Proskauer

UK Tax Round Up

July 2018

Draft Finance Bill 2018-2019

On 6 July, the Government published draft legislation in the Finance Bill 2018-2019 together with explanatory notes. Most of the provisions will, if enacted, come into force from next April.

Highlights in the Bill include:

Entrepreneurs' relief

As discussed in our blog post, individuals will be able to continue to access the 10% CGT rate under the entrepreneurs' relief (ER) rules where a company issues shares for genuine commercial reasons and for cash subscription and that new share issue reduces an individual's holding in the issuing company below the required 5% ordinary share capital. The change is intended to remove the problem faced by individuals holding ER-qualifying shares in growing companies where new capital injection can currently mean that the ER conditions cease to be satisfied.

In order to claim ER in these circumstances, the individual can make two elections: the first to elect a deemed disposal and repurchase of their shares at their market value (without discount for any minority holding) at the time of the share issue, and the second to delay the CGT liability until the individual actually disposes of the shares.

This is a welcome change and seems to entrench ER as a valuable relief that is unlikely to be materially limited in the near future.

Non-resident CGT on UK property

As discussed in our blog post, effective from 6 April 2019 the charge to UK capital gains tax will be extended to include gains made by non-UK investors in UK commercial property and in certain 'property-rich' vehicles. This will introduce a fundamental change to the tax system applying to non-UK resident investors in these circumstances, and it will have to be seen whether and how it might affect investment in the commercial property sector in the UK.

Profit fragmentation rules

These new rules will give HMRC another basis on which to attack arrangements which take business profits properly attributable to individuals working in the UK out of the UK income or corporation tax net by attributing (or paying) them on other than arm's length terms to offshore entities which are subject to a lower rate of taxation. Where such 'profit fragmentation' arrangements exist the rules will operate by seeking to charge UK tax on the relevant UK individual(s) by reference to the overall reduction in tax paid under the arrangements in contrast to what would have been paid had the relevant profits been subject to UK tax.

The rules are broadly drafted and, accordingly, may cover arrangements where other UK legislation (such as the disguised investment management fee, transfer of assets abroad, transfer pricing or the diverted profits tax rules) might reasonably be expected to apply, and HMRC recognises this overlap. It is hoped that the interaction between the respective legislative provisions will be clarified in the final text so that these rules will not result in additional compliance burdens in situations where the existing tax provisions should be perfectly adequate to ensure no loss of tax to the Exchequer.

In addition to the potential tax liability, the rules include an obligation to notify HMRC of arrangements that are subject to certain of the conditions for a 'profit fragmentation arrangement', not including that the amount received by the offshore entity in the arrangements is more than an arm's length amount (which is then left to HMRC to consider). The suggestion when the rules were consulted on earlier in the year that any tax payable under the rules might be subject to accelerated payment has been dropped.

The draft rules are currently under discussion between interested bodies and HMRC and it is hoped that their focus will be narrowed prior to their implementation.

VAT grouping

In order to comply with EU law, the Finance Bill proposes changes to the UK's VAT grouping rules (which currently only permit corporate bodies to be members of a VAT group) to allow individuals and partnerships to be VAT grouped with corporate or other entities that they control.

We understand that the extension of the VAT grouping rules in this way will not affect HMRC's current practice of recognising UK limited partnerships through their general partners for VAT purposes.

UK Tax Cases

Input tax recovery not available where supplies wrongly treated as VAT exempt

In *Zipvit v HMRC*, the Court of Appeal determined that the recipient of a supply could not recover input VAT where those supplies were originally considered by the parties and HMRC to be VAT exempt (and so no VAT was charged and no VAT invoices were issued) but were actually (following a subsequent ECJ case) standard rated.

Postal services are VAT exempt except where such services are individually negotiated. The Royal Mail treated its supplies of postal services to Zipvit as exempt, but this was the incorrect treatment because the arrangement was in fact individually negotiated.

Zipvit claimed that the consideration paid by it for the services should be treated as having included VAT and that it should be able to recover that input tax. The Court of Appeal rejected this. While the Court said that the answer to whether the payment by Zipvit should or should not be treated as including VAT was unclear, it also decided that Zipvit was not entitled to recover any input VAT cost that it had suffered because no VAT invoices were issued in respect of the supply of the services from the Royal Mail.

Both EU and UK law generally require a taxpayer to hold a VAT invoice in order to make a claim for VAT recovery, on the basis that the provision of invoices is essential in assisting HMRC to monitor VAT collection, and this case provides an important reminder of this principle.

Given, however, that this was a lead case which will form the basis of decisions for a large number of other cases involving about £1 billion of VAT, an appeal of the decision can be expected.

Claim by former VAT group member for overpaid VAT not made on behalf of representative member

In *HMRC v Taylor Clark Leisure*, the Supreme Court has held that only the representative member of a VAT group may make VAT claims in respect of supplies made to the group.

Taylor Clark (TC) was the representative member of a VAT group that included its subsidiary, Carlton. TC disposed of Carlton in 1998. In 2007, Carlton made a claim for overpaid VAT, including in relation to the period in which it was a member of TC's VAT group.

It was held that because Carlton was not the representative member of the VAT group and had not been given authority by TC to act on its behalf, it had no right to make a claim. TC was the only person entitled to make any claim in respect of the group's VAT and it had failed to make a claim within the required time period.

This case acts as a reminder of the difficulties that can arise on reorganisations or disposals involving only part of a VAT group and the importance of setting out clearly the parties' rights and obligations at that time in respect of future claims and the group's prior activities.

Meaning of 'payable' under a SPA indemnity

In *Minera Las Bambas v Glencore*, the High Court considered when tax was 'payable' for the purposes of an indemnity in an SPA, finding that tax was only payable once a court had upheld a disputed assessment issued by the tax authority.

Glencore had sold Xstrata to Minera under a SPA. The acquisition involved the resettlement of a rural community in Peru to a new town as part of a copper mining project that Xstrata owned.

No VAT was paid on the property transfers effected as part of the resettlement and the Peruvian tax authority ruled that this was incorrect and that VAT was due. Under the terms of the indemnity Glencore had control of the dispute and appealed against the tax authority ruling. It was understood that the dispute would not be resolved until 2019.

The issue was therefore whether the relevant VAT was 'payable' for the purpose of the SPA indemnity such that Glencore should pay the relevant amount to Minera prior to the conclusion of Glencore's appeal.

The High Court, applying the principles from *Wood v Capita*, determined that the fact that Glencore and Minera were represented in the drafting and negotiation of the SPA by major international law firms meant that the SPA, and not the wider commercial context of the transaction, should be given most weight in determining the intention of the parties.

The High Court accepted that, as a matter of Peruvian law, the tax assessment issued by the Peruvian authorities created a liability and that this liability was not contingent but that the tax authority could not compel the taxpayer to pay the assessed tax until the taxpayer's appeal had been finalised. On that basis, it was held that the natural meaning of the word 'payable' as used in the SPA was 'to be paid'. The tax was not 'to be paid' until the matter was settled by the courts.

This is another case highlighting the requirement to ensure that the intended effect of important contractual terms are spelt out in as much detail as possible to avoid future disputes like this.

EIS CGT relief claim dependent on income tax relief claim

The Upper Tribunal (UT) has decided in *Robert Ames v HMRC* that capital gains tax relief on the disposal of EIS shares is not available where income tax relief was not claimed in respect of the original acquisition of those shares.

The claimant had not claimed income tax relief because his taxable income in the year of acquisition of the EIS shares was only £42, and so there was no practical reason to make an income tax relief claim because it was below his personal allowance. However, the UT decided that the EIS legislation provides that claiming CGT relief on a disposal of EIS shares is dependent on the shareholder having first claimed income tax relief in respect of their acquisition of the shares.

The claimant observed that there was no obvious policy reason to deny EIS CGT relief in this situation. Although the UT was unwilling to read the detailed and prescriptive EIS legislation in such a way as to dissociate the claiming of the two reliefs, it accepted that his situation was anomalous and granted judicial review of HMRC's decision not to use its discretion to allow a late claim for EIS income tax relief that would then allow the CGT relief to be claimed.

This is the latest in a line of cases that have decided that the highly detailed and technical EIS rules have not been fully complied with, with resulting loss or clawback of reliefs, and highlights the need for thorough advice when trying to benefit under the EIS (or SEIS) rules.

No minimum investment required under SEIS

The First-tier Tribunal (FTT) has held in *Oxbotica Ltd v HMRC* that there was no requirement for a meaningful investment to be made in order to claim seed enterprise investment scheme relief in respect of an investment. The investment in question was only £316 and formed part of a wider and significant equity investment. HMRC argued that the investment was so small that it couldn't be considered to be used for a qualifying activity by the company and that the rules should be construed as requiring a meaningful investment.

Applying similar logic to that referred to above in the *Ames* case, the FTT stated that the SEIS provisions are "highly prescriptive" and that, since there was no stated minimum amount that is required to be invested to benefit from the relief, there was no requirement for a 'meaningful' level of investment and that it was not possible for them to impute one.

This case shows that HMRC's attempts to use strained purposive construction of statutes against taxpayers will be rejected in circumstances where tightly articulated legislation does not support broad construction that diverges from the words of the legislation.

Release of director's loan treated as employment income

In *Esprit Logistics Management v HMRC*, the FTT has held that the amount of a release of a loan owed by a director to a company in lieu of paying a bonus should be treated as employment income rather than being taxed as a distribution under section 415 ITTOIA 2005.

The FTT took a purposive approach to whether there was a 'release' of the director's loan or whether, in fact, the loan had been satisfied for an amount of equal value, being the bonus that would otherwise have been paid. It decided that, in reality, the debt was repaid and not released and that the amount should, therefore, be treated as earnings.

This case again highlights how consideration in various form given to employees and directors risks being treated as earnings under general principles rather than being subject to no or reduced tax under other provisions claimed to apply to the relevant arrangements.

Loan relationship does not require ability to repay

In *CJ Wildbird Foods Limited v HMRC*, the FTT has held that a loan made to a company by one of its shareholders qualified as a loan relationship (as a 'money debt') notwithstanding that the borrower had never paid any interest on the loan and was unable to pay the interest and/or repay the loan.

The appellant in the case had made a shareholder investment and also advanced a series of loans to a company which operated a website to develop a worldwide community for birdwatchers and people interested in ornithology. The website had not made any profit and had been unable to service the loans. The appellant wrote down the loan in its accounts and claimed a deduction under the loan relationship rules. HMRC argued that there was no loan relationship between the appellant and the borrower company since there was not a 'money debt' and, in essence, the advances had been akin to equity on the basis that there was no prospect that the loans could be repaid.

The FTT rejected this analysis and stated that the loans were loans as a legal matter, that they remained outstanding in the borrower company's accounts and that, notwithstanding that the appellant had written the loans in its accounts, the appellant could still make claims under the loans if the borrower became able to repay them in the future. The loans had, therefore, created a 'money debt' owed by the borrower company to the appellant and were, therefore, loan relationships.

The decision shows the limitations inherent in attempts by HMRC to override the legal nature of relationships between taxpayers and to substitute a different arrangement based on their view of the commercial reality.

European Tax Case

Taxable letting of property constitutes involvement in management for VAT purposes

In *Marle Participation Sarl v Ministre de l'Économie*, the ECJ has held that a holding company was involved in the management of its subsidiary when it let property to it for rent that was subject to VAT, provided the letting was made on a continuing basis and for VATable consideration.

It was then for the relevant Member State court to decide whether the holding company could deduct income tax incurred on fees relating to its acquisition of the subsidiary applying the principles from *Larentia + Minerva* as to whether relevant services were supplied to all or some only of it subsidiaries.

The ability of holding companies to deduct input VAT on fees incurred in acquiring subsidiaries has been the subject of a number of cases and much discussion over recent years. This case provides further clarification that what is required for the holding company to be in a position to reclaim its VAT costs is that it conducts an economic activity in respect of the subsidiaries that it acquires, such as the provision of management services for a fee or, as highlighted in this case, letting property for VATable consideration.

Other UK Tax Developments

New double tax treaties with Jersey, Guernsey and the Isle of Man

The Government has entered into new double tax treaties with Jersey, Guernsey and the Isle of Man (the Other Country) that will come into force once both the UK and the Other Country has completed its parliamentary procedures and exchanged written notes.

The three new treaties are on the same terms and include the following updates to the existing treaties:

- the inclusion of a 'principal purpose test' as required under the BEPS Action Plan on preventing treaty abuse;
- new interest and dividend articles which provide for exemption from withholding tax when received by residents of the relevant country that meet certain prescribed descriptions set out in the treaties; and
- the replacement of the double residence 'tiebreaker' test with a mutual agreement procedure under which the two jurisdictions will have to agree in which country a company is resident having regard to its place of effective management.

While the removal of the residence tiebreaker test is unlikely to have significant practical impact on the application of the double tax treaty between residents of the UK and the Other Country, the inclusion of the interest article and its application to certain specified classes of residents of the Other Country is likely to end any argument that interest received from a UK resident by a resident of the Other Country can benefit from exemption from UK withholding tax under the existing business profits article of the relevant treaty (a position with which HMRC is known to disagree).

HMRC offers 5 year payment period for disguised remuneration loans

Under provisions contained in the Finance Act (No. 2) 2017, loans falling within the scope of the disguised remuneration (DR) rules that are outstanding on 5 April 2019 will become immediately taxable.

On 18 July, HMRC published a policy paper that summarises the rules and guidance for taxpayers on how they should settle their liabilities.

The policy paper notes that taxpayers who are party to DR arrangements should register their involvement in them by 30 September 2018.

The guidance on settlement then states that early settlement of relevant arrangements will avoid the new charge on loans outstanding on 5 April next year and also offers the possibility for taxpayers to spread their tax payments over a number of years.

Taxpayers who would suffer the new outstanding loan charge and want to settle their affairs before next April and who expect taxable income of less than £50,000 in the current tax year can agree to pay the outstanding tax over a period of up to 5 years, provided that they are not engaged in any tax avoidance.

Taxpayers who expect to earn more than £50,000 in the current year or who think that they will need more than 5 years to pay their outstanding tax can engage with HMRC to try to work out a payment plan that is satisfactory to both parties.

In either case, HMRC recommends that taxpayers register their DR arrangements before 30 September, or as soon thereafter as possible, so that the outstanding tax and tax payment arrangement can be finalised before the loan charge arises next April.

Further guidance on the requirement to correct rules

On 11 July, HMRC published revised guidance on the rules in the Finance Act (No. 2) 2017 requiring taxpayers to correct undeclared tax due on offshore assets, income or gains by 30 September this year to avoid potential significant additional penalties on any tax due.

The guidance provides a comprehensive summary of the rules, potential penalties and the taxpayer notification obligation.

The revisions to the guidance cover, in particular:

- clear recommendation that taxpayers planning to correct their offshore non-compliance by giving notice to HMRC and providing the information needed to calculate the tax due should start the process before 30 September to ensure it is completed on time;
- clarification of the limited circumstances in which penalties for failing to correct by 30 September will not be levied where information is provided after that date under the separate Worldwide Disclosure Facility (WDF) or the Contractual Disclosure Facility (CDF); and
- further guidance on the extent to which penalties might be reduced for voluntarily disclosing non-compliance after 30 September 2018. Any reduction will depend on HMRC's view of the level of assistance given by the taxpayer.

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