreed in the OECD … in relation to the exchange of information … concerning … potential cross-border tax planning arrangements [being the OECD's Mandatory Disclosure Rules (MDR)]". The UK has decided that compliance with the MDR reporting only requires reporting of cross-border arrangements meeting the conditions in the category D hallmarks under DAC 6, which relate to arrangements designed to circumvent reporting under the OECD's Common Reporting Standards rules and/or to seek to hide the identity of the beneficial ownership of entities in the arrangements.

The new scope of DAC 6 reporting applies from 11 pm on 31 December 2020, so that the first reports (and future reports) under DAC 6 will only require reporting of these category D arrangements. This significantly narrows the range of transactions that might otherwise have had to have been reported on.

The government has also announced that it will consult on new reporting rules to implement the MDR as soon as practicable, and that these new rules will then replace DAC 6 in its entirety.

HMRC will update its guidance in due course to reflect these changes. Although the changes significantly narrow the scope of DAC 6 reporting requirements for the UK, the requirements set out in the applicable EU Directive continue to apply where an EU intermediary is involved in a transaction, so UK businesses (or their EU-based advisers) that are party to cross-border transactions involving the EU will still need to consider the full scope of DAC 6.

Second consultation on the tax treatment of UK asset holding companies

As part of the 2020 Budget, and as reported in our April 2020 UK Tax Round Up, HM Treasury has undertaken a consultation on the tax treatment of asset holding companies in alternative investment fund structures and has now published responses to that initial consultation and announced a second stage consultation.

Rather than a general relaxation of the UK tax rules which may make the UK a less attractive jurisdiction for alternative funds (in particular funds focused on making debt investments) to establish asset holding companies in, the proposal is that a specific regime would be established for such companies used in widely held investment fund structures.

The general idea behind the regime is that the tax rules (and tax payment obligations) should better reflect the role that intermediate holding companies play in facilitating the flow of investments and returns between investors and the target assets without creating additional material tax leakage on payments through the investment structure. In this regard it is proposed that the regime may include:

- a broader regime than the substantial shareholding exemption providing relief from tax on capital gains on a disposal of investment assets;
- certain exemptions from:
    - the hybrid mismatch rules;
    - the group relief rules;
    - stamp duty on share buybacks;
    - withholding tax on interest paid to investors; and

  - the general prohibition on the deductibility of results dependent interest on back-to-back loans; and

- special rules to preserve capital gains tax treatment for UK taxpaying investors to the extent that the asset holding company receives capital gains, removing the risk of distribution treatment on those amounts depending on the legal mechanism used to extract those profits from it.

Although the above is all welcome, there will be numerous details to consider before finalisation of any new regime.

It is expected that the regime would be subject to strict eligibility criteria, potentially applying only to intermediate holding companies owned by widely held collective investment structures which may (depending on the detail of any proposed rules) exclude certain private funds with small numbers of investors and asset specific coinvestment structures.

As an administrative matter, it is expected that eligible intermediate holding companies would need to elect into the regime.

The consultation also asks questions about improving the attractiveness of the UK as a real estate holding jurisdiction and expanding and simplifying the real estate investment trust (REIT) tax regime.

The consultation closes on 23 February 2021.

2021 Budget date announced

HM Treasury has confirmed that the 2021 Budget is expected to take place on Wednesday 3 March 2021.