

# UK Tax Round Up

## August 2017

UK Tax News and Developments Latest on the Finance (No 2) Bill 2017

On 20 July 2017 the government announced in Hansard that the House of Commons will, on Wednesday 6 September 2017, be asked to approve the Ways and Means Resolutions relating to the Finance (No 2) Bill 2017 provisions and, accordingly, our expectation is that the Finance (No 2) Bill 2017 itself will be published on or shortly after that date.

Draft corporation tax guidance published

### **Carried-forward losses**

HMRC has published [draft guidance](#) regarding the changes to carried-forward corporation tax losses which are expected to be included in the Finance (No 2) Bill 2017 but will be effective from 1 April 2017.

The new corporation tax loss relief rules provide a mixed picture for taxpayers:

- on the one hand, companies will be able to set certain carried-forward losses against total profits, rather than (as previously) only against profits of the same trade; and
- on the other hand, the amount of profits that can be reduced by carried-forward losses is to be restricted, so that only 50% of profits in excess of £5m can be reduced in this way.

The draft guidance is long and whilst it does include some useful numerical examples it also highlights just how complicated these new rules will be and the additional compliance burden that they will impose in deciding how losses can and should best be used.

Comments are requested by HMRC on the draft guidance by 25 September 2017.

### **Interest deductibility**

HMRC has also published [revised draft guidance](#) regarding the corporation tax interest deductibility rules which are expected to be included in the Finance (No 2) Bill 2017 but again will be effective from 1 April 2017.

In summary the corporation tax interest deductibility rules provide that the amount of interest that a UK group can deduct annually is restricted to the greater of:

- £2 million;
- 30% of a UK tax-rule adjusted measurement of the UK group's EBITDA; and
- a percentage of total interest expense equal to the worldwide group's ratio of interest expense to EBITDA, making certain UK-tax rule based adjustments and ignoring related party and some other interest expense.

As with the carried-forward loss guidance, it is long and detailed and illustrates the complexity of the legislation.

Comments are requested by HMRC on the revised draft guidance by 31 October 2017.

With both of these rules being effective as of 1 April 2017 but the guidance still being under consultation and, more importantly, the legislation itself not being finalised until the Finance (No 2) Bill 2017 receives Royal Assent, taxpayers and their advisors are unfortunately faced with a position of continued uncertainty.

### **UK government considering launch of new National Investment Fund**

On 1 August the UK government published its "[Financing growth in innovative firms](#)" consultation paper as part of its ongoing Patient Capital Review which looks at how innovative SMEs can be best supported.

The paper considers the respective benefits of tax breaks and government investment and determines that the latter provides greater value for money for the exchequer. In this vein the paper's most striking recommendation is the establishment of a proposed new National Investment Fund (NIF) to invest in patient capital (although it also acknowledges the success of reliefs such as EIS, SEIS and Entrepreneurs' Relief and considers options for future patient capital fund specific tax relief schemes such as patient capital ISAs and removing stamp duty from the purchase of interests in patient capital funds).

The paper is open about whether the NIF would be established as a public-private partnership, a new subsidiary of the British Business Bank or simply enhanced funding through existing government channels, and although there appears to be a clear preference for the former, there is an acknowledgement that private investors may be unwilling to invest or invest sufficiently in a new fund without an existing track record. The size of any NIF is said to depend in part on the extent to which EIF funding remains available to UK businesses after Brexit.

The paper requests responses to 26 questions in relation to the above proposals. The deadline for responses is 22 September 2017.

### **FTT decision on corporate residence: Development Securities (No. 9) Limited and others**

The recent First Tier Tribunal decision in the Development Securities ("DS") case indicates that implementing uncommercial transactions may adversely impact non-UK tax residence status and provides a reminder that care and attention needs to be applied to the operation of offshore companies.

#### **The facts**

DS incorporated a number of Jersey subsidiaries intended to be Jersey tax resident as part of its implementation of a scheme which was intended to increase available capital losses on UK real estate.

These Jersey subsidiaries were granted options by UK DS entities to acquire certain UK property at more than market value, immediately following which UK directors were appointed with the intention that the Jersey subsidiaries would then become UK tax resident. The Jersey subsidiaries were then to dispose of the UK property and generate a capital loss created by the acquisition at more than market value.

#### **The decision**

The FTT decided that the Jersey subsidiaries were UK tax-resident by virtue of their centre of management and control ("CoMC") always having been in the UK rather than in Jersey.

DS had sought to maintain Jersey tax residence of the Jersey subsidiaries by ensuring that (i) the board of directors had a Jersey-resident majority, (ii) the board meetings all took place in Jersey and (iii) the key decisions were actually taken at those board meetings.

However, in distinguishing DS from existing case law, the FTT pointed to the uncommercial nature of the transactions from the perspective of the Jersey subsidiaries themselves (which could only be justified in the context of the tax benefit to the DS group as a whole) and that Jersey corporate law meant that the Jersey subsidiaries could only enter into the uncommercial transactions with the approval of their UK-resident parent company.

Consequently, it was determined that, unlike in similar cases decided in the past, the Jersey subsidiaries' CoMC was always undertaken by the UK DS parent and, in taking on their director appointments, the Jersey directors were simply agreeing to implement what the UK DS parent company had already decided to do.

## **Analysis**

The DS decision provides some insight into what offshore directors have to do to be considered to be taking the key decisions at a board meeting. Of particular significance in this case was that the Jersey subsidiary board minutes focussed on whether the transactions were permissible as a matter of Jersey law only and did not consider the commercial rationale for the transaction for the relevant Jersey company entering into it, as opposed to the commercial rationale for the transaction for the DS group as a whole.

So, while decided on its particular, and uncommon, facts, this case provides us with some reminders as regards good practice in maintaining offshore tax residence:

- consideration of commercial (and not just legal or tax) rationale of transactions for the entity in question (and not just the group as a whole)
- the use of language in the board minutes – the Jersey subsidiary board minutes referred to the implementation of instructions and orders from the UK DS parent company
- avoiding prior authorisation of transactions purportedly considered by offshore entities

- maintenance of full and proper company documents explaining the deliberations and decisions of the directors

### **Court of Appeal decision on reliance on HMRC guidance: HMRC v Hely-Hutchinson**

The Court of Appeal's decision in this case shows that taxpayers should be wary of reliance on HMRC's published guidance and may not be protected if the guidance is amended or withdrawn after they have entered into a transaction but before the tax consequences of that transaction have been agreed.

In 2003 HMRC published guidance to the effect that the amount of income tax payable on the exercise of share options had to be added to the cost of the shares for CGT base cost purposes (often creating a capital loss on sale). However, in 2009 HMRC announced that its 2003 guidance was wrong and that it would no longer apply to open tax returns (i.e. returns still potentially subject to HMRC challenge).

Mr Hely-Hutchinson ("HH") had already submitted the relevant tax returns but resubmitted amended returns after the 2003 guidance was published and claimed losses in accordance with that new guidance. However, HH's tax returns were still open when the HMRC guidance was subsequently withdrawn and so HMRC denied him the losses. HH appealed to the High Court that HMRC's decision breached his legitimate expectations and was unfair because it treated him differently to other taxpayers.

The High Court accepted these arguments and HMRC appealed to the Court of Appeal.

Allowing HMRC's appeal, it was held that in order to rely on amended (or withdrawn) guidance, the individual taxpayer needs to be able to demonstrate (i) unfairness compared to equivalent taxpayers or (ii) such a firm legitimate expectation that for HMRC to not apply its original guidance would amount to an abuse of power.

In relation to (i) it was determined that HH's equivalent taxpayers were not those who would have been affected by the revoking of the guidance had their tax returns not been closed and so his position should not be compared to them, and in relation to (ii) it was noted that the revoking of the guidance in 2009 simply returned HH to his pre-2003 guidance position and that HH could not be said to have detrimentally relied on the 2003 guidance because he had concluded the relevant transactions and first filed the corresponding tax returns prior to its publishing.

In giving its judgment the Court of Appeal noted that HMRC has a duty of fairness to taxpayers but that it was a duty to both the individual taxpayer and to taxpayers collectively. In this instance, HH was unable to show a sufficient degree of comparative unfairness or detrimental reliance to satisfy the court that the interests of the individual should take priority over the interests of the collective. Although one might sympathise with HH, it is not altogether surprising that the court would require a very high evidential bar in a circumstance where HMRC is being asked to continue to apply a mistaken (and withdrawn) policy.

### **GAAR Advisory Panel provides first opinion**

In the 2013 Finance Act the controversial general anti-abuse rule ("GAAR") was adopted into UK tax law. The function of the GAAR is to provide HMRC with a mechanism of counteracting tax advantages arising from arrangements which are abusive (i.e. having regard to all the circumstances, arrangements in respect of which it would be reasonable to conclude that the obtaining of a tax advantage was (one of) the main purpose(s) of the arrangement (the so-called "double reasonableness" test)).

The GAAR Advisory Panel was established to provide a buffer between the taxpayer and HMRC in deciding whether the test was met and to deliver opinions where HMRC is seeking to apply the GAAR. This is the first opinion that the GAAR Advisory Panel has published and is in favour of HMRC, concluding that the conditions for the GAAR to apply were met.

The Panel was asked to opine on an arrangement involving the acquisition of gold bullion on behalf of two employees of a company which sought to circumnavigate the 'disguised remuneration' employment tax rules in Part 7A ITEPA 2003 (by reducing the value of the 'relevant step' of acquiring the gold to nil) whilst at the same time securing a corporation tax deduction for the employer.

The relevant disguised remuneration provision used by the scheme did not at the time have an express exclusion for tax avoidance arrangements (such an exclusion was subsequently inserted by the Finance Act 2016).

The Panel prepared three reports analysing the arrangement, one for the employer and one for each employee, each in broadly the same terms. The Panel found in favour of HMRC, concluding that the absence of a tax avoidance arrangement exclusion in the particular disguised remuneration provision was a shortcoming of the legislation, that the bullion arrangement was a contrived effort to frustrate the intention of parliament and that it was not a "reasonable course of action in relation to the relevant tax provisions".

While it is useful to have the Panel's first published opinion, and this was a seemingly straightforward example of abusive behaviour, it is a shame that the Panel did not take the opportunity to elaborate on why it was not a reasonable course of action to rely on the words of the legislation in this case rather than simply stating that it should not come as a surprise that they had reached the conclusion that the transaction was a not a reasonable course of action in the circumstances.

International Tax News & Developments

### **OECD - Report on neutralising branch mismatch arrangements**

The OECD has published its [report](#) on neutralising branch mismatch arrangements, which is part of its BEPS Action 2.

This report sets out recommendations for changes to domestic laws to prevent the use of hybrid entities to generate multiple deductions for a single expense or deductions without corresponding taxation of the same payment. Specifically, branch mismatches can occur where two jurisdictions take a different view as to the existence of, or the allocation of income or expenditure between, the branch and the head office of the same taxpayer.

From a UK perspective, the recommendations in the report will have a limited impact because the UK has already included permanent establishments in its hybrid mismatch rules.

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