Proskauer

UK Tax Round Up

June 2017

International Tax Developments **BEPS Multilateral Convention signed**

On 7 June, officials from more than 60 jurisdictions signed the BEPS Multilateral Convention which will transplant a number of measures in respect of Action 2 (Hybrid Mismatches), Action 6 (Treaty Abuse), Action 7 (Avoidance of Permanent Establishments) and Action 14 (Improving Dispute Resolution) directly into each signatory jurisdiction's existing network of bilateral tax treaties.

However, it is worth noting that a number of the provisions in the Convention include elements of choice (e.g. in relation to Action 6 (Treaty Abuse) amendments, signatory jurisdictions can choose to include (i) a principal purpose test, (ii) a simplified limitation of benefits provision or (iii) a detailed limitation of benefits provision along with either rules addressing conduit financing structures or a principal purpose test). It remains to be seen which approach each signatory jurisdiction will take in relation to these provisions although the UK has indicated its preference for the principal purpose test only.

BEPS Actions 8-10: Guidance on hard-to-value intangibles

On 23 May, the OECD published its public discussion draft of the guidance on hard-to-value intangibles as part of the work on BEPS Action 8. The guidance aims to set out a common position for tax administrations to take when applying the adjustments resulting from the hard-to-value intangibles rules, which should in turn improve consistency and reduce the risk of double taxation. This guidance takes the form of a set of principles together with a number of examples which detail how the hard-to-value intangibles rules should be applied in specific scenarios.

An important point to note is that when assessing the reasonableness of intragroup pricing of transactions involving hard-to-value intangibles (e.g. the transfer of IP rights in development), tax authorities can use the facts as they turn out after the intragroup transaction as evidence of what would have been a reasonable price (or set of assumptions on value) for the transaction.

EU Council adopts directive implementing additional hybrid mismatch rules

On 29 May, the EU Council formally adopted a directive amending the 2016 EU Anti-Avoidance Directive which is designed to prevent corporate groups from exploiting the disparities between two or more non-EU jurisdictions to reduce their overall tax liability. The new directive has been adopted as part of the EU Council's implementation of the OECD's recommendations on hybrid mismatches under Action 2 of the BEPS project. The text of the directive was originally agreed at a meeting on 21 February 2017 and the European Parliament provided its opinion on the directive on 27 April 2017. Significantly, it will extend the EU's anti-hybrid rules to transactions between Member State and non-Member State parties.

EU member states have until 1 January 2020 to transpose the directive into national laws and regulations (although implementation of certain aspects may be delayed until 2022).

EU Council agrees on text for a directive to resolve double taxation disputes within the EU

On 23 May, the EU Council agreed on a proposed directive designed to improve the mechanisms used for resolving disputes between Member States arising out of double tax treaties. In summary, the draft directive provides for a 'mutual agreement procedure' to be used under which the relevant Member States must reach an agreement on the matter within two years. If no agreement is reached within the two year time limit, an arbitration procedure will then be used to resolve the dispute within specified timeframes.

The next steps involve the draft directive being reviewed by the European Parliament. Once the European Parliament gives its opinion on the draft directive, it can then be formally adopted by the EU Council.

UK Case Law **Capital gains tax deductions**

In *Revenue and Customs Commissioners v Blackwell*, the Court of Appeal considered whether an amount paid for the release of a restriction on voting or transferring shares could be deducted when computing the capital gain made on sale of the shares. The taxpayer in the case entered into a personal agreement with a third party company which restricted the taxpayer's ability to freely exercise their share rights. Prior to selling the shares, the taxpayer paid £17.5 million to the third party in order to be released from the restrictions. The taxpayer then sought to deduct the £17.5 million when calculating their capital gains tax liability relating to the sale of the shares. The Court of Appeal held that such amount was not deductible because the agreement with the third party was a personal undertaking by the shareholder, rather than part of the rights and obligations conferred and imposed by the shares. As such, the payment to be released from the restrictions did not relate to the "*state or nature*" of the shares and so was not deductible when calculating the ultimate capital gains tax liability on sale of the shares. The case once again highlights the distinction between rights and obligations that are embedded in share terms (e.g. in a company's Articles of Association) and those that are agreed personally in addition to the share terms (e.g. in a shareholders' agreement). When parties want to ensure that the rights and obligations are part of the share terms they should be included in the company's Articles and apply to holder of the shares generally.

In *O'Donnell v HMRC*, the First Tier Tribunal was asked to consider whether a seller's reimbursement of certain of the costs of a purchaser in respect of a residential property transaction were allowable deductions for the seller when the seller came to calculate their capital gains tax liability. The Tribunal held that, despite the costs being primarily attributable to the purchaser (being their legal fees and the SDLT and the land registry fees), the costs were incurred by the seller wholly and exclusively for the purposes of the transaction and were therefore deductible when calculating the gain realised by the seller.

Conversion of qualifying corporate bonds and non-qualifying corporate bonds

In the long-running saga of *Hancock and another v Revenue and Customs Commissioners*, the Court of Appeal was asked to consider whether a gain arising in respect of the conversion of a mixed holding of qualifying corporate bonds ("QCBs") (which are exempt from capital gains tax) and non-QCBs (which are not exempt from capital gains tax) could be held over and then crystallise when the new QCBs were redeemed for cash or whether that gain was exempt from capital gains tax entirely. The taxpayer argued, on the wording of one of the relevant provisions, that the hold over rules could not apply by reference to the redemption of the new QCBs because QCBs were part of the transaction both before and after the conversion into those QCBs. The Court of Appeal agreed with the Upper Tier Tribunal that the conversion of the QCBs and non-QCBs into a single new QCB were actually two separate transactions, one transaction being a conversion of a QCB into a new QCB (which was an exempt transaction) and the other being the conversion of non-QCBs into a new QCB (which gave rise to a held over gain). As a result, the Court of Appeal held that the held over gain crystallised when the new QCBs intro which the original non-QCBs were converted were redeemed for cash. One of the key reasons for this conclusion was stated to be that a contrary interpretation of the rules would "subvert the evident intention of Parliament" and expose a loophole which would allow taxpayers to structure transactions to avoid tax completely. This is yet another example of the higher courts being willing to stray from a very literal interpretation of legislation needed to support tax avoidance schemes to avoid such interpretation allowing for the exploitation of what they consider to be loopholes in the rules.

VAT repayment subject to corporation tax

In *Coin-A-Drink Limited v HMRC*, the taxpayer lost its appeal against the finding by the First Tier Tribunal that a repayment of overpaid VAT plus interest from HMRC was properly subject to corporation tax. The taxpayer sought to argue that if corporation tax was charged on the repayment amount, it would undermine the European law requirement for effective remedy because the taxpayer would not have received a full repayment of the overpaid VAT. The Upper Tier Tribunal held (applying the general principles set out in the recent Supreme Court decision in the case of *Shop Direct Group v HMRC*) that the taxpayer was incorrect in its assertion that the repayment of the overpaid VAT and the corporation tax charge should be combined when determining if the taxpayer received an effective remedy in respect of the overpaid VAT as the corporation tax was imposed on the profits generated by the receipt of the repayment from HMRC, rather than the repayment itself. As such, there were no grounds for arguing that the normal tax rules should not apply to restitutitonary payments.

Ingenious **scheme defeated again**

In a supplementary decision to the main *Ingenious Games LLP and others v HMRC* case (which related to a tax-motivated film partnership scheme and in which HMRC has already won the principal argument), the First Tier Tribunal has held, albeit reluctantly, that the expenditure incurred by the investors when acquiring the rights in respect of the relevant films was capital in nature and so could not be written off against the income arising to the investors from the scheme. As a result, the investors in the scheme did not only fail to obtain the tax benefits that they expected, but will now be left with taxable income which is not sheltered by the amortisation of the cost of the film rights.

This decision highlights again the potential pitfalls associated with schemes designed to give rise to tax benefits and that the downside of entering into such schemes might be worse than initially considered.

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