Proskauer

UK Tax Round Up

June 2022

Welcome to June's edition of the UK Tax Round Up. This month's edition features a summary of HMRC's recent guidance on QAHCs and credit funds, the publication of the new UK/Luxembourg double tax treaty and the delay to the UK's implementation of the OECD-related Pillar Two rules on global minimum tax as well as an interesting case on whether a "white space disclosure" was a defence against carelessness of a tax agent.

UK Case Law Developments

White space disclosure no defence for carelessness of tax agent

In Johnson and another v HMRC, the First-tier Tribunal (FTT) considered whether a tax return had been prepared carelessly notwithstanding a white space disclosure on the return.

The appellants had entered into a swap transaction with a bank in 2007 and were subsequently awarded compensation from the bank following a review by the FCA of the type of interest rate hedging product that they entered into. The first appellants received a letter from the bank which included details regarding the amount of compensation payable to both appellants and included information on the gross interest and the amount of tax deducted from it, together with a statement that the remaining balance of the payment should be reported on the appellants' tax returns. The swaps related to a loan or loans taken out by the appellants that were used to acquire a property in their own names that they rented out.

The appellants’ tax agent, Mayfield & Co, did not include the payment from the bank as taxable income in the appellants’ tax returns. Instead, Mayfield included a white space disclosure stating that “a compensation payment of £43,218 was received during the year from the bank in respect of Interest Rate Hedging Products which is not considered to be taxable”. HMRC raised assessments on the appellants for the tax year 2013/2014 after the standard 12 month enquiry window following extensive correspondence between HMRC and Mayfield. The assessments were raised on the basis that Mayfield, as agent for the appellants, had been careless in preparing the tax returns and that the loss of tax had arisen from the carelessness. Under section 118 TMA 1970 a loss of tax is brought about carelessly if the taxpayer (or the taxpayer’s agent) “fails to take reasonable care to avoid bringing about [the loss of tax]”.

HMRC argued that the appellants’ agent had been careless when filing the returns on the basis that there was clear published guidance on HMRC’s website which stated that redress payments were taxable when the taxpayer had claimed a business deduction for the payments under the swap. Mr Green, a senior tax manager employed by Mayfield, admitted that he was uncertain as to the tax treatment of the redress payment at the time that he filed the returns despite accepting that HMRC’s guidance was readily available and that he had, in fact, read it. Mr Green said, however, that he thought that the payment related to compensation paid to the appellants in their personal capacities and, therefore, he was of the view that it was not likely to be taxable because it was not related to a business carried on by them. Mr Green submitted that the inclusion of the white space disclosure meant that neither he nor Mayfield were careless and that HMRC should have enquired into the return in the standard enquiry window. He stated that the loss of tax was caused by HMRC’s failure to enquire into the returns in time and not by his nor Mayfield’s carelessness.

When determining whether or not Mr Green acted reasonably (or carelessly), the FTT said that the test to be applied was a comparison of Mr Green's actions against the actions of a reasonably competent tax adviser. The FTT concluded that a reasonably competent tax adviser would have considered more carefully whether HMRC's guidance applied to the circumstances of the appellants. HMRC acknowledged that an agent who reads HMRC's guidance but subsequently takes a different and respectable view based on merit is not careless. However, in the circumstances of this case, the FTT found that Mr Green had failed to establish basic facts regarding the compensation payment in question and that this evidenced a lack of reasonable care which was causative of the loss of tax. The FTT noted that, had Mr Green undertaken a considered analysis of the compensation payment and the appellants' circumstances, the appellants' tax returns would have included the payment as taxable income since Mr Green would have concluded that the swaps were taken out for the purpose of the appellants' property rental business and that they had claimed deductions against their rental income for their payments under the swaps. Mr Green put forward the argument that the inclusion of the disclosure contained sufficient detail to comply with HMRC's Statement of Practice SP 1/06 in that HMRC were provided with enough detail to realise within the enquiry period that the self-assessment was insufficient. However, the FTT held that this argument is not a defence against carelessness which is, effectively, a strict liability obligation for taxpayers (and their agents).

This case highlights the importance for taxpayers and their advisers alike of giving due consideration to the expected tax consequences of payments, any published HMRC guidance that might be relevant to those consequences, and ensuring that any white space disclosure is fulsome enough to explain the considered and respectable basis on which a taxpayer might have taken a position contrary to relevant HMRC guidance. In addition, it is not sufficient simply to refer to a matter in a white space disclosure to move the burden onto HMRC to make enquiries when the tax return and disclosure have been prepared without due care.

Other UK Tax Developments

HMRC provides useful guidance on corporate lending vehicles and QAHCs

On 6 June, HMRC updated its guidance relating to the UK's new qualifying asset holding company (QAHC) tax regime which was introduced from 1 April this year to cover companies which are used as corporate lending vehicles (for instance, by credit funds).

One of the requirements for a company to be able to qualify as a QAHC is that the company carries on an investment business and that any other (e.g. a trading) activity is merely ancillary to that investment business and is not carried on to a substantial extent. Since publication of the rules, there has been concern expressed that companies used to make loans (either through origination or acquiring existing debt) and which receive related fees might be treated as carrying on a trading activity and, therefore, not be able to qualify as QAHCs.

The new guidance clarifies HMRC's approach to whether corporate lending vehicles used by credit funds should be treated as carrying on an investment activity and whether any other activity, such as the receipt of fees or disposal of acquired debt, might be treated as trading which was not ancillary to the company's main investment activity. The updated guidance confirms that, in the context of credit funds, loan origination is not in itself indicative of a trade and that, where loan originators receive standard fees as part of their loan origination activity, the fee income is likely to be considered part of the investment activity. There is similar helpful reference to companies acquiring debt with a view to holding it to maturity but then possibly disposing of it on a speculative basis.

While the guidance does state that facts and circumstances must be considered in each case, the updated guidance provides a welcome clarification of HMRC's interpretation of how the QAHC legislation should apply to lending/debt acquisition companies set up by credit funds which should provide a high measure of comfort to credit fund asset managers who are considering using QAHCs within their fund structures.

For further information on the updated guidance please read our Tax Talk Blogs available here and the updated guidance here.

UK delays implementation of minimum global tax rate under Pillar Two

The UK Treasury confirmed on 14 June that it will delay the introduction of the 15% minimum corporate global tax rate to be introduced under the OECD's proposals relating to the taxation of the digital economy (Pillar Two) following lack of progress in the development of talks at the OECD level.

In a letter from the Financial Secretary it was confirmed that the regime will first apply to accounting periods starting on or after 31 December 2023 and not April 2023 as originally proposed. In the letter, the Financial Secretary noted that respondents had raised concerns regarding the implementation of the rules in the UK before other countries as this would be likely to put UK businesses at a competitive and administrative disadvantage. This delay will be welcomed by many as previous responses to consultations had highlighted that sufficient lead in time would be required for an orderly implementation of the new regime due to the complexity of the rules.

The draft legislation to implement the rules is still expected to be published later this year although the actual date and terms of implementation might still depend on how progress is made with the rules at the OECD level.

HMRC publishes new UK-Luxembourg double tax treaty

A new UK/Luxembourg double tax treaty was signed on 7 June and will replace the existing treaty once it is ratified by both countries.

While the changes are largely to align the treaty with the OECD model (including the changes made under the BEPS-related multilateral instrument), the new treaty also contains significant change for UK real estate investors with Luxembourg holding structures. Under the current treaty, the UK cannot tax capital gains of a Luxembourg resident. The new treaty changes this and allows the UK to tax gains arising to a Luxembourg resident where the gain arises on the sale of shares or similar interests that derive at least 50% of their value from UK real estate (although the UK's domestic rules require the company to derive at least 75% of its value from UK real estate).

In addition, under the new treaty investors in investment funds will no longer have to file individual claims for withholding tax relief on interest and dividends (noting that there is currently no withholding tax on Luxembourg interest payments). Instead, such claims will be able to be filed directly by an authorised representative of the fund on behalf of the investors. Further detail on the practicalities regarding these arrangements is to be confirmed by both the UK and Luxembourg tax authorities.

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