Proskauer

# UK Tax Round Up

**December 2017**

## Finance (No. 2) Bill 2017-19

The first version of the Finance (No. 2) Bill 2017-19 was published on 1 December 2017. The majority of the Bill's content had been previously announced at the Autumn 2017 Budget (see further below), so there were no real surprises in terms of the measures included. It is expected that the Bill will proceed through Parliament and receive Royal Assent next year as the Finance Act 2018.

The key measures included in the Bill are:

- Indexation allowance in relation to corporation tax on capital gains will be frozen from 1 January 2018 and no relief will be available for inflation after 1 January 2018.

- The top rate of R&D expenditure credit will be increased from 11% to 12%.

- An extension of HMRC's powers to hold online marketplaces jointly and severally liable for the unpaid VAT of UK and overseas traders on their platforms.

- A new restriction on the availability of treaty relief in relation to tax incurred by an overseas permanent establishment (PE) of a company where the company has already received relief for the losses of the PE against profits other than those of the PE.

- A number of amendments to the recently introduced interest deductibility restriction rules considered necessary for the regime to operate as intended, with some changes being deemed to have always had effect.

- Amendments to the powers for giving effect in domestic law to international treaties to enable the implementation of the BEPS multilateral instrument.

- New measures to counter disguised remuneration through the use of close companies.*

- A withholding tax exemption for debt traded on a multilateral trading facility.*

*See September Tax Round Up for further information on these measures.

The Bill also includes provisions to clarify the taxation of partnerships, the initial draft of which was covered in our September Tax Round Up. Crucially, the Bill did not include provisions that sought to align the allocation of a partnership's profits or losses for tax purposes with the commercial allocation of profit between partners, which received a negative response for being unclear and difficult to apply. The remainder of the provisions broadly remain as previously drafted and it is possible that the missing provisions on profit allocation will be introduced before the Bill is finalised. No reason was given for why these provisions were not included.

**Autumn Budget 2017**

The Autumn budget was delivered by the Chancellor on 22 November. Below is a brief summary of the key announcements on tax (not including measures covered in the Finance (No.2) Bill 2017 – 19):

- All gains by non-residents arising from the disposal of UK property (residential and commercial) will from April 2019 be subject to UK corporation tax (for companies) or UK capital gains tax (for individuals), with a targeted exemption for institutional investors (such as pension funds). In addition, from April 2020, income received by non-resident companies in respect of UK property will be chargeable to corporation tax, rather than income tax which might well mean increased tax through reduced reductions for interest expense. Further information on this consultation can be found on our Proskauer Tax Talks blog.

- With effect from 6 April 2018, the individual personal allowance will be increased from £11,500 to £11,850, the higher rate threshold will be increased from £45,000 to £46,350 and the CGT annual exempt amount will be increased from £11,300 to £11,700.

- The government will consult on relaxing the requirements for entrepreneurs' relief where individuals fall below the 5% threshold as a result of the company that they hold shares in raising funds for commercial purposes by means of an issue of new shares. The proposed changes will allow individuals to claim entrepreneurs' relief on that part of the gain that arose before their shareholding was diluted below 5%, even if they dispose of their shares after dilution.

- The government will be consulting on the introduction of new withholding tax obligations for non-UK residents in relation to payments of royalties by them to low/no tax jurisdictions where the royalties relate to sales to UK customers.

- The government will consult on changes to the tax treatment of intangible fixed assets to consider whether changes to the regime could better support UK companies investing in intellectual property.

- The VAT registration threshold will be retained and kept at £85,000 until 31 March 2020. The government will also conduct a consultation on the design of the VAT threshold.

- The assessment time limits for non-deliberate offshore tax non-compliance will be increased so HMRC can assess at least 12 years of back taxes, without needing to establish deliberate non-compliance.

**High Court judgment on VAT on pension fund management services (United Biscuits (Pension Trustees)** ***Limited v. HMRC*****)**

The High Court has determined that investment management services supplied to a defined benefit pension scheme by a company which was not authorised to conduct insurance business were subject to VAT.

The claimants in this case were the trustees of a defined benefit pension scheme and the former trustee of a collective investment fund in which the assets of the pension scheme were invested. The claimants received pension fund management services from various investment managers, including entities authorised to conduct insurance business ("Insurers") and entities not so authorised ("Non-Insurers"). Pursuant to the contractual arrangements between the claimants and the investment managers, which provided that VAT (if applicable) was payable alongside investment management fees, the claimants paid VAT to the investment managers that were Non-Insurers. The claimants sought to recover the VAT paid to the investment managers that were Non-Insurers from HMRC on the basis that these supplies of services were exempt from VAT.

The applicable domestic legislation and practice treated investment management services provided from Non-Insurers as chargeable to VAT. The claimants sought to argue that pension fund management services fell within the exempt category of "insurance transactions" provided for under EU VAT legislation. The court rejected this claim and found that pensions fund management services did not constitute "insurance activities" and therefore were not exempt from VAT. The court also held that, if the services had been VAT exempt, the claimants' remedy would have been against the Non-Insurers, rather than HMRC and, even if that were not the case, the claims would have been time-barred under the domestic VAT legislation.

As Insurers supplying pension fund management services have historically been treated by HMRC as making exempt supplies for VAT, the claimants were relying to some extent on the principle of fiscal neutrality by arguing that similar supplies should be treated in the same way, regardless of whether they were supplied by an Insurer or a Non-Insurer. However, the court firmly rejected this argument on the basis that, under the EU legislation, defined benefit pension fund management services were chargeable to VAT whether supplied by an Insurer or a Non-Insurer. Going forward, HMRC announced earlier this year that the exemption from VAT for insurers for defined benefit pension fund management services would be withdrawn from 1 April 2019.

**Upper-tier Tax Tribunal permits corporation tax loss to be set against income tax profit (*HMRC v. English Holdings (BVI) Limited*)**

In this case, HMRC were appealing against a decision of the First-tier Tribunal, which allowed the taxpayer's claim to set off losses generated in a business subject to corporation tax against profits subject to income tax. The taxpayer was a BVI company and not resident in the UK for tax purposes, although it maintained a permanent establishment (PE) in the UK through which it carried on a trade in land in the UK. Any profits generated by the PE from that trade would have been subject to corporation tax in the UK. However, the PE was loss-making. In addition to the PE's trade, the taxpayer also held a number of properties in the UK directly from which it generated rental income. As the letting business was not carried on through a UK PE, the profits from the letting business were subject to income tax. The taxpayer was claiming loss relief by setting off the loss generated in the PE trade against the profits generated by the letting business.

HMRC argued that, as the corporation tax and income tax regimes were entirely separate, the taxpayer was not entitled to set the losses of the PE trade against the profits of the letting business. The Upper-tier Tribunal rejected this argument and agreed with the First-tier tribunal that the losses from the PE trade could be set off against the letting business's profits (although, before set-off against the profits of the letting business subject to income tax, the losses of the PE trade had to be calculated under the income tax rules). The judgment states that the draftsman of the relevant legislation could have expressly restricted losses generated under the corporation tax regime from being used to relieve profits that fall within the income tax regime, as it has done for other instances of sideways relief for losses, but it had not done so. Further, the Tribunal identified instances in which companies subject to income tax (by way of withholding tax, for example) are able to deduct this from a corporation tax liability, which did not support HMRC's contention that income tax and corporation tax must be interpreted so as to be mutually exclusive.

HMRC argued that, if it was possible to use losses generated by the PE trade against profits subject to income tax from the letting business, there was no rule that prevented that same loss being set against future profits from the PE trade, thereby allowing them to be double counted. Although no firm conclusion was reached on this issue, it was not considered sufficient to undermine the taxpayer's case. The Tribunal also found that HMRC's view of the legislation may have breached the EU right to free movement of capital.

The facts of this case are unusual and, given the government's plans to extend corporation tax to non-resident companies, it is unlikely to have a direct impact on many taxpayers in the future. However, it does provide an interesting view of the interaction between the corporation tax and income tax regimes.

**Warranty claim under a sale and purchase agreement failed for not being validly served (*Zayo Group International Limited v. Ainger and others*)**

In this case, the High Court held that a notice of a warranty claim under a sale and purchase agreement (SPA) was not valid because it was not served in accordance with the notice provisions of the SPA. The terms of the agreement required that the notice was served on all of the sellers under the SPA, which had not been done as one seller was not served the relevant notice. As such, the warranty claim was held to be ineffective against all of the sellers, not just the seller that did not receive the notice of claim.

This case is an important reminder of the care and attention needed when drafting notice provisions and serving notices in accordance with such provisions.

**Payment on early termination of fixed term contract not taxable as earnings (*HMRC v. Tottenham Hotspur Ltd*)**

The Upper-tier Tax Tribunal has held that payments made by an employer in respect of early termination of a fixed term contract pursuant to a mutual consent clause were not taxable as earnings and, as such, were not subject to national insurance contributions (NICs). The key test in the decision was whether the employment contract was terminated in exchange for the payment in question, or whether the payment was made pursuant to an obligation under the contract of employment.

It is worth noting that, from April 2019, the government has announced that taxable termination payments will be subject to NICs. As such, the applicability of this case will be short-lived.

**Validity of accelerated notices (*Rowe and others v. HMRC*; *Vital Nut Co Ltd and others v. HMRC*)**

A number of taxpayers who received advanced payment notices (APNs) or partner payment notices (PPNs) have challenged those notices by way of judicial review. The Court of Appeal dismissed the taxpayers' appeals, finding that the APNs and PPNs in question were neither ultra vires, unreasonable nor contrary to human rights.

Interestingly, the judgment in this case leaves some uncertainty of whether the same decision would be reached in a situation where the taxpayer faced financial hardship as a result of receiving an APN or PPN and this may leave the door open for a future challenge, although it was intimated that the level of hardship would have to be severe.

**Government's response to VAT grouping consultation published**

On 1 December, the government published a summary of the responses received in relation to its VAT grouping consultation launched last December.

The government's response to the paper makes clear that it would not broaden the VAT grouping rules where this would result in a loss of revenue for HMRC and may consult further on this topic and that any future expansion of these rules would require robust anti-avoidance measures, although it may consult further about certain aspects of the rules. In response to a number of concerns that were raised about the application of VAT grouping rules to partnerships, the government has committed to clarify the position through improved guidance and a policy paper.

**OECD consultation: Model rules for mandatory disclosure of arrangements to avoid CRS reporting and of certain offshore structures**

On 11 December, the OECD issued a consultation on the model rules for mandatory disclosure by intermediaries (promoters and certain service providers) or, in limited circumstances, taxpayers, of certain arrangements to avoid reporting obligations under the Common Reporting Standard (CRS). The proposed rules are based in part on the recommendations made pursuant to Action 12 (*Mandatory Disclosure Rules*) of the BEPS project which sets out the key features of mandatory disclosure rules for high risk structures.

The model rules are similar in nature to the UK's disclosure of tax avoidance schemes (DOTAS) rules in that they include a number of "hallmarks" identifying CRS schemes. Under the model rules an intermediary (or, in certain circumstances, the taxpayer) must disclose to its tax administration certain information regarding the prescribed CRS avoidance arrangements and offshore structures including the details of taxpayers using the arrangement to avoid being reported about under CRS. There will be penalties for non-disclosure.

The deadline for responses to the consultation is 15 January 2018.

**2017 Update to the OECD Model Tax Convention**

On 21 November, the OECD approved a number of updates to the Model Tax Convention.

The key changes include the addition of the "limitation on benefits" provision and "principal purpose" test and extensions to the definition of permanent establishment pursuant to the BEPS Action Points 6 and 7 recommendations. There have also been certain other changes made as a result of the other BEPS Action Plans.

**EU Commission publishes code of conduct on withholding tax procedures**

On 11 December, the European Commission published a voluntary code of conduct on withholding tax procedures which is aimed at reducing costs and simplifying procedures for cross-border investors.

The code of conduct makes eight recommendations:

- Allow non-residents to claim relief from withholding directly, rather than through a resident fiscal agent.
- Allow digital claims for refunds of withholding tax.
- Greater use of IT to process reclaims/refunds, including relief at source.
- 6 month time limit on reclaims.
- Clear and comprehensive documentation available online.

- Single point of contact for withholding tax.

- Providing relief at source, where appropriate.

The code of conduct seeks a voluntary commitment from each member state to adopt the eight principles by 2019.

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