Proskauer

UK Tax Round Up

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UK Case Law Developments

Tax avoidance motive did not prevent availability of share for share exchange treatment

In *Euromoney Institutional Investor plc v HMRC*, the FTT held that the share for share exchange treatment in section 135 TCGA 1992 applied despite the presence of a tax avoidance purpose.

Euromoney sold its shares in a subsidiary company to a third party buyer. The consideration was originally intended to be satisfied by ordinary shares and cash. However, upon the advice of the company's tax director, the cash portion of the consideration was substituted for preference shares so as to allow the transaction to benefit from share for share exchange treatment under section 135 TCGA 1992 (and thus prevent an immediate tax charge). Following a 12 month ownership period, the preference shares could then be redeemed with the benefit of the substantial shareholding exemption (SSE) applying to the redemption given the holding of the ordinary shares so that the disposal of the preference shares would be exempt from corporation tax on chargeable gains.

HMRC denied relief under section 135 TCGA 1992 on the basis that the transaction formed part of a scheme or arrangement of which the main purpose, or one of the main purposes, was the avoidance of liability to tax. The taxpayer appealed.

The FTT rejected HMRC's arguments that the relief should be denied, stating that the arrangements in question were the entire disposal and exchange and not just the substitution of the portion of consideration payable as cash for preference shares. The FTT stated that it did not reflect reality to split the aspects of the exchange in the way that HMRC argued. The FTT further concluded that, although there was a purpose of avoidance of a tax liability in switching the cash for the preference shares, this was not the main purpose, or one of the main purposes, of the transaction (despite the FTT describing it as "more than trivial"). It considered that Euromoney would have proceeded with the transaction with the portion of cash consideration if necessary and did not seek clearance in respect of share for share exchange treatment in advance on the basis it would not affect whether they completed the deal. The FTT further stated that the whole transaction was of a commercial nature and the tax advantage gained through use of the preference shares was just a bonus.

Although the tax advantage in question was relatively small (less than 5% of the consideration) and the taxpayer's actions supported the assertion that tax was not a key driver in the transaction, the FTT's decision still highlights that HMRC cannot expect to always succeed in cases where there is a tax avoidance purpose in any form or related to any individual part of a wider transaction.

Sale and leaseback did not trigger a VAT self-supply charge

In *Balhousie Holdings Ltd v HMRC*, the Supreme Court (SC) allowed the taxpayer's appeal stating that a sale and leaseback arrangement did not create a VAT self-supply charge as the taxpayer had not disposed of its entire interest in the property.

The taxpayer had acquired a recently constructed care home under a VAT zero-rated first grant from the developer. The acquisition was financed by a sale and leaseback of the building with a finance house. The question at issue between the parties was whether the sale and leaseback constituted a disposal of the taxpayer's entire interest in the property and, as such, resulted in a VAT self-supply charge as a clawback of the benefit of the initial zero-rated first grant from the developer (under paragraph 36(2) Schedule 10 VATA 1994).

The taxpayer succeeded in the FTT, which held that there was no period of time in the course of the sale and leaseback transaction during which the taxpayer did not have an interest in the property. However, HMRC had succeeded in the UT and the Inner House of the Court of Session arguing that the sale alone, irrespective of the leaseback, constituted an entire disposal of the exact interest in the property which the taxpayer had acquired via the zero-rated first grant from the developer. This was on the basis that the VAT self-supply charge under paragraph 36 was triggered regardless of anything which happens at the same time as the sale (or, in fact, in between the initial grant and the sale).

The SC, disagreeing with both the UT and Court of Session, held that there was no period of time during which the taxpayer did not have a major interest in the property as the sale and leaseback occurred simultaneously and that a disposal of ownership (such as under the sale) would not always be sufficient on its own to amount to a disposal of the entire interest. The SC stated that HMRC's argument that the sale of the specific interest acquired by way of the zero-rated first grant triggered the clawback regardless of any other interest which might be held did not make practical sense as such disposal would not necessarily mean that the entire interest had been disposed of (as it considered in this case).

It is worth noting that the application of EU law to the VAT provisions in this case drew differing views from the SC. Lord Briggs, giving the leading judgement, considered that whether the sale and leaseback were separate supplies or one composite supply for VAT purposes was irrelevant to the question of whether the entire interest had been disposed of (and so the principles of EU law on this point were of little assistance). Conversely, Lady Arden considered that the question was relevant as the conditions for VAT zero-rated supplies must comply with EU law. However, Lady Arden agreed that the appeal should be allowed as she concluded that the sale and leaseback was one composite supply and so the entire interest had not been disposed of.

This case highlights the SC's use of a purposive interpretation of the legislation as the purpose of the self-supply clawback was to prevent a person receiving the benefit of zero-rating where they are not committed to keeping an interest in the property for a significant period of time after its construction.

No substantial shareholding exemption available as the subsidiary company not deemed to have been held for 12 month period

In *M Group Holdings Ltd v HMRC*, the FTT held that the taxpayer was not entitled to substantial shareholding exemption (SSE) relief on the sale of its subsidiary as the subsidiary had been incorporated less than 12 months before the sale.

The taxpayer, which at the time operated as a stand-alone trading company (and so was not a member of a group of companies), had incorporated a subsidiary and transferred its trade and assets to the subsidiary on its formation. Less than 12 months after this transfer and the subsidiary's incorporation, the taxpayer sold its shares in the subsidiary to a third party buyer and claimed SSE on the sale on the basis that paragraph 15A Schedule 7AC TCGA 1992 applied to extend the taxpayer's ownership of the subsidiary. HMRC disallowed the claim for SSE and the taxpayer appealed to the FTT.

The parties agreed that all the conditions for SSE relief were satisfied except the requirement that the taxpayer had held the shares in the subsidiary for a period of 12 months in the period beginning not more than two years before the day of the disposal. The parties agreed that in isolation the 12 month holding period requirement was not satisfied (as there was a period of only ten months and 28 days between the subsidiary's incorporation and its sale by the taxpayer). However, the taxpayer argued that the deeming provision contained in paragraph 15A Schedule 7AC TCGA 1992 applied to extend the holding period to the required 12 months as the assets in question were only required to have been used by a member of the current group during the 12 month period and not that the group itself must have been in existence for the full 12 month period. Conversely HMRC argued that, as the taxpayer was not a member of a group prior to the incorporation of the subsidiary, the deeming provision did not extend the ownership of the holding period. Paragraph 15A states that a company disposed of can be treated as having carried on any trade transferred to it by a member of the same group where "the asset was previously used by a member of the group … for the purposes of a trade carried on by that member at a time when it was such a member".

The FTT, agreeing with HMRC, stated that the ordinary meaning of the legislation was to extend the holding period in respect of assets used by a member of a group and not a stand-alone company and that the words “when it was such a member” were clear in that regard. Despite this conclusion, the FTT agreed with the taxpayer that its conclusion did result in a seemingly arbitrary distinction of when SSE relief was available depending on whether a subsidiary had been set up (in this case) or, for example, an existing dormant subsidiary was used in its place. The FTT did not, however, consider that it was able to construe the legislation in any way to allow the taxpayer’s appeal given the specific wording and that the odd result was not sufficient for it to otherwise alter the language in question.

This case highlights the nuances of certain pieces of tax legislation and their effect on practical corporate transactions. It is worth noting the FTT’s awareness of the limited scenarios where the courts could seek to alter the language of the legislation and consequently its meaning and it did not consider the current case justified such action. In this case, it was reasonably clear that the plain meaning of the provision in question did not meet the circumstances of the transaction and it would be interesting to know what the FTT would have concluded had paragraph 15A not included the words “at a time when it was such a member”.

Other UK Tax Developments

Finance Bill 2021 progress update

Finance Bill 2021 (FB 2021) continues its progress through Parliament to Royal Assent with the second reading in the House of Commons taking place on 13 April 2021, followed by the start of the Public Bill Committee stage on 19 April 2021.

The government has tabled three sets of amendments to FB 2021, to be considered as part of the Public Bill Committee stage, relating to the temporary extension of carry-back of trade losses, the new defined contribution pension schemes framework and VAT late payment and repayment interest.

The Public Bill Committee stage is currently scheduled to conclude on 6 May 2021.

HMRC publishes cryptoassets manual

On 30 March 2021, HMRC published its cryptoassets manual.

The manual replaces the previous “Cryptoassets: tax for individuals” and “Cryptoassets: tax for businesses” guidance (see our December 2019 UK Tax Round Up).

While the new manual does not signal a change in approach by HMRC to the taxation of cryptoassets, it does offer expanded guidance on some topics (e.g. record keeping) and includes a number of new sections, in particular on compliance, which both taxpayers and advisers working in the cryptoassets sector will welcome.

Order made applying late payment and repayment interest to NICs debts under extended off-payroll working regime

On 31 March 2021, the Finance Act 2009, Sections 101 and 102 (Social Security Contributions, Intermediaries) (Appointed Day) Order 2021 (SI 2021/445) (Order) was made which appoints 6 April 2021 as the day from which the interest regime contained in section 101 (late payment interest) and section 102 (repayment interest) of Finance Act 2009 applies in respect of national insurance contribution (NIC) debts payable under Part 3AA of Schedule 4 to the Social Security Contributions Regulations 2001 (SI 2001/1004). This change relates to the extended off-payroll working regime (commonly referred to as IR35), effective from 6 April 2021.

Other Developments

OECD Secretary General publishes tax report

The Secretary General of the Organisation for Economic Co-operation and Development (OECD) has published an updated tax report on the latest developments in the OECD’s international tax agenda and the Global Forum on Transparency and Exchange of Information for Tax Purposes since February 2021.

In particular, the report includes the following updates:

- The G20 finance ministers unanimously agreed to continue working towards reaching an agreement by mid-2021 in respect of the two pillar approach to the taxation of the digital economy.
- Continued work on developing a new tax reporting framework for cryptoassets.
- Information on the progress in respect of BEPS Action 5 (standard for the exchange of information on tax rulings), Action 6 (minimum standard on treaty shopping), Action 13 (country by country reporting) and Action 14 stage 1 (mutual agreement procedures peer review reports).

- Measures introduced by individual countries in response to the Covid-19 pandemic.

OECD announces consultation on amendments to Article 9 of Model Tax Convention commentary

On 29 March 2021, the OECD announced a consultation and invited comments on a discussion draft of proposed changes to the commentary on Article 9 and related articles of its Model Tax Convention on Income and Capital.

Article 9 of the Convention deals with transactions between associated companies and provides for adjustments in the taxable profits of an entity where these profits are different to those which would have arisen on an arm's length basis. The changes are intended to clarify the application of Article 9, in particular given that it impacts domestic law on interest deductibility.

The proposed changes include:

- Deleting references to domestic thin capitalisation rules and inserting commentary concerning the need to consider whether an interest payment can be regarded as an arm's length amount and whether a loan should be regarded as a contribution to equity capital, referring to both domestic law and the OECD Transfer Pricing Guidelines.
- Clarifying that once profits have been allocated between two entities in accordance with the arm's length principle, the taxation of these profits (including the deductibility of expenses) are matters for domestic law (i.e. the corporate interest restriction in the UK).
- Explaining that a profit adjustment by one jurisdiction only requires a corresponding adjustment by the other jurisdiction to the extent that the other jurisdiction considers it necessary to reflect profits calculated on an arm's length basis.

Further, consequential changes to other articles are also included. Responses are invited until 28 May 2021 with the changes expected to be included in the next update of the Convention.

US announces next steps in its investigation into international digital services tax regimes

The Office of the United States Trade Representative (USTR) has published details of the next steps in its investigation into the digital services tax (DST) regimes of certain of its trading partners.

Following its conclusion in January 2021 that the UK's DST regime was discriminatory against US digital companies (alongside a number of other jurisdictions' regimes, including India, Spain and Italy), the USTR has announced the commencement of the public notice and comment stage in respect of possible trade actions against such countries. In doing so, the USTR made clear its intention to work with the global community on international tax issues but did not rule out the imposition of tariffs if necessary. The USTR noted that four trading partners (the EU, Brazil, the Czech Republic and Indonesia) had not, as yet, implemented a DST regime and so the USTR was terminating its investigations into these jurisdictions although it stated that it may re-open investigations if such regimes are adopted in the future.

The possibility of tariffs (up to 25%) imposed on the UK is highlighted in the USTR's report on the UK as part of its investigation process. Although the review is ongoing and there is no firm indication that the imposition of tariffs will occur, the UK will keep a close eye on the USTR's process on this issue given the possible economic impact on trade between the UK and the US.

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