UK Tax Round Up

May 2017

Budget and Finance Bill **General Election – Finance Bill (No.2) 2017 Curtailed**

The Finance (No.2) Bill received Royal Assent on 27 April 2017, becoming the Finance Act 2017. However, as a result of Theresa May calling a general election for 8 June 2017, a large number of provisions in Finance Bill 2017 were dropped as a result of lack of Parliamentary time to consider properly the draft legislation. It is expected that those provisions that have been removed will be re-introduced following the election, depending, however, to some extent on which political party forms the next Government. The current Government stated that it intended to legislate "at the earliest opportunity" at the start of the new Parliament for the draft items that were not included in the final Finance Act.

The original draft provisions that were not enacted include the following:

- The reduction in the nil rate of dividend taxation from £5,000 to £2,000
- Amendments to the taxation of employment termination payments
- Amendments to provisions relating to Venture Capital Schemes, EIS and SEIS
- Corporation tax carried–forward loss restrictions*
- Restrictions on corporate interest relief*
- Amendments to substantial shareholding exemption*
- Extension of disguised remuneration rules to self-employed earners*
- Penalties for enablers of defeated tax avoidance

*see April 2017 Tax Round-Up for details

Other Items **Revised Double Taxation Treaty Passport Scheme**

On 6 April 2017, HMRC published revised terms and conditions and guidance for the double taxation treaty passport scheme. This followed consultation over the previous year in relation to how the scheme could be amended to serve better the needs of lenders and borrowers in the commercial debt market where loans were being made to UK borrowers.

By way of reminder, once a lender has applied for and been issued with a double taxation treaty passport ("DTTP") number, it is able to give the passport number to a borrower under a new loan and the borrower can then apply to HMRC for a direction to pay interest gross of UK withholding tax that otherwise would be applicable. The scheme until recently has been fairly limited in scope. In particular, broadly speaking, only corporate lenders and corporate borrowers could participate.

Highlights of the revised terms and conditions and guidance are as follows:

1. The scheme is now available to all UK borrowers that have an obligation to apply UK withholding tax on interest, including UK partnerships, individuals and charities.
2. Certain transparent entities, including some partnerships, are able to participate in the scheme as lenders and apply for passports.
3. Sovereign wealth funds and pension funds which are using withholding tax treaty rates (as opposed, for example, to relying on sovereign exempt status) can be admitted into the scheme as lenders.

In general, the relaxations and extensions to the DTTP scheme are welcome, particularly in allowing a broader range of borrowers to be able to rely on passports. However, it is disappointing that the revised conditions that allow partnerships to participate in the scheme as lenders are as restrictive as they appear. In order for an overseas partnership lender to be able to apply successfully for a passport, all the partners in the partnership need to be resident in the same jurisdiction and entitled to the same treaty benefits. In practice, this is not often the case.

Criminal Finances Act 2017

The Criminal Finances Bill has received Royal Assent. This new Act introduces several new criminal offences for corporate bodies that facilitate tax evasion, and changes to the proceeds of crime legislation. Of particular note is the creation of new offences for companies which fail to prevent their staff from facilitating tax evasion in the UK and abroad.

Hybrid Mismatch – Revised Guidance Published

On 31 March 2017, HMRC published revised draft guidance on the hybrid mismatch rules. These rules came into force for UK companies on 1 January 2017, but there is still considerable uncertainty over their scope and application. This is particularly the case in relation to "imported mismatch" legislation, which has been introduced into UK legislation in a manner that goes beyond the OECD's final Report on the subject, and in some circumstances can deny a UK tax deduction for interest paid to a foreign lender where there are hybrid features in the upstream financing structure. Unfortunately, the opportunity has not been taken to clear away uncertainties in this, and other, areas of the legislation.

VAT Recovery for Holding Companies

On 20 April 2017, HMRC published revised guidance on the extent to which holding companies are able to deduct input tax on costs incurred in acquiring, holding and managing subsidiaries. This follows the decision of the ECJ in *Beteiligungsgesellschaft Larentia + Minerva mbH & Co. KG* (Case C 108/14).

HMRC's position in relation to the recovery of VAT incurred by UK holding companies was significantly out of line with the principles outlined in those cases and the new guidance – that is set out in the updated VAT Input Tax Manual – substantially aligns HMRC policy with the ECJ case law.

In particular, HMRC will no longer require VAT incurred on acquisition-related costs to be apportioned between the non-economic activity of holding the shares in the subsidiary and the economic activity of providing taxable services to the subsidiary. In addition, the stipulation has been dropped that required VAT incurred on the acquisition to be recovered by the holding company within a reasonable period through the onward charging of management fees to subsidiaries. It remains vital, however, that real management services be provided by the holding company for a proper fee. In addition, management fees cannot be structured as contingent upon the profitability of the subsidiaries, as in that case the holding company will not be viewed as engaged in economic activity.

Buyers are always well-advised to consider VAT planning on acquisitions early in the process and to document management arrangements in a careful manner to maximize VAT recovery opportunities.

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