Proskauer

UK Tax Round Up

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Case Law Developments

The impact of discounts on consideration for VAT purposes *(Finanzamt Bingen-Alzey v Boehringer Ingelheim Pharma GmbH & Co. KG)*

The ECJ has confirmed that consideration for VAT purposes should be reduced by any discount applied, regardless of who benefited from the discount. This case involved the supply of medicines to various wholesalers and pharmacies, which then sold the medicines on to the end consumers, who would often get the cost of the medicines reimbursed by their private health insurer. Under German law, suppliers of medicine are required to offer a discount to private health insurers. As a result, the supplier sought to reduce the consideration received for VAT purposes by the amount of the discount. This approach was challenged by the German tax authority which claimed that, as the discount was not received by the end user of the products, it could not be used to reduce the consideration received for VAT purposes.

In its decision, the ECJ confirmed the decision in *Elida Gibbs Ltd v Customs and Excise Commissioners*, which stated that the amount of VAT collected in a supply chain did not need to exceed the amount of VAT paid by the final consumer. In particular, the ECJ stated that a fundamental principle of VAT is that the taxable consideration is the amount actually received in return for the goods or services and, as a result, the consideration can be reduced by any amounts not received by the supplier regardless of whether the discount was awarded to the end user. In addition, the ECJ noted that, as the discount was fixed by statute, the amount of the discount could not be treated as part of the consideration for VAT purposes.

Rejection of tax warranty claim under a share purchase agreement *(Tesco UK Limited v Aircom Jersey 4 Limited and Aircom Global Operations Limited)*

This case provides another example of the Courts rejecting a claim under a share purchase agreement by following the strict terms of notice provisions agreed between sophisticated parties. In it, the Court of Appeal considered whether the agreed procedural requirements had been complied with in relation to a claim for a breach of tax warranties contained in the share purchase agreement.

The case relates to the acquisition of a target company by the purchaser in November 2013. The SPA stated that "No seller shall be liable for any claim unless" the purchaser gave notice to the sellers of such claim "setting out reasonable details of the claim (including the grounds on which it is based …)" by 31 July 2015. Prior to that date, the purchaser sent two letters to the sellers stating that certain tax liabilities had been identified in respect of which it reserved its right to make a claim but without specific detail of which provisions of the SPA the claim related to. In August 2015, the purchaser issued proceedings claiming damages for the breach of tax warranties in relation to those tax liabilities. However, when the proceedings were heard, the High Court found in favour of the sellers and struck out the claims on the basis that the purchaser had failed to provide a sufficiently detailed notice of the claim within the relevant time limits.

The Court of Appeal has now agreed with the High Court and found in favour of the sellers on the basis that the purchaser had failed to specifically identify the tax warranties which they considered had been breached. In order to comply with the terms of the SPA, the purchaser was required to set out the grounds of the claim, which required explicit reference to particular warranties or other provisions (although the judge did note that there may be exceptional circumstances, which did not apply to this case, where reference to specific warranties would not be required).

This case highlights once again the importance of complying strictly with the notice provisions in legal agreements. Where a party is required to give notice under a legal instrument, such notice should be as clear and specific as possible and claimants should err on the side of giving more rather than less information than might be required.

Court of Appeal decision on QCB status *(Nicholas Trigg (A partner in Tonnant LLP) v The Commissioners for Her Majesty's Revenue and Customs)*

In the latest of a line of cases in relation to whether bonds fall within the qualifying corporate bond ("**QCB**") regime (and therefore benefit from an exemption from capital gains tax), the Court of Appeal was asked to determine whether a mechanism which provided for the currency of certain bonds to be redenominated from sterling to euros in the event that the UK adopted the euro as its national currency prevented the bonds from being QCBs. This was on the basis that the terms of the bonds provided for conversion into or redemption in a currency other than sterling where any such redemption was not a simple spot rate conversion on the date of redemption. The Court of Appeal disagreed with the Upper Tier Tribunal and held that the bonds retained their status as QCBs because the conversion into euros and the fixed rate at which the UK would enter the euro meant that the euro redemption would be at the rate of exchange prevailing at redemption. Rather than viewing the mechanism as a way for the securities to be converted into a currency other than sterling, the Court of Appeal sided with the taxpayer by agreeing that the mechanism set out a way for the securities to be redeemed in another currency in the event that the national currency of the UK changed from sterling.

The case highlights how relying on technical provisions in bond (or other) terms might prove dangerous when they are being relied on to give a desired tax result from a transaction.

Upper Tier Tribunal decides employment related securities were not "restricted" (*Cyclops Electronics Ltd and another v Revenue and Customs Commissioners*)

The Upper Tier Tribunal decided that loan notes that were subject to forfeiture restrictions which did not have any commercial basis were not restricted securities for the purposes of the employment related restricted security rules in Part 7 of the Income Tax (Earnings and Pensions) Act 2003. As a result, the securities were held to fall outside a specific exemption in this regime and the undervalue on their issue was instead subject to income tax and national insurance contributions under the general (unrestricted) employment related security rules.

When reviewing whether a restriction is sufficient to make a security restricted for these purposes, the Upper Tier Tribunal confirmed that it is necessary for the restriction to have a "business or commercial purpose". This is therefore a useful reminder that artificially manufacturing restrictions on employment related securities is unlikely to give rise to beneficial tax treatment that relies on the securities being "restricted".

Penalty cancelled for failure to file tax return (*Goldsmith v HMRC*)

In the case, the First Tier Tribunal was asked to consider whether HMRC were correct in levying penalties against a taxpayer for a failure to deliver tax returns. The powers granted to HMRC by section 8(1) of the Taxes Management Act 1970 ("**TMA**") allow them to issue notices requiring taxpayers to deliver tax returns "for the purpose of establishing the amounts in which a person is chargeable to income tax and capital gains tax for a year of assessment". A failure by a taxpayer to submit the required tax returns then gives rise to penalties.

However, on the facts of the case, the taxpayer's liability to tax had already been established as a result of the taxpayer being subject to income tax via the PAYE system. As a result, the First Tier Tribunal held that the notices issued by HMRC to the taxpayer requiring a tax return to be filed were not issued for the purpose set out in section 8(1) of the TMA and so were invalid. This, in turn, meant that there was no proper basis for HMRC to levy penalties against the taxpayer. The First Tier Tribunal also noted that it considered attempts by HMRC to require tax returns to be filed retrospectively which enabled interest and penalties to be levied on any underpaid tax to be an "inappropriate" use of the self-assessment rules.

Other UK Tax Developments

GAAR panel decision on the loans to participators charge

The GAAR Advisory Panel has published its third opinion and said in it that tax planning arrangements which sought to allow for the tax-free extraction of cash from a close company through the use of trusts and which involved "contrived and abnormal steps" was not a reasonable course of action having regard to the loans to participators and company distribution rules.

The tax planning which was considered in this opinion involved a loan of £460,000 from a close company to its sole shareholder. In order to eliminate both the loans to participators tax charge on the outstanding loan and an income tax charge on either a distribution or the release of the loan, the shareholder acquired a settlor's interest in a trust funded with assets of £500,000 and then received a loan from the trust for £500,000. The shareholder then sold the interest in the trust to his company for £500,000 and used the purchase price to extinguish the outstanding loan.

The GAAR Advisory Panel held that, while there was no direct distribution involved, "the only purpose of the Trust is to bring into being an asset, without which there would be no doubt as to the application of the distributions legislation". As a result, it had no problem in confirming that the transaction was not a reasonable course of action in the circumstances.

HMRC issues guidance on the Serial Tax Avoidance Regime

HMRC has issued detailed guidance in relation to the Serial Tax Avoidance legislation that came into effect on 15 September 2016. The regime applies to taxpayers who have used an avoidance scheme which has been defeated by HMRC under any of the various legislative regimes, such as the General Anti Abuse Regime (GAAR) or the Disclosure of Tax Avoidance Schemes (DOTAS) regime. The sanctions available to HMRC include the issuing of warning notices (which require taxpayers to submit information notices about DOTAS arrangements that they have used during a fixed period of time), various tax-geared penalties if they are party to avoidance arrangements that are defeated and, in certain circumstances, the public naming of tax avoiders.

The guidance issued by HMRC includes a number of examples which help to illustrate how the legislation will be applied. In particular, there are a number of examples covering the aggregation of penalties and how the valuation of any counteracted advantage should be calculated.

International Tax Developments

The European Commission's proposals on VAT rates and a new regime for SMEs

On 18 January 2018, the European Commission issued proposals for reduced rates of VAT within the European Union and a special VAT regime for SMEs. The proposals aim to reduce the level of VAT fraud across the European Union, update the rules applicable to VAT to reflect modern business practices and address the problem of smaller companies bearing a disproportionate amount of overall VAT compliance costs.

The current European Union rules on VAT currently allow Member States to apply a reduced rate of VAT (which can be as low as 5%) to two distinct categories of products. The new proposals would instead allow:

- two separate reduced rates (of between 5% and the standard rate chosen by the Member State) to be applied;
- one exemption from VAT (i.e. the "zero rate"); and
- one additional reduced rate set at between 0% and the other reduced rates applied.

In addition, the European Commission's proposals includes a plan to abolish the current complex list of goods and services to which reduced rate VAT can be applied, to be replaced by a new list of products which would always attract the standard rate of VAT in each Member State. However, the Member States would be required to ensure that the weighted average VAT rate in their jurisdiction is at least 12%.

In relation to SMEs, the European Commission issued proposals in an attempt to mitigate the "cliff edge" effect of VAT thresholds in each Member State which negatively impact growing SMEs. The proposals include plans for:

- a simplified VAT regime for all EU small business which fall under a €2 million revenue threshold, regardless of whether the businesses have already been exempted from VAT;
- Member States to be able to exempt all small businesses that qualify for a VAT exemption from various requirements (specifically those relating to identification, invoicing, accounting or returns); and
- a single turnover threshold of €100,000 below which companies operating in more than one Member State would benefit from the general VAT exemption.

While these proposals are still subject to negotiation and approval, they could, if enacted, represent a significant shake up of the VAT landscape across Europe.

And Finally

Excuses for late filing of tax returns

On a lighter note, HMRC has published its annual list of "imaginative and intriguing" excuses for the late filing of tax returns, with the top entries including:

- "I couldn't file my return on time as my wife has been seeing aliens and won't let me enter the house",
- "I've been far too busy touring the country with my one-man play" and
- "My business doesn't really do anything".

In addition, they released details of some of the "wildly optimistic" expense claims it has received over the course of the last tax year. The 'winners' this year include:

- vet fees for a rabbit;
- hotel room service (including candles and prosecco); and
- £4.50 for sausage and chips meal expenses for 250 days.

If the 250 sausages were not enough to give the taxpayer indigestion, it is quite possible that the loss of the tax deductions did.

Related Professionals

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