

# UK Tax Round Up

**March 2018**

Welcome to the March edition of the Proskauer UK Tax Round Up. As promised, the Spring Statement from the Chancellor focused on the economy and public finances without any major tax announcements. However, a few interesting consultation and position papers were published. We have summarised these below along with a handful of other developments since our last issue. Finally, the Finance Bill 2018 was granted Royal Assent on 15 March 2018.

## Spring Statement publications

### **Entrepreneurs' relief on gains before dilution: consultation**

As promised in the Autumn 2017 Budget, HM Treasury has released a consultation on improving access to entrepreneurs' relief where shareholdings are diluted. At present, entitlement to the 10% rate of capital gains tax may be lost when new shares are issued and that new issue results in an individual's shareholding falling below 5%.

The proposal announced at Autumn 2017 Budget, as detailed in the consultation, allows an individual in this position, where the new shares are issued for genuine commercial purposes, to elect to be treated as if they had disposed of their shares and reacquired them at their market value just before the time the company issued the new shares. The individual may then pay the CGT (applying the entrepreneurs' relief rate) on that gain either at the time of election or on a future disposal of shares.

If enacted, these new rules are expected to apply to fundraising events occurring on or after 6 April 2019.

### **Corporate tax and the digital economy: position paper**

HM Treasury updated its position paper (published as part of the Autumn 2017 Budget) on corporate tax and the digital economy in the context of the international tax framework.

The latest paper focuses on how user participation can be said to create value for certain digital businesses and how this should be built into the international tax rules in the long term.

It also proposes a tax on revenues (rather than profits) of digital businesses as a potential interim measure to address the perceived disconnect between the location of value creation and the location of taxable profits, and the challenges of getting international consensus for changes to address this.

The EU Commission is also set to release its proposals on these issues shortly. As has been widely reported, a draft of the Commission's proposals which has been circulating also proposes a tax on digital revenues as an interim measure, with a suggestion that the tax might be between 1% and 5% of revenues, with an EU official reported as saying that the EU Commission was likely to propose a 3% rate.

Linked to this, the EU Parliament has approved proposed Directives in respect of the common consolidated corporate tax base and the common corporate tax base that would introduce the concept of a "digital permanent establishment". It will be interesting to see whether this concept becomes more widely accepted as a basis for taxing digital activities.

The OECD is also considering these issues. On 16 March 2018 it released an interim report as part of its work on achieving a consensus based solution to the tax questions raised by digitalisation by 2020. That is an ambitious timeframe but nevertheless more than 110 countries have agreed to work towards it.

### **EIS and knowledge-intensive fund: consultation**

Following on from the Patient Capital Review, HM Treasury is consulting on how to support investment in knowledge-intensive companies, defined as those which have high growth potential but are R&D and capital intensive.

In particular, the consultation explores possible options for an EIS (Enterprise Investment Scheme) fund structure aimed specifically at investment in knowledge-intensive companies. If introduced, eligible investors would then not be limited to the nominee structures which are currently provided by some fund managers to facilitate EIS investment.

## **Securing debt in insolvency: consultation**

As announced in the Autumn 2017 Budget, the Government intends to extend the current scope of security deposit legislation to include corporation tax and construction industry scheme deductions with effect from April 2019. HMRC can currently require businesses which are at high risk of not paying certain taxes on time to provide an upfront security deposit.

HMRC are now consulting on the detail of how this measure can be extended to corporation tax and the construction industry scheme.

## **Short term business visitors' relief: future consultation**

The Government has announced that it will be consulting in the coming months on simplifying the tax treatment of short-term visitors from a non-UK branch of a UK company to its UK office to ensure that the UK is an attractive location to headquarter a business. This follows HM Treasury's December 2017 UK Investment Management Strategy II paper and is in response to concerns voiced by the asset management industry.

## **Off payroll working in the private sector: future consultation**

The Government will also consult in the coming months on addressing non compliance regarding off payroll workers in the private sector. This follows recent reforms on this point for public sector workers under which any employment tax obligations in respect of the worker now reside with the public sector client.

## **Abuse of corporate insolvency regime including through "phoenixism": future discussion paper**

HMRC announced that they will in due course publish a discussion paper entitled 'Tax Abuse and Insolvency: A Discussion Document'. This will seek views on how to tackle taxpayers who deliberately abuse the insolvency regime to avoid or evade their tax liabilities, including through the use of so-called "phoenixism".

HMRC gives an example of "phoenixism" as a person being actively involved with a business which ceases to trade and leaves behind tax debts becoming responsible for the operation of a new business which carries out the same trading activities, from the same address and with the same personnel and clients as the previous failed business, with trading recommencing very shortly after the closure of the previous business.

### **Taxing non-residents' gains on UK real estate: update**

Alongside the Spring Statement, HMRC published a consultation status tracker which confirms the Government's intention to legislate the proposals on taxing gains made by non-residents on UK immovable property in next year's Finance Bill.

## **Other UK tax developments**

### **Trail commission is not annual payment (*Hargreaves Lansdown v HMRC*)**

The First-tier Tribunal has found that "loyalty bonuses" paid to investor clients which represented sums rebated by investment fund managers from their management fee were not "annual payments". Such payments are often referred to as "trail commission".

This is contrary to the position taken in HMRC's Brief 04/13 that amounts paid to investors or intermediaries, often reflecting a rebate of a percentage of a fund manager's annual management charge, should be taxable as annual payments in the hands of the recipients and so potentially paid subject to withholding tax.

"Annual payment" is not defined in legislation and must be interpreted in line with case law. One case law requirement is that the amount represents "pure income profit" to the recipient which, broadly, requires the recipient to have no obligations to fulfil to be entitled to receive the payment.

The tribunal found that this requirement was not met because the "loyalty bonus" receipt was dependent on the investors continuing to bear what was effectively the investment management fee received by Hargreaves Lansdown. HMRC can be expected to appeal the decision given their recently stated position on this point.

Whenever rebates of fund management fees are anticipated, not only must these questions be taken into account, but also the VAT implications of any rebate should be considered. It will normally be preferable to reduce the management charges of the affected investor, rather than have a rebate mechanism, although if this decision survives any appeal it might allow fund managers to simplify their rebate payment mechanism, particularly where they are currently paid through non-UK fund entities.

### **Value shifting rules applied where controlling persons acted together with no requirement for connection (*Conegate Ltd v HMRC*)**

This case relates to the rules on value shifting under which there is a deemed disposal for the purposes of tax on chargeable gains if a person controlling a company passes value out of their shares and into other shares in the company, in this case by a structured share buy-back for less than market value.

The First-tier Tribunal found that the rules can apply to two or more controlling shareholders acting together even if those two shareholders are not connected. This may be seen as an extension to the previous case law that had decided that a controlling person included controlling persons acting together, but in the relevant case those controlling persons had been connected with each other.

The case involved an arrangement under which funds had been injected into West Ham United by a subscription for shares which were then converted into deferred shares and bought back for a nominal price, generating a capital loss and shifting value into the other shares in the company.

The tribunal also agreed with HMRC on two other anti-avoidance provisions, namely that the transaction in question was not a bargain made at arm's length and, consequently, market value could be imputed to it and the rules on losses deriving from arrangements with a tax avoidance purpose would also have prevented an allowable loss arising from the transaction.

### **Consultation on extending time limits for "offshore" non-compliance**

HMRC are consulting on extending the time limits for assessments for non-deliberate non-compliance involving "offshore" matters from 4-6 years to 12 years. This would affect income tax, capital gains tax, inheritance tax and possibly corporation tax assessments. "Offshore" in this context refers to any territory outside the UK, so the extended timeframes for making assessments would affect cross-border arrangements generally, not just those involving what is traditionally thought of as an offshore jurisdiction.

### **GAAR panel considers EFRBS transaction is not a reasonable course of action**

The GAAR (general anti-abuse rule) panel has published another opinion in HMRC's favour concluding that the transaction in question was not reasonable in the circumstances. In this instance, an employer, its employees and a third party entered into arrangements involving an employer financed retirement benefit scheme (EFRBS) under which funds were made available to the EFRBS by the employer and to the employees by the EFRBS using a complicated set of arrangements between the employer, EFRBS trustee and employee. The purpose of the arrangement was to avoid employment income tax under section 62 ITEPA and the disguised remuneration rules on the amounts received by the employees.

The panel found that there was economic equivalence between the arrangements and a direct loan from the EFRBS to the employee, that the arrangements were abnormal and contrived, that there was no reason other than avoiding the disguised remuneration legislation to put the complex and carefully orchestrated arrangements in place, that the steps were intended to exploit shortcomings in the disguised remuneration legislation and that it was inconceivable that Parliament intended the arrangements should fall outside the disguised remuneration legislation. Accordingly, the panel thought that the arrangements were not reasonable in the circumstances.

Since it gave its first opinion in July 2017, the GAAR panel has opined in favour of HMRC in each of the four cases it has looked at. To some degree this is reflective of the nature of the cases in which HMRC has sought to apply the GAAR (each of which has related to highly structured arrangements, and three of which have related to avoiding employment taxes), but it is informative nonetheless. What is becoming clear is that the GAAR panel view "contrived and abnormal" arrangements as indicative of something that is likely to be unreasonable for a taxpayer to enter into and that the panel will have very little sympathy with any highly abnormal or contrived arrangements seeking to avoid the natural tax consequence of a transaction.

### **Informal consultation on VAT grouping including for partnerships**

As part of its ongoing VAT grouping consultation, HMRC has informally approached the Chartered Institute of Taxation in relation to expanding VAT grouping to certain non-corporate entities following a 2015 judgment of the Court of Justice of the European Union. HMRC considers that without amending the current "control" test, UK VAT grouping could be extended to (i) allow non-corporate entities (for example partnership or individual) to join a VAT group with body corporate subsidiaries which it controls, (ii) allow a partnership to join a VAT group where all of the partners in the partnership are bodies corporate and all of the bodies corporate are already in a VAT group, and (iii) allow a limited partnership to join a VAT group where the sole general partner is a body corporate and manages the limited partnership.

The final category is relevant to UK-based fund managers with "onshore" limited partnership fund structures and could help put beyond doubt for all UK limited partnerships how such structures should be treated for UK VAT purposes.

# EU tax developments

## **Interest and Royalties Directive - Advocate General opinion on meaning of "beneficial ownership" and scope of anti-abuse provision (*N Luxembourg 1 v Skatteministeriet*)**

In this case, non-EU funds incorporated companies in Denmark and Luxembourg as part of the acquisition structure for a Danish company. Reliance was placed on the EU's Interest and Royalties Directive (the "Directive") to pay interest free of Danish withholding tax at source. The question for the Court of Justice of the European Union (the "CJEU") was essentially whether the Luxembourg companies could be regarded as the beneficial owners of the interest for the purposes of the Directive and whether the structure fell foul of the anti-abuse provision in the Directive.

The Advocate General has given her opinion which the CJEU will take into account when making its decision. She opined that the meaning of beneficial owner for the purpose of the Directive does not accord with the "international meaning" for the purpose of interpreting tax treaties. She considers that the legal owner of the claim to interest is in principle as the beneficial owner unless it was acting not in its own name and on its own account, but for and on the account of a third party. This appears to set the bar relatively high for tax authorities to challenge on these grounds.

She also found that where the anti-abuse provision applies, the national court in question must undertake a fact based assessment looking at whether the arrangement is a wholly artificial arrangement that does not reflect economic reality or the essential aim of which is to avoid tax. In the case of withholding tax on interest, abuse may be assumed if the structure is designed to take advantage of a lack of information exchange between jurisdictions in order to prevent the effective taxation of the ultimate interest recipients.

This case is an example of an EU member state challenging intermediate holding structures from the perspective of whether payments can be made free of withholding tax under the Directive. Other similar areas of challenge can include whether a holding company can rely on a double tax treaty which might include whether the company is truly the beneficial owner of the payment as that is interpreted in a treaty context (although in that case an international fiscal meaning is more likely to be applied), and in a dividends context whether the EU Parent-Subsidiary Directive is being relied on. While not dependent on the meaning of "beneficial ownership", we expect these kinds of challenges to treaty and Directive benefit claims will become more frequent with the anti-abuse clause inserted into the EU Parent-Subsidiary Directive from 2016 and the impending implementation of the BEPS Action Plan 6 "principal purpose test" to counter treaty abuse.

### **EU blacklist: three jurisdictions added, three removed**

The EU has amended its list of non-cooperative jurisdictions in tax matters, removing Bahrain, the Marshall Islands and Saint Lucia and adding the Bahamas, Saint Kitts and Nevis and the US Virgin Islands. This leaves nine jurisdictions on this "blacklist": American Samoa, Bahamas, Guam, Namibia, Palau, Samoa, Saint Kitts and Nevis, Trinidad and Tobago and the US Virgin Islands.

The EU and the Member States are expected to apply "defensive measures" against blacklisted countries, but the full implications of being on the list are not yet clear. For example, EU level and member state anti-avoidance and transparency measures are likely to use the list as an automatic arbiter of whether arrangements are classed as avoidance or subject to reporting requirements, and there may be enhanced withholding tax provisions and increased monitoring of structures involving these jurisdictions.

Investment managers or others who are operate or invest in entities in blacklist jurisdictions or are otherwise engaged with the jurisdictions should be aware of the EU's focus on the blacklisted jurisdictions.

### **Luxembourg appeals against Amazon state aid decision**

Luxembourg has appealed the EU Commission's October 2017 decision that, through a tax ruling on transfer pricing which resulted in unjustified selective tax treatment, Luxembourg had granted Amazon illegal state aid of around €250 million. This high profile case gives an example of one way in which the EU Commission is playing a role in reshaping the international tax landscape to address perceived avoidance and injustice. It is also a useful reminder of how that landscape has changed over the course of the past 10 to 15 years, in large part due to the OECD's BEPS project.

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