Proskauer

UK Tax Round Up

September 2017

UK Tax News and Developments

Finance (No 2) Bill 2017

The second Finance Bill of 2017, known as Finance (No 2) Bill 2017, has now been published. As expected, this contains most of the provisions which were dropped from the first Finance Bill of 2017 due to the condensed parliamentary timetable once the June 2017 general election was called.

In particular Finance (No 2) Bill 2017 contains provisions relating to:

- corporation tax carried-forward loss restrictions*
- restrictions on corporate interest relief*
- amendments to the substantial shareholding exemption*
- extension of disguised remuneration rules to self-employed earners*
- amendments to the taxation of employment termination payments
- amendments to provisions relating to Venture Capital Schemes, EIS and SEIS

As expected, most of the provisions of Finance (No 2) Bill 2017 will come into effect from April 2017 to reflect the government's original intention. Given the upcoming parliamentary recess for the party conference season, it is expected that the review of the bill in committee will start in mid-October. This leaves a tight timetable if the government intends to achieve Royal Assent before the Autumn budget is announced.

* See April 2017 UK Tax Round Up for more details

Draft legislation for Finance Bill 2018

Draft legislation for certain provisions to be included in the next Finance Bill, known officially as Finance Bill 2017-2018 and also referred to as Finance Bill 2018, was published for consultation on 13 September. The final contents of this next Finance Bill will be confirmed in the Autumn budget. Clauses published for consultation include:

- amendments to the disguised remuneration rules including the introduction of a close company gateway – these were originally intended for inclusion in the first Finance Bill of 2017;
- changes to certain aspects of partnership taxation – as proposed in the government responses to the August 2016 consultation on partnership taxation; and
- a new exclusion from UK withholding tax for debt traded on a multilateral trading facility – this was announced in the March 2017 budget.

A brief summary of the proposals is given here and they are subject to consultation until 25 October.

Disguised remuneration and the close company gateway

The draft legislation will add a new class of transaction that can give rise to employment income tax under the disguised remuneration rules in Part 7A ITEPA 2003, and will apply to certain arrangements relating to employees or former employees of close companies (or non-UK companies which would be close if they were UK resident).

There was considerable concern about the scope of the rules when initial draft legislation was published earlier this year and that they could apply to a wide range of commercial transactions involving payments to employee or director shareholders of close companies. This was of particular concern to the funds industry because most companies owned by private funds will be close.

The government has listened to those concerns and the new draft legislation includes a "main purpose of tax avoidance" provision which should mean that commercially-driven transactions would be expected to be excluded from the charge. The new rules will mean, however, that consideration will have to be given to them in any transaction involving payments to shareholding employees or directors of close companies.

The rules will apply to transactions from 6 April 2018.

Partnership tax reform

As with the close company gateway, HMRC had announced earlier in the year that they would introduce a number of rules intended to simplify and clarify aspects of partnership taxation and compliance.

The draft legislation covers the following areas among others:

- providing that when a partner holds an interest in partnership profits as bare trustee for a beneficiary, the beneficiary is treated as the partner in respect of the relevant profits

- an attempt to clarify how a partnership's income profits and losses are to be allocated between the partners and purportedly to ensure that the allocation of profits between partners for the purposes of tax on income is the same as the allocation of commercial profit between the partners. Unfortunately, the draft legislation does not really seem to provide any real clarification as to how the partnership computation rules should apply to investment

partnerships and it is somewhat unclear what is intended by the reference to allocation of commercial profit and what the draft legislation is designed to achieve in the context of investment partnerships. It is expected that this aspect of the draft legislation will be the subject of representations to HMRC and the final published rules will hopefully be clearer and easier to apply

- rules setting out how a partnership which has partners which are themselves partnerships should prepare its partnership return and likewise how partnerships which are partners in other partnerships should prepare their partnership returns

- as a welcome change, a provision ending the requirement for a unique taxpayer reference number (or UTR) to be provided on the partnership return for non-UK resident partners who have no liability to UK tax as a result of being partners if the partnership is an investment partnership (and does not carry out a UK property business) and reports to HMRC under the Common Reporting Standard rules

WHT exemption for debt traded on a multilateral trading facility (MTF)

In order to enhance the competitiveness of the UK as a market for debt traded on MTFs, the quoted Eurobond exemption from withholding tax on interest paid by a UK company will be extended to cover interest paid on UK company debt that is traded on a MTF.

Autumn budget date announced

The government has announced that the Autumn budget statement will be delivered on Wednesday 22 November 2017. This is the first Autumn budget to take place since the Chancellor announced the move to a single fiscal event each year, rather than the previous system of an Autumn pre-budget statement and a Spring budget.

Corporate offence of failure to prevent facilitation of tax evasion: final guidance published

Our July edition of UK Tax Round Up highlighted that this new corporate offence will come into effect from 30 September 2017. Our Tax Talks blog sets out more detail about the offence. There is a statutory defence if the organisation in question had in place reasonable prevention measures or if there were reasonable grounds for not having such procedures in place. Under the statute, the government is obliged to prepare and publish guidance about such procedures. Regulations have been introduced which bring HMRC's final guidancepublished on 1 September, and which largely replicates the draft guidance issued in 2016, into operation on 30 September 2017.

Organisations that might be within the scope of the rules need either to have reasonable prevention procedures in place (or be able to show that it is reasonable not to have any prevention measures in place), or at least to have carried out a risk assessment and have a plan for how they will put reasonable prevention procedures in place by 30 September. Organisations should consult with advisers if they think that they might need assistance in this regard.

Chancellor responds to OTS stamp duty and corporation tax reports

The Chancellor has published a letter to the Office of Tax Simplification (OTS) responding to the OTS's recommendations on modernising stamp duty (see the July edition of UK Tax Round Up for more detail on these recommendations). The Chancellor's letter indicates that generally he agrees with the tenor of the OTS's proposals. That said, there is no set timetable for implementation and he acknowledges that there are areas of stamp duty which will need further consideration if stamp duty is made into an assessable tax, including notably the transfer of partnership interests.

The Chancellor has also published a second letter to the OTS regarding its report on the simplification of corporation tax computation (again see the July edition of UK Tax Round Upfor more detail). This brief response indicates that the government is not currently planning to implement the suggestions regarding a separate corporation tax roadmap to sit alongside the business tax roadmap, the alignment of definitions between management expenses and trading deductions, or reforming the schedular system, but is prepared to consider further the use of accounts depreciation instead of capital allowances (which the Chancellor asked the OTS to explore further while noting concerns about the risk of reduced tax take or opening up opportunities for avoidance) and the proposals for aligning tax and accounts in particular for small companies.

HMRC published statistics on its success in tax avoidance cases

HMRC has published a list of the outcome of the 26 tax avoidance cases that were heard in 2016/17, which showed that they won 22, lost three and that one was a mixed result.

The cases were predominantly about complex corporate financing arrangements, whether a particular entity (e.g., film partnership) was or was not trading and PAYE and NICs avoidance schemes.

UK Case Law

Zero dividend shares are ordinary share capital (*HMRC v McQuillan*)

As described in more detail in our recent Tax Talks blog, the Upper Tribunal has recently concluded that shares without dividend rights are ordinary share capital. This resolves the confusion which arose in 2016 when two decisions of the First Tier Tribunal were published on the same day coming to polar opposite views on ostensibly the same facts and is relevant to the effect that such shares might have on various tax provisions such as entrepreneurs' relief and grouping arrangements. The decision confirms HMRC's previously published practice on this point.

VAT: Investment fund management services cannot be apportioned between standard rated supplies and exempt supplies (*Blackrock v HMRC*)

The First Tier Tribunal (FTT) recently held that the supply of services of an investment manager computer system by a U.S. group company to a UK VAT group, which used that computer system in managing both funds which were classed as "special investment funds" (SIFs) for UK VAT purposes and funds which were not, should be treated as standard rated taxable supplies. As background, the default position is that fund management services are not exempt supplies for UK VAT purposes, but the management of funds which are designated as SIFs is exempt. In this case the VAT exemption for management of SIFs was found not to be relevant. While the supply of the computer system amounted to a supply of management services (in accordance with the European Court of Justice decisions in *Abbey National* and *GfBk*), this was a single composite supply which attracted VAT at the standard rate given that the funds in question were predominantly non-SIFs. It was held that it was not possible to apportion the supply based on the use as between the two types of funds.

VAT: Third-party consideration (*Tesco Freetime Ltd v HMRC*)

In this case relating to Tesco's right to recover as input tax the VAT charged to it by service providers under the Tesco Clubcard scheme, the FTT has held that Tesco can reclaim the VAT, broadly following the Supreme Court's decision on input VAT recovery under the Nectar card scheme.

In this case, Tesco Freetime made contractually agreed payments to the participating businesses under the scheme to partly reimburse them for the cost of providing services to Tesco Clubcard holders when the cardholders redeemed their points with the service providers (for instance, for a free meal at a restaurant).

HMRC sought to argue that there were differences to the Nectar card scheme and that, in this case, Tesco was simply paying third-party consideration (i.e., was simply paying the cardholders' bills for the services provided).

The FTT held that the service providers were also providing a "fulfilment" service to Tesco under the terms of the scheme and that the economic reality of the arrangement was that the cardholders bore the cost of the scheme as part of the price that they paid for their shopping and that Tesco then paid the scheme service providers for fulfilling their obligation to Tesco to provide the contracted services to the cardholders.

VAT: Input tax recovery following TOGC (*NT Advisors Partnership v HMRC*)

The FTT has confirmed in *NT Advisors* that the transferee under a business transfer that qualified as a transfer of a going concern (TOGC) could reclaim the VAT that it paid as input tax on invoices that it settled after the transfer notwithstanding that the invoices had been addressed to the transferor even when the transferor and transferee had not elected for the transferor's VAT registration to be taken over by the transferee.

As a general matter, a taxpayer is entitled to reclaim VAT costs "on the supply to him" of any services "used or to be used for the purpose of any business carried on or to be carried on by him". Where a business is transferred as a TOGC, the transfer is treated as neither a supply of goods or services and the transferee is treated as having always carried on the business when determining the transferee's registration requirement. It is possible to elect for the transferee to take over the transferor's VAT registration, although this is rarely done in practice.

This case has confirmed that it is not necessary for the transferee to take over the transferor's VAT registration to be able to recover VAT costs that it incurs relating to the business even if the VAT relates to services supplied to the transferor and is paid on invoices addressed to the transferor where the business transfer agreement provides for the transferee to be liable to pay the invoices.

International

OECD further guidance on country by country reporting

The OECD published updated guidance on country by country (CbC) reporting on 6 September. The guidance now addresses the definition of revenues, the treatment of multinational enterprise (MNE) groups with a short accounting period and the treatment of the amount of income tax accrued and income tax paid. Guidance has also been released on the appropriate use of the information contained in CbC reports by taxing authorities, with such use being limited to high level transfer pricing risk assessment, assessment of other base erosion and profit shifting risks and, where appropriate, economic and statistical analysis. The report also confirms that the provision of information in CbC reports should not be used as a substitute by tax authorities for detailed transfer pricing analysis based on a full functional analysis and does not, on its own, constitute conclusive evidence that a transfer pricing adjustment is appropriate.

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