Proskauer

UK Tax Round Up

April 2020

UK COVID-19 developments

Proskauer Tax Talks blogs

We have published a number of additional COVID-19 related Tax Talks blogs, including:

- the UK Chancellor's measures and further measures to support the British economy, including for the self-employed;
- the impact of COVID-19 on individual and corporate tax residence, including HMRC's updated guidance on the UK statutory residence test to determine individual UK tax residence and the statements published by HMRC and the OECD in relation to corporate tax residence;
- HMRC's interim measures on stamp duty; and
- the postponement of IR35 changes until 6 April 2021.

Please visit our Tax Talks page where we provide regular COVID-19 and other UK and international tax updates.

Temporary changes to the statutory residence test for inbound COVID-19 workers

The UK Chancellor has written to the chair of the Treasury Select Committee outlining temporary changes to the statutory residence test (SRT) for those coming to the UK to work on COVID-19 related activity.

The SRT will be amended so that periods between 1 March and 1 June 2020 spent in the UK by individuals working on COVID-19 related activities will not count towards the residence tests. The Chancellor further wrote:

- that the qualifying criteria will be designed so that the relaxation of the rules is tightly targeted, minimising the risk of abuse;
- that the duration of the measure will be kept under review as the situation develops, in line with the other support already provided; and

- he reaffirmed the Government's commitment to tackling tax avoidance and to ensuring compliance with tax legislation, mentioning the package of measures announced at the most recent Budget to clamp down on aggressive tax avoidance, evasion and non-compliance that will raise an additional £4.7bn between now and 2024-25.

This guidance is in addition to that already published by HMRC on the SRT (as mentioned above) in which HMRC confirmed that days spent in the UK because an individual is (a) quarantined or advised by a health professional or public health guidance to self-isolate in the UK as a result of the virus, (b) advised by official government advice not to travel from the UK as a result of the virus, (c) unable to leave the UK because of international borders closing, or (d) asked by their employer to return to the UK temporarily because of the virus will amount to days spent in the UK in "exceptional circumstances".

Deferral of VAT payments

HMRC has provided further guidance on the deferral of VAT payments due to COVID-19. UK VAT registered businesses with VAT payments due between 20 March 2020 and 30 June 2020 have the option of deferring payment to a date on or before 31 March 2021. This measure, first announced by the UK Chancellor on 20 March 2020 (and reported by us), is to help businesses manage their cash flow in these extraordinary times. There is no requirement to tell HMRC of any such deferral. The deferral will include "payments on account" (advance payments towards a business's VAT bill). HMRC has confirmed that it will not charge interest or penalties on amounts deferred.

HMRC publishes insolvency guidance

As individuals and businesses face the financial strain wrought by COVID-19, HMRC has published additional guidance (HMRC Insolvency Guidance) specifically for companies or individuals that are already in insolvency processes.

The guidance is for parties involved in ongoing company or individual voluntary arrangements where contributions cannot be made or post arrangement tax obligations cannot be met because of COVID-19. HMRC states that where the terms of any such voluntary arrangement allows the insolvency practitioner discretion (for example, with regard to collecting payments, distributing dividends or determining whether any conditions precedent are fulfilled), that discretion should be exercised to its maximum. Reference to creditors should only be made where essential. HMRC will support a minimum three month deferral of contributions ordinarily payable under the voluntary arrangement from customers impacted by COVID-19. There is no need to contact HMRC to request such deferment. HMRC also confirmed that where a debtor company is entitled to a deferral of tax under another of the government's COVID-19 business support schemes, such deferment will not amount to a breach of a voluntary arrangement (however, this will not cover a serious non-payment of VAT predating the pandemic).

In respect of its enforcement activity, HMRC has confirmed that it has paused the majority of its insolvency activity until 1 July 2020 meaning that it will only petition for bankruptcy and winding up orders if deemed essential (such as in cases of fraud and criminal activity). It also confirmed that it will continue to consider fresh company voluntary arrangements, administrations, individual voluntary arrangements and trust deed proposals to continue to support businesses in financial need.

HMRC has said that it will review the position and publish further guidance following this initial three month period.

Law Society asks HMRC to consider deferring DAC 6 reporting

The Law Society of England and Wales has asked HMRC to consider deferring the commencement of the DAC 6 cross-border transaction reporting regime. The Law Society considers there to be a strong case for deferral in light of COVID-19 and "the burden [DAC 6 will] place on both private and public sectors, including law firms". It is understood that similar concerns have been raised in other EU member states. HMRC is "carefully considering the representations". The UK's International Tax Enforcement (Disclosable Arrangements) Regulations 2020 implementing DAC 6 into UK law are to come into force on 1 July 2020 with the first report covering relevant transactions since 25 June 2018 to be submitted by 31 August 2020.

It isn’t clear whether the request is for a delay in the introduction of the rules or of the date for the first report, although in practical terms these might amount to the same thing.

Given that the rules will, whenever they are introduced, require reporting of relevant transactions entered into from 25 June 2018, affected people should continue to keep appropriate records of transactions that are being entered into irrespective of the first reporting date.

UK case law developments

When is a VAT invoice required?

In *Zipvit v HMRC*, the Supreme Court (SC) has determined that the requirement for a VAT invoice and the meaning of “due or paid” under the Principal VAT Directive 2006/112/EC (VAT Directive) were not clear in the relevant circumstances and, accordingly, referred a number of questions to the European Court of Justice (ECJ).

As we reported in our July 2018 UK Tax Round-Up, the Court of Appeal (CA) in this case determined that the recipient of a supply (here Zipvit) could not recover input VAT where those supplies (here postal services provided by Royal Mail) were originally considered by the parties (and HMRC) to be VAT exempt but were actually, as determined in a subsequent ECJ case, standard rated. The circumstances were such that the Royal Mail was very unlikely to be able to recover any VAT due from Zipvit and HMRC was equally unlikely to be able to recover such VAT from the Royal Mail. The relevant contract between Zipvit and the Royal Mail stated that the consideration for the postal services was exclusive of any VAT and that any VAT would be paid in addition.

Zipvit's claim for input VAT recovery was based on an argument that the consideration paid by it for the services should be treated as including VAT because VAT was, as a matter of fact, due on the consideration. This was rejected by the CA on the basis that, although it was not clear whether the consideration should be treated as including VAT, as a practical matter no VAT invoices were issued for the supply and so no input VAT was recoverable. This reflected the general requirement of both EU and UK law that a taxpayer must have a valid VAT invoice in order to make a claim for input VAT recovery.

As expected, Zipvit appealed the CA's decision to the SC. The SC has concluded that the VAT Directive was insufficiently clear for it to provide a decision and, accordingly, has referred several questions to the ECJ, including:

- Where a supply is treated as VAT exempt but (a) the consideration was stated as being VAT exclusive (with any VAT being payable by the recipient in addition), (b) the supplier did not charge VAT and (c) the relevant tax authority does not claim this VAT from the supplier and is now time-barred from doing so, under the VAT Directive should the consideration paid be treated as including applicable VAT?
- Alternatively, if input VAT can be recovered when VAT is "due" (even if not "paid") can a taxpayer claim a deduction of input tax as VAT "due" within the meaning of the VAT Directive?
- In the absence of a VAT invoice, can a claim for an input tax deduction still be made in accordance with the VAT Directive if alternative evidence of VAT being paid or due can be provided?

Given that the result of this case will impact other cases between HMRC and taxpayers, with amounts of about £1 billion of VAT at stake, clarification from the ECJ is important.

Fixed annual contract not a prompt payment discount to a monthly contract for VAT purposes

The recent Upper Tribunal (UT) case of *Virgin Media v HMRC* is a helpful example of taxpayers being unable to divorce the VAT treatment of an arrangement from its commercial reality.

Prior to 2014, UK VAT legislation provided that any discount offered to a customer for prompt payment of fees reduced the consideration for the purposes of calculating VAT, whether or not the conditions for the prompt payment discount were in fact satisfied.

In *Virgin Media v HMRC*, Virgin offered customers the choice between (a) 12 month fixed line rental for a single annual advance payment of £120 and (b) a monthly fixed line rental for £13.50 a month. Virgin argued that the lower overall cost of the annual contract in (a) was effectively a prompt payment discount compared to the monthly contract in (b) such that the consideration for VAT purposes in respect of the monthly payments should be reduced to £10.

Unsurprisingly, on the basis that the annual and monthly contracts were separate options and were not on the same terms (for example, the monthly contract could be terminated with 30 days' notice whereas the annual contract could not be terminated and Virgin could vary the cost of the monthly contract with 30 days' notice) the UT rejected Virgin's position that the annual contract was a prompt payment discount. It was held that there were two entirely separate contracts and, accordingly, two separate supplies for VAT purposes each subject to VAT on their own terms.

Ramsay principle applied to capital allowances claim

In *Cape Industrial Services v HMRC*, the First-tier Tribunal (FTT) applied the anti-avoidance principle from the *Ramsay* line of cases in rejecting Cape's claim for capital allowances on an amount in excess of the expenditure actually incurred by it.

The *Ramsay* principle is an anti-avoidance doctrine that has evolved through case law and, in essence, is that one should, in appropriate circumstances, look at the effect of a composite transaction as a whole and not each transaction step in isolation and consider that overall effect in light of the purpose of the relevant legislation when determining the tax consequences of the transaction.

In this case, Cape sought to make use of a leasing scheme which, if it had worked as intended, would have permitted Cape to claim capital allowances twice for a single item of expenditure. Under the transaction, Cape sold certain plant and machinery in respect of which it had already claimed capital allowances to a third party which the third party immediately leased back to Cape subject to a put option requiring Cape to repurchase the assets in four weeks' time. For the scheme to work as intended the plant and machinery had to be disposed of to the third party for the purposes of the capital allowance rules. The FTT accepted that on the scheme would have operated as intended applying a literal reading of the relevant legislation to each step of the overall transaction (although specific anti-avoidance legislation has been added which would now prevent this).

Notwithstanding this, the FTT, applying the *Ramsay* principle, held that Cape had made no real disposal of the assets and was, therefore, not entitled to claim capital allowances on the option price. The FTT held that the transactions were designed to operate as a composite whole. It considered that it was commercially inevitable that the put option would be exercised and that Cape would reacquire the assets, particularly given Cape never stopped using the assets in the interim under the lease arrangement. Applying the *Ramsay* principle, the FTT held that it couldn't be said that Cape had ever disposed of the relevant assets in the sense meant by the relevant capital allowance rules.

This case is of interest for two reasons. Firstly, in reminding taxpayers that relying on an overly technical approach to tax rules is always susceptible to this composite, purposive approach by the courts. Secondly, the FTT provides an extended discussion of the *Ramsay* principle and its application.

Court of Appeal considers the meaning of "fairly represent" under the derivative contracts rules

In *Union Castle v HMRC*, the CA has clarified that the term “fairly represent” used in determining which credits and debits should be brought into account in determining a company’s profits and losses for tax purposes under the derivative contracts rules operates as an effective override to the simple credits and debits that the company might reflect in its accounts applying applicable accounting standards. This is a question which has been considered in a number of cases over recent years, but this decision gives the clearest conclusion that the “fairly represent” has a wide application. As stated in the decision, this is equally applicable to the loan relationship rules as to the derivative contract rules.

Union Castle was appealing against a decision of the UT (reported in our October 2018 Tax Round Up) in which the UT had determined that no deduction was available because the relevant loss had not arisen from the derivatives themselves. Union Castle had wanted to novate some derivative contracts to its investment trust parent company. This would, however, have triggered a tax charge in Union Castle. Rather than incurring the tax charge, Union Castle issued bonus shares to its parent which carried a right to receive a dividend equal to 95% of the economic benefit of the derivative contracts. As a result, Union Castle derecognised the contracts and reflected a debit in its accounts. It claimed a tax deduction the accounting debit. HMRC had denied the deduction and the FTT and UT had found in favour of HMRC in that denial.

Rejecting Union Castle’s appeal, and finding in favour of HMRC, the CA held that the loss did not “fairly represent” a loss arising from the derivative contracts since Union Castle had not suffered any loss. Rather, it retained all of its rights under the contracts and had simply agreed to distribute the relevant amount of its profits to its parent. The CA considered the previous recent cases on the equivalent “fairly represent” wording in the loan relationship rules and gave it an even broader reading affirming that the “fairly represents” requirement was a separate and overriding condition to an accounting debit giving rise to a tax loss. The CA stated that "fairly represent" test requires an examination of the totality of the relevant transaction in its factual context. Richards LJ concluded that the debit required under GAAP to be made in Union Castle’s accounts by the derecognition did not, as a matter of legal analysis or economic reality, fairly represent a loss to Union Castle under the rules. Union Castle had lost no asset nor incurred any liability other than a liability to pay a dividend on shares, and that was an agreement to distribute its profit and not any amount that reduced its profits.

Other UK tax developments

HMRC publishes further guidance on new digital services tax

HMRC has published additional guidance on the new digital services tax (DST) which is due to come into force under the Finance Act 2020 effective from 1 April this year, including:

- a summary of the DST registration requirements and the process for registration;
- details of how to pay DST; and
- how to submit a DST return.

As reported last month in our Finance Bill 2020 summary**,** 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 DST will apply to revenue earned from 1 April 2020.

The Finance Bill had its second reading on 27 April 2020. Affected businesses have made representations to the Government to delay the introduction of the rules as a result of the current COVID-19 crisis.

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