Proskauer

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This month has seen a number of developments, both on the domestic and international tax fronts. We have set out below a summary of some of the main points of interest.

General UK Tax Developments

Finance Bill

The Finance (No 3) Bill 2018-19 (which will become the Finance Act 2019) was published on 7 November and includes legislation to enact the changes highlighted in our UK Budget blog post (UK Budget Blog).

Another key area covered by the Finance Bill was the final version of the legislation to introduce the extension of tax on chargeable gains arising from UK land (including companies that derive at least 75% of their value from UK land) to non-UK residents from April 2019. We covered the initial version of this legislation in our in July 2018 tax blog (UK Property Tax Blog). The final legislation now includes special provisions to deal with UK property-rich collective investment vehicles (CIVs) such as offshore property unit trusts. CIVs will generally be within the scope of the new tax charge, but can make one of two elections (a transparency election or an exemption election) subject to fulfilment of certain conditions. In one respect, however, investors in CIVs may be treated less favourably than those investing in non-CIV property holding companies. If the CIV is UK property-rich (i.e. it derives at least 75% of its value from UK land), an investor selling a stake in the CIV will be subject to UK tax regardless of the size of the investor's stake in the CIV. By contrast, there will be a 25% ownership threshold for payment of the tax on the disposal of shares in a non-CIV UK property-rich company.

UK Case Law Developments

Deemed UK trade relevant for double tax treaty rights

In *Fowler v HMRC*, the Court of Appeal (CA) has decided, on a split decision, that the UK could not charge tax to a resident of South Africa (Mr Fowler) who had carried out diving activities in UK territorial waters under a contract of employment by reason of the combined effect of the UK's tax laws treating his activities as the carrying on of a trade in the UK and the terms of the UK-South Africa double tax treaty.

In addition to the relatively narrow point in issue, the case provides an interesting illustration of how the natural consequences of a deeming rule should be given effect in other relevant tax provisions.

Although Mr Fowler was held to be an employee, rather than self-employed, as a matter of fact, section 15 ITTOIA 2005 states that the performance of duties of diving employment is treated for income tax purposes as the carrying on of a trade in the UK.

The question at issue was whether those words of the statute that deemed there to be the carrying on of a trade meant that his income also constituted business profits for the purposes of Article 7 of the UK-South Africa double tax treaty (in which case South Africa had sole taxing rights) or whether he was treated as receiving employment income for those purposes (in which case the UK could tax the income). The CA, in a majority decision, held that the deemed UK trading treatment did carry through into the tax treaty so that Mr Fowler's income was subject to Article 7 rather than Article 14 and sole taxing rights went to South Africa rather than the UK.

While possibly a counterintuitive result, which granted taxing rights for the employment income of a person working in the UK to the foreign state of residence, it illustrates the wide ranging effect that a deeming provision can have applying the House of Lords' principle from the *Marshall v Kerr* case that "because one must treat as real that which is only deemed to be so, one must treat as real the consequences and incidents inevitably flowing from or accompanying that deemed state of affairs, unless prohibited from doing so".

New GAAR Panel opinions

The GAAR Advisory Panel (the Panel) has published three new opinions, each ruling that tax planning designed to avoid an employment income tax charge under both section 62 and Part 7A of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA 2003) was not a reasonable course of action.

The arrangements covered similar facts in three cases (and, in many ways, similar to the Panel's previous opinions in favour of HMRC). In each of the arrangements, a series of steps were taken that attempted to increase the post-income tax return to an individual from between 48-56% to 79-82% of the underlying payment. The facts of the first were as follows (the other cases were similar with small variations relating to an executive services contract):

- the individual was employed by a company (XYZ) through which their services were supplied to another company (A Ltd). A Ltd would normally have been the direct employer;
- A Ltd paid a fee to XYZ;
- A Ltd paid the national minimum wage to the individual and also advanced to him interest free, repayable on demand, "discretionary" loans; and

- XYZ then transferred the creditor rights in the loans to an employer financed retirement benefit scheme (EFRBS) of which the individual was a beneficiary.

The Panel concluded that it was contrived and abnormal for an agency employer to provide most of an employee's remuneration on a discretionary basis by way of a loan and for the creditor rights to be assigned to an EFRBS for the individual's benefit. The Panel stated that there was no economic difference between the arrangements and circumstances involving a payment by an employee trust that would be subject to Part 7A of ITEPA 2003.

The Panel referred back to a Ministerial Statement sets out the thinking behind Part 7A which stated that "The legislation ensures that where a third party makes provision for what is in substance a reward or recognition, or a loan, in connection with the employee's current, former or future employment, an Income Tax charge arises". The Panel felt clearly that these steps would be caught by the GAAR. They referred to the GAAR Guidance which states that "the GAAR is designed to put a stop to the game of legislative catch-up where, for example, taxpayers have sought to devise contrived ways of avoiding the disguised remuneration rules".

The Panels in particular, found that several of the steps were "contrived and abnormal", including the "discretionary" loan and the assignment of the creditor rights to the loan to the EFRBS.

These decisions follow the Panel's previous decisions on structured employment tax arrangements and show that it is unlikely to have much sympathy for similar cases brought to it by HMRC in the future.

While it may be unlikely, it would be interesting if the Panel considered a case in the future that it decided was a reasonable course of action to provide a better idea of where the line between reasonable and unreasonable might lie.

EU Case Law Developments

Input VAT recovery on sale of shares

In *C&D Foods Acquisition ApS v Skatteministeriet*, the ECJ has determined that a Danish company incurring input VAT on fees related to its proposed sale of an indirect subsidiary was not recoverable because the sale of the shares was not sufficiently linked C&D Foods' provision of management and IT services to the subsidiary. The ECJ was clear that its ruling would have been the same had the sale completed.

The facts of this case were that had C&D Foods (C&D) was the parent of the Arovit group. C&D had entered into a management agreement with its subsidiary Arovit Petfood relating to the supply of management and IT services for a fee. The group defaulted on loans taken out with Kaupthing Bank, which assumed ownership of the group and decided to sell Arovit Petfood. C&D entered into consultancy agreements with third party consultants in relation to the proposed sale, on which VAT was incurred. The Danish authorities denied recovery of that VAT.

The ECJ reiterated that a company which has as its sole purpose the acquisition of holdings in other companies, without it becoming directly or indirectly involved in the management of those companies, is neither a taxable person for VAT purposes nor a person entitled to recover input VAT. The mere acquisition and ownership of shares does not, in itself, constitute an economic activity conferring on the holder the status of a taxable person, since those transactions do not amount to the exploitation of property for the purpose of obtaining income on a continuing basis. However, a company holding shares in a subsidiary in order to provide or with the intention of providing VATable services for a fee will be conducting an economic activity and should be able to recover its input VAT incurred in acquiring the shares in the subsidiary, as has been reiterated recently in the *Ryanair* case.

In this case, Kaupthing's (and so C&D's) objective in selling the shares was to use the proceeds of the sale to settle the debts owed to Kaupthing Bank by the C&D group. The Danish authorities had argued that C&D could not recover its VAT costs because they were incurred in relation to the (proposed) sale of shares which was itself an exempt transaction for VAT purposes. The ECJ stated that the question of input VAT recovery depended on whether the sale of the share had sufficient link to the taxpayer's economic activity (e.g. the sale proceeds would be used in its general taxable business or, possibly, would be used to acquire a new subsidiary to which it would provide services). The ECJ decided that there was no such link since the sale of the shares was to allow the proceeds to be used to repay C&D's debt (not part of its taxable business).

In some ways, this case contrasts with the recent ECJ decision in the *Ryanair* case. As a reminder, in that case, Ryanair had planned to acquire another airline, but was not able fully to complete the takeover due to competition law reasons. Nevertheless, Ryanair had planned to supply management services to the target post-completion. As the ECJ stated in *Ryanair*, the parent (or intended parent) company can be carrying on an economic activity and hence a VAT taxable person "where the holding is accompanied by direct or indirect involvement in the management of the companies in which the holding has been acquired, if that entails carrying out transactions which are subject to VAT, such as the supply of administrative, financial, commercial and technical services".

These two cases produced directly opposite results with, in some senses, similar facts. Management arrangements between the parent and target (or intended target) were in place or intended to be implemented. What the decision in *C&D* shows, however, is that it is much more difficult to show that the sale of shares has an immediate and direct link to the seller's taxable business than it is to show that the acquisition of shares does provided the acquisition is made with a view to the purchaser providing taxable services to the target.

Other Developments

Double Tax Treaties

Austria

The UK signed a new double tax agreement with Austria on 23 October 2018. It will come into force when both countries have completed their legislative processes and exchanged diplomatic notes. The agreement is largely based on the OECD model tax convention, but has a couple of variations. For example, there is a place of effective management tie-breaker for corporate residence instead of the OECD model provision which requires contracting states to agree residence by mutual agreement.

New Zealand and Japan

HMRC has published two more in its series of "synthesised" texts of double tax agreements to incorporate the effects of the changes made by the adoption of the Multilateral Instrument (MLI). The latest in the series are the agreements with Japan and New Zealand.

As a reminder, the MLI came into force in the UK on 1 October 2018 and agreements will have effect subject to the changes effected by the MLI over time as other contracting States deposit instruments of ratification with the OECD.