Proskauer

UK Tax Round Up

March 2020

Budget Announcements

We reported on the most significant announcements in the Budget in our Tax Talks publication which you can read here.

The most significant announcements were:

- immediate reduction in the lifetime limit for entrepreneurs' relief from £10 million to £1 million along with some "anti-forestalling" provisions to negate the effect of certain transactions entered into before the change was announced on 11 March
- as expected the corporation tax rate remains at 19%
- delay of the introduction of the new IR35 rules for the private sector until 6 April 2021
- the start of a consultation into the UK's private funds landscape and how it might be improved.

Finance Bill 2020

The Finance Bill 2020 was published on 19 March 2020. Among a number of measures introduced, the Bill contains legislation covering the following areas:

- **Reduced lifetime limit for entrepreneurs' relief** – as mentioned above, the lifetime allowance to qualify for a reduced 10% tax rate on capital gains tax under the entrepreneurs' relief scheme has been reduced from £10m to £1m. The change has been introduced due to the Government's belief that the relief was not a cost effective method of encouraging business creation and development and that its cost would be better directed towards other reliefs. The amended relief will be known as "business asset disposal relief" and will be effective for disposals made on or after 11 March 2020.
- **Intellectual property ("IP") assets created before 2002** – the Finance Bill contains legislation that will allow IP assets that were created before 1 April 2002 and were acquired from related parties on or after 1 July 2020 to fall within the single regime that currently applies to IP assets created after 1 April 2002 contained in Part 8 of the Corporation Tax Act 2009. Broadly, UK taxation (and

relief) of IP assets currently follows the accounting rules subject to adjustments for tax that are based on the IP regime contained in Part 8 of the Corporation Tax Act 2009. The current IP regime does not allow IP assets created prior to 1 April 2002 to benefit from corporation tax relief on the cost of acquisition of those assets. The new legislation would allow more IP assets to come within the Part 8 regime and, while reasonably narrow in its scope, should be viewed as a welcome development for IP-rich businesses. It does not, however, reintroduce the regime that existed prior to 2015 allowing broad relief for the acquisition cost of goodwill.

- **Digital services tax (DST)** – following a consultation, the Government has gone ahead with the introduction of the controversial DST that will apply from 1 April 2020. The DST, at the rate of 2%, will apply to any company (whether located in or outside the UK) that is engaged in provision of social media platforms, online marketplaces and search engines and that has global revenues of £500m (calculated by reference to the whole corporate group). DST will apply to the company's revenue, if any, above £25m which is derived from UK users. Companies can elect to pay tax based on 80% of their profit margin, so taking loss-making businesses out of the scope of the tax charge. The regime requires one company within the group to be responsible for quarterly DST reporting with payments of DST to be made on a yearly basis.
- **Corporate capital losses** – Finance Bill 2020 extends the rules that were introduced in 2017 to restrict the amount of carried-forward trading losses that can be set off by a UK company against its trading profits. The rules currently permit set off of trading losses generally against 50% of total profits once the initial annual allowance of £5m has been used. The new draft legislation contains an extension of these rules to carried forward capital losses. The new restriction will not affect the ability of companies to set off current year capital losses against capital gains arising in the same year but will affect how much of any excess capital loss can be set off against future years' capital gains. Subject to the Finance Bill receiving Royal Assent, the rules will be effective from 1 April 2020.
- **Priority of HMRC debts** – Finance Bill 2020 contains a provision that amends the Insolvency Act 1986 and the Bankruptcy (Scotland) Act 2016 giving HMRC priority in insolvency proceedings for the recovery of value added tax and certain other taxes which a company has collected on behalf of someone else (e.g. PAYE, employee NICs, construction industry scheme tax and other tax deductions to be determined separately by regulations). HMRC will become a secondary preferential creditor in respect of the specified taxes. Prior to this change HMRC was an unsecured creditor for all of its debts which meant that it was paid only following the payments to holders of fixed and floating charges and the expenses of the insolvency process. This change, which will come into effect on 6 April 2020, will

mean that HMRC will have to be paid prior to payments to holders of floating charges and unsecured creditors but after payments to holders of fixed charges and of the insolvency expenses. HMRC will continue to hold its unsecured creditor status with respect to payments of corporation tax and employer NICs.

- **Joint and several liability of company directors** – Finance Bill 2020 also introduces a new regime giving HMRC a power to issue notices to make directors of companies, shadow directors and other connected persons jointly and severally liable for certain of a company's tax liabilities in certain specified circumstances, related broadly to tax avoidance, tax evasion and repeated insolvency. This regime is driven by HMRC wishing to have a mechanism that would enable it to recover tax liabilities arising from, for example, tax avoidance and tax evasion and during insolvency proceedings where there is a risk that some or all of the tax liability could be lost to HMRC. The regime will apply from the date on which the Finance Bill 2020 receives Royal Assent.

HMRC has also published a number of consultations that will run alongside the progression of the Finance Bill 2020 to Royal Assent. In particular, the Government is inviting views of the tax community on the following topics: notification of uncertain tax treatment, withdrawal of LIBOR and anti-hybrid mismatch rules.

Announced consultations

UK's private funds regime

The Government has opened a consultation seeking views on how to improve the competitiveness of the UK tax regime as it applies to private fund structures. The consultation is running until 20 May.

The review, which is expected to last throughout 2020, is commencing with a focus on the tax treatment of asset holding companies for credit funds, real estate funds and private equity funds. This will include detailed consideration of the effect on the UK as a preferred holding company jurisdiction from the perspective of withholding taxes, the hybrid mismatch rules and methods of returning proceeds to funds, including distribution treatment of certain interest payments.

The Government will also look at the VAT treatment of fund management fees.

The Government wants to understand whether any further tax changes could be made in order to make the UK a more attractive jurisdiction for private funds establishment.

Notification of uncertain tax treatment

HMRC has published a consultation paper seeking views by 27 May 2020 on the implementation of their proposed measure to require large business to report certain arrangements that are likely to have "uncertain tax treatment". An uncertain tax treatment is one where the business believes that HMRC may not agree with their interpretation of the legislation, case law, or guidance.

The objective of this measure is to provide HMRC with timely and accurate information regarding tax treatments adopted by large businesses which HMRC may disagree with. The measure is expected to assist HMRC in identifying areas of law that are currently unclear and allow HMRC to focus on clarifying these areas of uncertainty. This is expected to result in fewer disputes caused by uncertainty in the tax law.

The term "uncertain tax treatment" is expected to be based on the International Accounting Standard IFRIC23 (Uncertainty over Income Tax Treatments) in respect of which large businesses already have to make reference in their accounts. It is proposed that only those uncertain tax treatments which, individually or combined (based on the principles of the IFRIC23), result in an uncertain tax liability of over £1 million will be notifiable.

The measure will only apply to large businesses that have either (i) a turnover above £200 million or (ii) a balance sheet total of over £2 billion. The notification measure is intended to apply to corporates, partnerships and limited liability partnerships that are treated as large businesses for this measure. The requirement to notify will apply with respect to the following taxes: corporation tax, income tax (including PAYE), VAT, excise and customs duties, insurance premium tax, stamp duty land tax, stamp duty reserve tax, bank levy and petroleum revenue tax.

The notification is proposed by the Government to be made in a similar manner to the existing Senior Accounting Officer certification process that currently provides for a certification to be made six or nine months after the end of the accounting period of the company. The new notification regime proposes to impose penalties of (i) £5,000 on the entity that fails to notify HMRC of the person liable to notify and (ii) £5,000 on the person liable to notify, or the entity, if they fail to do so.

HMRC notes in the paper that the measure is not intended to establish that HMRC's interpretation of the tax treatment is always correct but it seeks to ensure that HMRC is aware of cases where a large business has adopted a tax treatment with which HMRC may disagree.

Hybrid tax mismatches

HMRC published a consultation on 19 March 2020 on a number of questions relating to the UK's anti-hybrid mismatch rules. Responses are requested by 29 May 2020. HMRC is seeking preliminary views on the following concerns with the existing anti-hybrid rules:

- "acting together" concept - HMRC intends to bring some clarity to the application of the "acting together" requirement, which is fundamental in determining the "control group" structures to which the anti-hybrid rules can apply. HMRC noted taxpayers' concern that the concept is so widely drafted that it can lead to the application of the rules to certain structures even if there is no effective cooperation between unconnected parties. HMRC indicated that it was seeking to narrow the extent of this concept to better target it to arrangements involving co-operation between the parties to relevant transactions.
- "tax exempt investors" – HMRC noted the concern amongst taxpayers regarding the application of the anti-hybrid rules to structures which involve tax exempt investors (such as pension plans) investing in hybrid entities. HMRC noted that there was a concern that the anti-hybrid rules could apply to a hybrid entity even if that hybrid entity did not offer any benefits to it tax exempt investors. HMRC is seeking to collect information as to the types of entities that are affected with the view to (i) creating a "white list" of tax exempt entities to which an exemption from the anti-hybrid rules would apply, (ii) creating a "black list" of tax exempt entities that would automatically trigger the application of the anti-hybrid rules or (iii) arriving at a principle-based definition of tax exempt entities that would not lead to the application of the anti-hybrid rules.
- "double deduction rules" – HMRC is looking to address concerns raised by the tax community in relation to the application of the double deduction element of the rules to certain groups of companies. It highlighted a concern that a side effect of the application of the rules can be double taxation in certain cases. HMRC is seeking to understand the scope of the arrangements relevant to this point with the view to finding a solution to minimise the impact on the affected taxpayers.

Because the UK anti-hybrid legislation is relatively new and is largely untested, the consultation is a welcome step taken by HMRC. The outcome of this consultation would be particularly interesting to private funds that regularly need to assess the application of the anti-hybrid rules to their fund and investment structures from the perspective of their "tax exempt investors" and when considering the "acting together" concept.

Other UK Tax Developments

Taxation of gains and property-rich collective investment schemes

Following a consultation in 2019, the Government has published a set of regulations amending Schedule 5AAA to the Taxation of Chargeable Gains Act 1992. Schedule 5AAA recently introduced a new set of rules concerning capital gains tax treatment of disposals of interests in UK land by non-UK residents. These rules can also apply to non-resident investors investing directly or indirectly in UK property through collective investment vehicles (CIVs). From 6 April 2019 the rules applied to disposals of interests in entities deriving at least 75% of their value from UK land. The rules apply only to those non-UK residents that hold at least 25% of interest in such entities.

In the context of CIVs, the original rules could trigger a double tax charge on both the CIV and the investor in the CIV. In order to remove this discrepancy, the rules were subsequently amended to allow CIVs to be treated as transparent, which meant that the tax charge could move to the investors and double taxation would be avoided.

The new regulations have been introduced to clarify certain aspects of the position of tax exempt investors (e.g. pension plans) investing in CIVs to ensure that they will not lose their exemption when investing directly or indirectly in a UK property-rich CIV. In addition, the regulations have refined the definition of CIVs to include the principal company of a group provided that it is not a close company and to any other member of a group if it is a close company that has a qualifying investor (such as a pension plan) as a participator. Additional refinements were made to the process of making exemption and transparency elections by CIVs including introduction of a new requirement on CIVs making a transparency election to provide information to HMRC regarding its investors.

The regulations come into force on 10 April 2020 and have effect in relation to most disposals made on or after 6 April 2019, with certain changes affecting elections having effect on or after 10 April 2020.

Other UK Tax Developments

Late payment interest rates revised

The Government has announced that the interest rate for late payment of tax will be revised following the Bank of England's interest rate decrease. Because the Bank of England base rate was reduced from 0.75% to 0.25% on 11 March 2020, HMRC announced a corresponding decrease in its late payment interest rate bringing it down to 0.25%.

A further reduction was announced on 20 March 2020 following a further decrease in the Bank of England base rate from 0.25% to 0.1%. The new 0.1% HMRC late payment interest rate will apply from 23 March 2020 for quarterly instalment payments and from 30 March 2020 for all other instalment payments.

Repayment interest rates remain unchanged.

UK Case Law Developments

Transfer of assets abroad cases

Following HMRC's recent increase in seeking to apply the transfer of assets abroad (ToAA) rules contained in Chapter 2 Part 13 Income Tax Act 2007 to purported tax avoidance transactions, there have been two recent Upper Tribunal (UT) decisions considering the rules with mixed success for HMRC and the taxpayers.

In *Fisher v HMRC*, the UT found in favour of the taxpayers. In this case, a UK company that ran an online betting business decided to transfer its business to a Gibraltar company owned by the same UK taxpayers. The main purpose of the transfer was stated to be to save the UK company's online betting business that was in financial difficulty due to the high cost of UK betting duty and the fact that its competitors were established in other jurisdictions (e.g. Gibraltar). HMRC sought to apply the ToAA rules to the UK taxpayers by claiming that they were the effective transferors of the UK business.

The UT determined that the ToAA rules could not apply to the shareholders of the UK company because it was the UK company that transferred its business and assets to the Gibraltar entity and not its shareholders or directors as individuals acting through the company. The UT noted that a different finding would lead to a result that similar transfers could be attributed to all shareholders and directors of a company if they participated in the decision to transfer the company's assets and this was not the intention of the ToAA rules.

The UT also stated, overturning the decision of the First-tier Tribunal (FTT), that even if the ToAA rules could apply to the UK individuals, they would have had the motive defence available to them on the basis that the transfer of the business was a bona fide commercial transaction designed to rescue the business and did not have a main purpose of avoiding UK betting duty. This was a surprising finding in this case because it was clear on the facts that one of the purposes for the transfer was to minimise the UK betting duty that was making the business non-profitable albeit that this tax saving was only desired in the context of saving the business. The UT distinguished a situation where a taxpayer was engaging in tax avoidance in order to save tax, on the one hand, and a situation in which a taxpayer had to restructure its business in order to rescue it, on the other hand. The UT found that the situation in this case was similar to the latter situation and decided that the avoidance of betting duty in this case was simply the means of achieving the main purpose which was to save the business. For this reason, a commercial motive defence was available to the taxpayers on this particular set of facts. This does beg the question of how avoiding the betting duty was not a main purpose of the transaction when it was the very thing that had been identified as necessary to assist the business and one can see a different tribunal reaching a different decision in similar circumstances in a different case.

In addition, the EU rules on freedom of establishment were also considered in this case because one of the shareholders of the UK company was an Irish national. According to the UT, if the ToAA rules were to apply to the facts they would have breached EU law because the ToAA charge would be disproportionately imposed. In this case the ToAA charge could not be viewed as preventing a tax avoidance arrangement when the business was already taxed on its profits in another jurisdiction and the ToAA rules would have also taxed the UK resident directors on those same profits. Thus, the ToAA charge could not have been applied to the Irish national shareholder.

In the second case, *Davies v HMRC*, the UT confirmed the previous decision of the FTT that the ToAA rules were not prevented from applying by reason of the business profits article of a double tax treaty. In this case, a Mauritius company acquired a property development business in the UK and HMRC sought to apply the ToAA rules to the taxpayers who were benefiting from the profits of this business.

The UT upheld the FTT's finding on the facts that the taxpayers had a tax avoidance motive in transferring the property development business from the UK to Mauritius and that no defence was available to them. In this case, the taxpayers could benefit from the profits of the offshore company's business in a tax efficient manner through a structure involving life insurance policies.

The taxpayers argued that the ToAA charge should not apply to them on the basis that the Mauritius company could benefit from the exemption from UK tax on its profits under Article 7 of the UK/Mauritius double tax treaty. However, the UT held that while Article 7 could exempt the Mauritius company from UK tax on its own profits on the basis that it did not have a permanent establishment in the UK, it was not relevant to the ToAA charge, which deemed the income of the company to be the income of its UK resident shareholders, because the ToAA charge applied to the taxpayers and not to the company. This was the position irrespective of the fact that the taxable deemed income that was attributable to the taxpayers under the ToAA provisions was calculated by reference to the underlying trading income of the company.

While the decision followed that in the *Bricom* case, it also said that a double tax treaty provision might be effective to prohibit a UK tax charge based on the receipts of a treaty-protected non-UK entity, depending on the terms of the treaty provision and of the UK anti-avoidance provision. The terms of a capital gains tax article in a double tax treaty might well, therefore, be effective to preclude a UK capital gains tax charge under section 3 Taxation of Chargeable Gains Act 1992 (previously section 13) because section 3 operates to treat a gain realised by a non-UK resident close company as realised by its UK resident shareholders in contrast to the ToAA or controlled foreign company rules which treat the UK taxpayers as subject to tax on an amount of income not directly connected to the non-UK resident's income but calculated by reference to it.

GAAR Advisory Panel opinion

The GAAR Advisory Panel published an opinion on 12 February in relation to arrangements entered into by a taxpayer that involved currency forward purchase contracts settled by certificates of deposit and gilts for the purpose of generating an income tax loss that was not commensurate with the commercial risk incurred by the taxpayer. The Panel concluded that the entering into and implementation of these arrangements was not a reasonable course of action in the context of the applicable tax legislation.

The arrangements were based on a future value of an index as a result of which the taxpayer would acquire certificates of deposit or gilts. As a result of the transactions and subsequent sale of the acquired certificates of deposit and gilts, the taxpayer claimed (i) a loss for income tax purposes from a transaction in respect of the certificates of deposit with the view to offsetting it against other income and (ii) an exemption from capital gains tax on the gilts that were sold under the arrangements because they were exempt from capital gains. The loss in (i) and profit in (ii) were broadly the same so that the taxpayer's tax loss was greater than the economic loss.

Even though the taxpayer argued that the transaction had a prospect of generating profit, the Panel found on the facts that there was no possibility that the taxpayer could make a pre-tax profit from the transaction as a whole after paying fees and expenses. The Panel also noted that the transaction were not comparable to commercial transactions, as was argued by the taxpayer, because commercial parties do not normally enter into transactions where there is no prospect of a commercial profit or some other benefit (other than tax).

The Panel's opinion was that the arrangements were contrived and abnormal and inconsistent with principles and policy objectives of the legislation, and clearly did not amount to a reasonable course of action in relation to the applicable tax legislation.

Although the Panel agreed with the taxpayer that the legislation relating to certificates of deposit in Chapter 11 Part 4 Income Tax (Trading and Other Income) Act 2005 and section 152 Income Tax Act 2007 could allow losses to be created as a result of the sale of the certificates of deposit and for an exemption from capital gains tax to apply on a sale of gilts, these provisions did not envisage the contrived result that the combination of these provisions allowed as a result of the taxpayer participating in the transaction in question.

This GAAR Advisory Panel's opinion is another reminder to taxpayers that the GAAR can and will be used by HMRC as a weapon to attack taxpayers' arrangements that appear to be artificial and that are not comparable to commercial transactions.

Other Tax Developments

Luxembourg interest and royalty deductibility – EU blacklist

On 31 March 2020, Luxembourg adopted draft legislation that has the effect of denying deductions for interest and royalties paid to related companies established in one of the jurisdictions on the Luxembourg blacklist of harmful tax jurisdictions. If this measure is implemented, Luxembourg entities would not be able to claim such deductions for Luxembourg corporate income tax and municipal business tax purposes from 1 January 2021. It is expected that deductions claimed as part of genuine commercial transactions reflecting economic reality would not be caught by this measure.

It is understood that the Luxembourg blacklist has not yet been published but is expected to be published during the course of 2020 and will be based on a recent EU blacklist. The current EU blacklist has been recently updated and, as at February 18, it includes the following twelve jurisdictions: the Cayman Islands, Fiji, Guam, Oman, Palau, Panama, Samoa, the Seychelles, Trinidad and Tobago, Vanuatu and the Virgin Islands.

In its current form, it is understood that the draft law does not automatically apply to payments made to tax transparent entities (e.g.: limited partnerships) but it is likely that a separate assessment would need to be made to determine if the rules would be triggered if any participant or ultimate beneficial owner in such entities is located in one of the blacklisted jurisdictions.

It is also understood that only related/connected companies would fall within the new rules and the connection between companies broadly exists under the relevant Luxembourg rules where either (a) one company directly or indirectly participates in the management, control or capital of the other or (b) the same persons participate directly or indirectly in the management, control or capital of both companies.

Under the proposal, interest is expected to include all types of interest including interest and arrears paid on a profit participating loan and premiums payable on a loan note. Royalties are intended to capture any payments made for the use of IP rights (e.g.: patents, trademarks and know how).

The new measure will require taxpayers to provide evidence that deductions of interest and royalties to entities located in the blacklisted jurisdictions form part of genuine commercial transactions or structures and there are "valid economic reasons" for making such payments that provide a real economic benefit.

It is expected that the final legislation adopting this measure will be published at the end of 2020. Any clients that have operations or presence in any of these countries can contact any member of the Proskauer tax team to discuss further.

OECD Tax Policy Review: Seychelles

On 12 March, the OECD published a report following its review of the Seychelles' tax system. The headline conclusion reached by OECD was that "Despite significant tax reforms in recent years, the Seychelles' tax system needs to be fairer and more sustainable, in particular through a rebalancing of its business tax."

The EU took the step to move the Seychelles from the grey list to the black list because of the failure of the country to address certain questions around its existing harmful preferential tax regime. Although the OECD's report acknowledges the reforms introduced by the Seychelles in recent years, it also notes that the Seychelles have been failing to deal with certain questions relating to tax evasion and tax avoidance.

In its report, the OECD recommended a number of tax reforms across different industries in the development of a modern, fair and transparent tax system, in line with international.

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