Proskauer

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This month has seen a rich crop of tax cases on topics ranging from the requirements of a tax claim notice provision in a sale and purchase agreement to the ability of HMRC to raise a discovery assessment. There have also been some interesting developments on the international tax front.

UK General Tax Developments

Stamp Duty and COVID-19

Since the start of the first UK lockdown in March 2020, HMRC has been accepting that documents can be stamped electronically. HMRC has now confirmed that, where this process has been used, there will be no need also to send the original instruments of transfer to HMRC for physical stamping when they have already been stamped under the electronic procedures. It has also announced that this electronic document submission process will become permanent.

Finance Bill 2021

The Finance Bill 2021 continues its progress through the legislative process. Several, largely technical, amendments have been made at the Report Stage.

We expect the Bill to receive Royal Assent within the next couple of months.

UK Case Law Developments

Taxpayer not entitled to rely on Ramsay principle on share buy back

In *Khan v HMRC*, the Court of Appeal (CA) has upheld the earlier decision of the Upper Tribunal (UT) by finding against Mr Khan in an unfortunate case under which Mr Khan suffered a £600,000 tax liability on an amount of money that he did not receive as an overall economic matter. The decision is not surprising, however, given the transaction structure that was used.

The case involved Mr Khan acquiring a company that had a significant amount of distributable reserves but whose owners intended to wind it up. Originally, it was intended that the company would buy back nearly all of its shares from the shareholders and then sell the company to Mr Khan for a relatively low amount reflecting its remaining net asset value. Following negotiations, however, the structure was changed so that Mr Khan agreed to buy the company, pregnant with distributable reserves, for £1.95 million. Mr Khan funded the purchase price through a buy back of the company's shares immediately after his completion of the acquisition of the company. HMRC sought to tax Mr Khan on his receipt of the share buy back proceeds as a distribution since the amount paid on buy back of the shares exceeded the original subscription price for them. This resulted in a very significant income tax charge on Mr Khan with no matching cash receipt (or retention). Mr Khan sought to argue that because the various transaction steps were designed to

flow sequentially and uninterrupted, the court should apply the tax rules to the end result of the transaction, being a small profit for Mr Khan and a large receipt for the company's shareholders applying the well known *Ramsay* principle of legislative construction.

The CA rejected Mr Khan's argument that the *Ramsay* principle should be applied to look at the overall result of the transactions as a whole. It is unusual for a taxpayer to invoke the *Ramsay* case. Whilst of general application, it is normally relied on by HMRC to attack tax avoidance transactions that include a series of preordained steps. Here the CA was clear that the individual steps (including the share buy back after Mr Khan's acquisition of the company) were to be examined and taxed as such. Mr Khan was and remained entitled to the distribution arising on the buy back and was accordingly taxable on it.

This is a salutary tale that careful tax planning (or at least an understanding of the different tax consequences of two seemingly similar transactions) is required before effecting corporate transactions. Share repurchases are particular bear traps for the unwary, where the holder's purchase price for the shares may be irrelevant to the income tax computation for the deemed distribution on a buy back.

CA rules on level of detail required in notice of tax claim

In *Dodika Ltd & Ors v United Luck Group Holdings Limited*, and as reported in our TaxTalks blog of 11 May 2021, the CA overturned the High Court and found that the content and form of a notice of claim under a tax covenant was sufficient taking into account the knowledge that the sellers already had about the relevant company's tax affairs and the issues that would be relevant to the claim.

Some useful guidance on what is required in a notice of claim is included in the judgment. Please refer to our blog article for a full discussion.Tax Talks blog - Dodika.

This is one of a number of recent cases discussing the requirements for valid claim notices and is a reminder that purchasers should be extremely careful in accepting specific information requirements in sale and purchase documentation which go beyond simply notifying a seller of circumstances likely to give rise to a claim.

Unilateral credit allowed for US tax when unavailable under double tax treaty

In *Aozora GMAC Investments v HMRC*, the First-tier Tribunal (FTT) allowed the taxpayer's claim that it should be entitled to unilateral credit in the UK against US tax on its income notwithstanding that the UK-US double tax treaty (the Treaty) did not permit the credit.

The US Internal Revenue Service had determined that the UK resident taxpayer (Aozora) was not a "qualified person" and so was not entitled to benefits under the Treaty applying the limitation on benefits (LOB) Article of the Treaty. Aozora had received interest from its US subsidiary subject to US withholding tax. As a result of not meeting the LOB test, no relief was available for the withholding tax under the Treaty.

As a result, Aozora claimed unilateral relief under the UK tax legislation for the tax withheld in the US from the interest payments. The relevant UK legislation at the time (subsequently rewritten but still substantively the same) required that there be no "express provision" in any relevant double tax treaty which stated that relief by way of credit should not be given under that treaty in the relevant circumstances.

The FTT ruled in favour of Aozora and held that the LOB Article in the Treaty is not "an express provision that relief shall not be given". It simply prescribes who will be "qualified persons" under the Treaty. In addition, Article 1(2) of the Treaty states that it shall not restrict any benefit accorded

by the laws of either the UK or the US in any manner. At least one other Article is carved out from that general principle under the Treaty, but the LOB Article is not.

This is an interesting decision. It remains to be seen whether HMRC appeals the case, but, as an FTT decision, it is not binding precedent. It is, however, a useful exposition of some cogent arguments to support a claim for unilateral UK tax relief where the notoriously complex LOB provisions are engaged.

Supreme Court rules on taxpayer's alleged deliberate inaccuracy

In *Raymond Tooth v HMRC*, the Supreme Court (SC) had to consider whether the taxpayer, Mr Tooth, had included a deliberate inaccuracy in his annual tax return which allowed HMRC to raise a discovery assessment. It found in his favour. While agreeing with Mr Tooth that there was no deliberate inaccuracy, the SC also concluded that there is no concept of "staleness" in the rules for raising a discovery assessment and that, had there been a deliberate inaccuracy, a discovery assessment could have been raised.

Mr Tooth had entered into a tax avoidance scheme. He then inaccurately declared the loss in his annual tax return as a partnership loss rather than an employment loss (which is what it would have been). This was, however, because his online tax return did not allow him to enter his loss appropriately and he (or his tax adviser) was advised to enter the loss on a different box and explain what had been done in the return's "white space". He did this and stated in the white space of his return that the loss was really an employment loss.

HMRC had raised an enquiry into Mr Tooth's return, but this was ruled by the courts to have been ineffective because it was raised under an invalid statutory provision. So HMRC then issued a discovery assessment, alleging that the insufficiency in Mr Tooth's self-assessment had been brought about deliberately, relying on the 20-year period within which to make the assessment since the standard enquiry window had expired.

In order for HMRC to succeed, it needed to show that the inaccuracy in the tax return was a "deliberate inaccuracy". The SC considered two alternative interpretations. First, a deliberate statement which is (in fact) inaccurate (so, broadly, strict liability for the accuracy of the statement). Second, a statement which, when made, was deliberately inaccurate (in other words where the maker of the statement knew it to be inaccurate or, perhaps, that the maker was reckless rather than merely careless or mistaken as to its accuracy). The SC held that the latter was the correct interpretation of deliberate inaccuracy. Given this, Mr Tooth had not made a deliberate inaccuracy because of the clarificatory explanation in the white space on the tax return.

The other point that was concluded by the SC relates to "staleness" of assessments. It had no bearing on the outcome of the case, given the conclusion on deliberate inaccuracy, but it is now settled by the SC that the fact an officer of HMRC makes a discovery on one date but does not raise the assessment until a later point in time does not affect the validity of the "discovery" assessment.

Parent company made VAT taxable supplies of management services to subsidiary

In *HMRC v Tower Resources PLC*, the UT upheld a prior decision of the FTT and rejected all of HMRC's grounds of appeal.

In this case, a parent company had charged its subsidiaries for management, logistical and technical services. The cost of the services was added to intercompany loan accounts and, although the loans were repayable on demand, the parent company had, in practice, not demanded repayment. HMRC had argued that the parent company (Tower) was not making taxable supplies for consideration to its subsidiaries and had denied Tower credit for input VAT in

excess of £600,000 and issued an assessment for repayment of input VAT previously claimed for a further amount of over £800,000.

The FTT had found in favour of Tower, holding that Tower did indeed make supplies to its subsidiaries for consideration on the basis that there was a legal obligation on the subsidiaries to make payment on demand and the fact that the loans had not yet been repaid did not mean there was no consideration for the supply. The FTT considered that the addition to the intercompany loan account would in any event amount to "payment" if actual payment was required for there to be a supply for consideration.

The UT has upheld this decision. It found that the subsidiaries' obligation to pay was, on the facts found by the FTT, neither contingent nor uncertain. Furthermore, it was confirmed by the UT that the involvement of a holding company in the management of its subsidiaries will be regarded as an economic activity for these purposes if the management services provided by the holding company are supplied for consideration. As set out in the European case law, those services may include administrative, financial, commercial and technical services, but that is not an exhaustive list.

This is a reassuring decision in favour of the taxpayer.

Other Developments

Luxembourg wins and loses State Aid cases

The EU General Court (EGC) has overturned the 2017 decision of the European Commission (EC) that Luxembourg had granted €250m of state aid to Amazon. That case had concerned a tax ruling issued by the Luxembourg authorities to Amazon that resulted in what the EC decided was too high a rate of royalty payments applying transfer pricing principles. The EGC concluded that the EC had made several errors in its methodology of calculating the arm's length rate of royalty that could be applied and that the EC did not prove to the requisite legal standard that there was an undue reduction of the tax burden of a European subsidiary of the Amazon group. The EC competition chief, Margrethe Vestager, is considering whether to appeal this decision further.

Luxembourg, however, lost a different State Aid case (*Engie*). In that case, the ECJ upheld the EC's findings that various tax rulings given by the Luxembourg authorities to Engie in relation to financing arrangements had resulted in tax advantages flowing from the inconsistent treatment of intra-group financing transactions. The EGC found that the tax rulings had led to an artificial reduction in Engie's tax burden, leading to an effective corporate tax rate of 0.3% on certain profits in Luxembourg.

Although Amazon has won this round in the case, the EC may yet appeal the decision, and the *Engie* decision went against the taxpayer. The EC remains very focused on pursuing what it sees as unduly advantageous tax deals between Member States and large multinationals, particularly in the area of transfer pricing.

Jersey substance rules to be extended to non-fund partnerships

On 18 May 2021, the Jersey Government announced that it intends to include partnerships carrying on a "relevant activity" within the scope of its existing economic substance law. This stems from undertakings given by the Jersey government to the EU Code of Conduct Group. We covered the initial launch of these rules in our June 2019 UK Tax Round Up.

The economic substance rules would be extended to (i) general partnerships, limited partnerships and limited liability partnerships, in each case formed in Jersey or under Jersey law and (ii) non

Jersey limited partnerships which have their place of effective management in Jersey. Partnerships that are collective investment funds will not fall within the extended rules.

We understand that substance will be judged at the partnership level (rather than at the level of the limited partners) and will look at the activities of the governing body of the partnership. In the case of a limited partnership this would look at the general partner's activities.

Partnerships that are within the new substance laws will need to be managed in Jersey and carry on their core income generating activities in Jersey. These are, broadly, similar to the substance requirements for relevant companies and are likely to require an adequate number of people, expenditure and physical assets in Jersey.

As with the existing rules for companies, there will be a focus on ensuring that the partnership's governing body meets in Jersey frequently enough in the context of the decisions that need to be made, that members of the governing body are experienced and knowledgeable enough and that proper records of strategic decision making are made and kept in Jersey.

We understand that partnerships in existence as at 30 June 2021 will be in scope for accounting periods commencing on or after 1 January 2022 and partnerships formed on or after 1 July 2021 will be in scope from the date of their formation.

It remains to be seen how (or whether) the proposed extension of the rules may (or will) affect investment funds which are formed as Jersey limited partnerships. We would expect that they would generally remain out of scope as they would qualify as "collective investment funds". Care may need to be taken, however, in the case of certain coinvestment structures and single asset or single investor partnerships. Guidance is expected to be released which may help the interpretation of the new law in cases of uncertainty.

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