Slaughter and May Podcast
Tax News Highlights: May 2022

Zoe Andrews	Welcome to the May 2022 edition of our tax news highlights podcast. I am Zoe Andrews, PSL Counsel & Head of Tax Knowledge.
Tanja Velling	And I am Tanja Velling, Senior Professional Support Lawyer in the Tax department. In this podcast, we will cover five recent cases: the First-Tier Tribunal decisions in *Sally Judges*, *Alexander Beard*, *JTI* and *Hexagon Properties*, and the Supreme Court decision in *NCL Investments*. We will also discuss the summary of responses to the re-domiciliation consultation and the European Commission's consultation on a "new EU system to avoid double taxation". This podcast was recorded on the 10th of May 2022 and reflects the law and guidance on that date. Shall we start with the cases today?
Zoe Andrews	The *Sally Judges* case illustrates the complexity of personal tax computations involving life insurance chargeable events gains and the calculation of "top-slicing relief". So you will be relieved to discover that we do not wish to go into the detail of such calculations here. In essence, the legislation sets out, quite clearly according to the FTT, the steps to be taken to work through the calculation, but HMRC had a different view from the taxpayer of the ordering of reliefs and how the personal allowance fitted in. HMRC's view had already been proved wrong in the 2019 FTT decision in *Silver* and subsequently the legislation was amended to reflect HMRC's view with effect from the 11th of March 2020. Although HMRC had initially appealed the *Silver* case, it withdrew the appeal before the Upper Tribunal heard it. The taxpayer completed the tax return and self-assessment online in 2019, using the HMRC self-assessment calculator. As the calculator was based on HMRC's (incorrect) method, it resulted in less top-slicing relief and more tax being due. So the taxpayer used the white space disclosure to challenge the calculation method and claim the relief the taxpayer was entitled to under the legislation.
Tanja Velling	The FTT concluded that the legislation, prior to the amendment with effect from the 11th of March 2020, had the effect that the taxpayer argued for. HMRC did not succeed in arguing that the later legislation (and related explanatory notes and Hansard) confirmed its interpretation of the earlier legislation. The effect of HMRC's submission was essentially that the

	amendments were clarificatory and the FTT should interpret the pre-amendment legislation as if the amendments had retrospective effect. Although the FTT reached the right result, paragraph 49 of the judgment may be a cause for concern as it suggests that, if the pre-amendment legislation was sufficiently ambiguous to require clarification and the purpose of the later amendments was to provide such clarification, HMRC might have succeeded. This does not seem right as it would give HMRC the ability to change the interpretation of legislation retrospectively. The task of the FTT is to interpret the legislation as it was drafted at the relevant time (pre-amendment) taking into account the purpose of the legislation and the historic background to the legislation. Subsequent amendments should not affect the interpretation of the earlier legislation, regardless of whether the earlier legislation was ambiguous, or whether the amendments were stated to be merely clarificatory.
Zoe Andrews	*Alexander Beard* revisits ground that should be familiar from the Court of Appeal's decision in *First Nationwide* back in 2012. In that case, HMRC had sought to argue – in the context of a structured finance transaction which relied on the income nature of the payment to work - that a dividend exclusively paid out of share premium should be treated as a capital rather than an income receipt. The Court of Appeal rejected that argument and confirmed that the character of the distribution is determined by the mechanism through which it is effected.
Tanja Velling	In *Alexander Beard*, it was the taxpayer who sought to argue that distributions made by the Jersey incorporated, Swiss tax resident and London-listed company Glencore out of share premium were either not dividends or dividends of a capital nature and should therefore be subject to capital gains tax rather than income tax. The FTT, however, rejected both arguments. Essentially, both, whether something is a dividend and whether that dividend is of an income or capital nature must be determined by reference to the mechanics by which it is paid rather than by reference to the account from which it is sourced. In this case, the payment mechanics chosen under Jersey law meant that the payments were equivalent to English law dividends and such dividends were of an income nature. This result is somewhat unsurprising and accords with the Court of Appeal's decision in *First Nationwide*. As a practical point for English companies, the case highlights the importance of being clear about payment mechanisms. The tax treatment of a repayment of capital and a distribution from distributable reserves created through a reduction of capital will be different.
Zoe Andrews	Now for a case on deductibility of interest. Interest on borrowing in the UK to finance foreign subsidiaries is deductible in the same way as interest on

	borrowing to finance activities in the UK, subject to the “unallowable purpose” rule. Borrowing by a UK company to finance a corporate acquisition is not an unallowable purpose, is it Tanja?
Tanja Velling	You might have thought that, but the FTT disagreed in the recent case of *JTI*. A US group intended to acquire a US company and a 9-step funding structure was put in place which used a UK acquisition vehicle, JTI. Debt was pushed down from the US to JTI. The structure resulted in around £40 million of non-trade loan relationship debits being claimed as group relief for UK subsidiaries. Approximately £9 million of corporation tax was at stake.
Zoe Andrews	The FTT concluded that there was a tax advantage because the debits surrendered as group relief put the UK companies in a better position by reducing their tax liabilities. The FTT also concluded that the purpose of the loan notes issued by JTI was to generate loan relationship debits for surrender to other UK group companies. This was found to be a tax avoidance purpose and an unallowable purpose. In fact, the FTT determined that tax avoidance was ***the*** main purpose and, because no other purpose was found, all the debits would be attributable to this purpose and disallowed. The facts did not present well for the taxpayer in this case, did they?
Tanja Velling	That’s right. All unallowable purpose cases are fact-specific and it is hoped that this case can be distinguished on its facts. The FTT did not find the taxpayer’s witness evidence credible and highlighted a lack of genuine commerciality in the structure. John Gardiner QC had argued that the loan notes were issued as part of structuring a company’s legitimate activities referring to the Hansard debate on the unallowable purpose rule, but the FTT rejected this. In 1996, when the unallowable purpose rule was first introduced, a Ministerial Statement was given and provided some reassurance. Remind me what it says?
Zoe Andrews	Reassurance was given in the Ministerial Statement in 1996 that financing to acquire shares in companies, whether in the UK or overseas, would not be affected by the unallowable purpose rule, but that it might bite, if the financing was structured in an artificial way. To quote from the Ministerial Statement: “It has been suggested that structuring a company’s legitimate activities to attract a tax relief could bring financing within this paragraph - some have gone so far as to suggest that the paragraph might deny any tax deduction for borrowing costs. These suggestions are clearly a nonsense. A large part of what the new rules are about is ensuring that companies get tax relief for the cost of their borrowing.”

	It goes on to say: "Provided that companies are funding commercial activities or investments in a commercial way, they should have nothing to fear. If they opt for artificial, tax-driven arrangements, they may find themselves caught." The FTT considered the scheme used in this case exactly the kind of "artificial, tax-driven arrangements" within this caveat in the Ministerial Statement. How does this fit in with the FTT decision in *BlackRock*, another unallowable purpose case involving a debt pushdown from the US to the UK?
Tanja Velling	In both cases, debt was pushed down to the UK as part of the financing structure for the acquisition of a US company from a third party. But in *JTI*, the UK borrower itself made the acquisition whereas, in *BlackRoc*k, the UK borrower invested, for various tax and non-tax reasons, in a US subsidiary which then made the acquisition. As compared to the indirect acquisition in *BlackRock*, one might have thought that a direct third party acquisition as in *JTI* would be more likely to constitute an allowable, commercial purpose. Yet, in *BlackRock*, the unallowable purpose rule did not apply to deny any deductions whereas, in *JTI*, it did. From a policy perspective this seems odd. The Upper Tribunal hearing in *BlackRock* took place in February. So it will be interesting to see what that decision is in due course. There is also the *Kwik-Fit* case on unallowable purpose which the Upper Tribunal is scheduled to hear in September. So watch this space for further developments – which will hopefully bring some clarity into what are now somewhat murky grounds.
Zoe Andrews	*Hexagon Properties* is another loan relationships case. The taxpayer had taken out certain loans and purchased an interest rate hedging product. It later brought a claim against the bank for the mis-selling of that hedging product. This claim was settled, with the bank effectively waiving around £3.5 million of the approximately £5 million it was then owed by the taxpayer. The taxpayer and HMRC disagreed as to the tax treatment of this release from liability, and the FTT's decision addresses as a preliminary issue whether or not the amount of £3.5 million is taxable in its entirety under the loan relationships regime. HMRC argued that the amount was so taxable on the basis that it was a profit that arose from a transaction related to a pre-existing debt which was clearly a loan relationship. The FTT agreed with HMRC that the release was a related transaction; it was irrelevant that the release constituted in economic terms the settlement by the bank of its liability to pay damages.

Tanja Velling	The FTT then, however, parted company with HMRC: “Any objective consideration of what the £3.5 million arose from in this case would conclude that it arose “from” the Appellant’s claim in damages against its bank and not “from” any related transaction of its loan relationships.” Hence, the amount was not taxable under the loan relationships regime.
Zoe Andrews	And now for a case where HMRC was granted leave to appeal to the Supreme Court even though it had lost each previous appeal stage and then lost before the Supreme Court too.
Tanja Velling	Yes – the Supreme Court unanimously dismissed HMRC’s appeal in the *NCL Investments* case, deciding that NCL is entitled to a deduction as a trading expense in respect of its accounting debits recognised on the grant of share options to its employees by an employee benefit trust (or EBT). NCL employs staff and, in return for a fee, makes those staff available to other companies in the group. Whenever the EBT Trustee granted employees of NCL an option to acquire shares in NCL’s parent, NCL agreed to pay the parent an amount equal to the fair value of the options granted to its employees. This cost was then passed on to other group companies by including it in the fee charged by NCL. Under IFRS2, any grant of share options by the EBT Trustee to employees triggered an obligation on NCL to recognise an expense in its income statement equal to the fair value of the options that the EBT Trustee had granted. IFRS2 also required the expense in the P&L to be matched by a balance sheet entry which was shown as a capital contribution from NCL’s parent. No amounts were then recognised in NCL’s accounts in respect of the recharge payments. The vast majority of the options lapsed unexercised, which really annoyed HMRC as they thought companies should only be able to get a deduction for the cost of providing shares on the exercise of the options. HMRC argued on four grounds that the debits required by IFRS2 are not allowable as deductions for corporation tax purposes. Three of the grounds are relevant to disputes about deductibility generally, but the fourth ground was specific to deductibility of employee benefit contributions prior to the change made in the Finance Act 2013 which removed the possibility of claiming a deduction for the IFRS2 debit from the 20th of March 2013 onwards. This decision is of relevance to taxpayers with claims for 2013 and before who are sitting behind this case, but also highlights more general trading tax principles. So let’s have a look at HMRC’s four grounds of appeal taking the general trading tax principles first.

Zoe Andrews	The first ground argued by HMRC was that disregarding the debits is an "adjustment required or authorised by law" within section 46(1) of the Corporation Tax Act 2009. The Supreme Court held that HMRC had failed to show any convincing case law or statutory authority for such adjustments. The second ground was based on the wholly and exclusively test. The FTT had found as a fact that the purpose requirement of section 54(1)(a) CTA 2009 was satisfied because the debits were required by IFRS2 to reflect the consumption by NCL of the services provided by the employees, who were in part remunerated by the grant of the options. NCL consumed those services wholly and exclusively for the purposes of its trade, being the provision of its employees' services to other group companies at a profit. The third ground was that the items were capital in nature and so disallowed by section 53 CTA 2009, but the Supreme Court held that they were revenue for the reasons given by the FTT. The fact that the matching credit entry was a capital contribution does not change the character of the debits; these were revenue in nature, not capital. The fourth ground is specific to deductibility of employee benefit contributions and is relevant to the other cases with pre-FA 2013 deductions claims stood behind this case. The Supreme Court dismissed HMRC's argument based on section 1290 CTA 2009 and held that this provision, as it was drafted at the time, did not apply to deny or defer allowance of the debits.
Tanja Velling	During the November 2021 edition of this podcast, we mentioned that the UK Government was looking to introduce a corporate re-domiciliation regime which would allow non-UK incorporated companies to change their jurisdiction of incorporation to the UK – and potentially vice versa – while retaining their existing legal identity. An initial consultation on this proposal had been published alongside the Autumn Budget. Last month, the summary of responses – around a quarter of which came from business representative organisations and trade industry groups – was published. The government still intends to introduce a re-domiciliation regime (although a lot more work is needed to flesh out the details). Respondents were largely supportive of this. Somewhat unsurprisingly, they did, however, note that the existence of such a regime would not, in and of itself, be sufficient to encourage companies to move to (or out of) the UK.
Zoe Andrews	One key theme in the responses was equality of treatment between companies originally incorporated in the UK and companies that re-domiciled to the UK. In respect of stamp taxes, for example, respondents thought the best solution would be for a re-domiciled company's shares to be subject to UK stamp duty and SDRT in the same manner as the shares

	of UK incorporated companies (although it was also noted that this might make the UK less attractive as a re-domiciliation destination). Most respondents seemed to consider that re-domiciled companies should be treated as tax resident in the destination country, unless the central management and control test or an applicable double tax treaty gave a different result. It was suggested that, on an inward re-domiciliation, capital gains and intangible assets should enter the UK tax net at market value, with an exit charge on outward re-domiciliation; further thought would have to be given to capital allowances assets. The government was also encouraged to consider how the tax treatment on re-domiciliation would fit with regimes such as that for qualifying asset holding companies. Respondents mentioned that certain anti-avoidance measures may be needed, such as a time-based charge on outward re-domiciliation to prevent stamp duty avoidance. Some also noted “that an economic substance test could prevent tax and other financial abuse” even though 79% of respondents agreed that such a test was unnecessary.
Tanja Velling	Respondents also noted that thought should be given to the potential impact on individuals who are resident, but not domiciled, in the UK because, post-re-domiciliation, the remittance basis would become unavailable in respect of gains realised on a disposal of shares in the company and in respect of distributions (assuming that these would become UK source). The introduction of specific rules and exemptions was suggested as a solution. Given recent news coverage around non-dom status, this could, however, turn out to be a rather thorny issue. And, if the remittance basis rules were abolished, as some have called for, it would become a moot point in any event.
Zoe Andrews	In its “Action plan for fair and simple taxation supporting the recovery strategy” which was published back in July 2020, the European Commission promised to “propose a legislative initiative for introducing a common, standardised, EU-wide system for withholding tax relief at source, accompanied by an exchange of information and cooperation mechanism among tax administrations” in 2022/23. Earlier this year, the European Parliament passed a resolution calling on the Commission to fulfil this commitment and urging it to propose a standardised procedure for withholding tax refund applications. The European Parliament envisages that the system should simultaneously reduce complexity for investors and limit avoidance opportunities. It should also establish a uniform definition of “beneficial owner”.
Tanja Velling	The Commission is now stepping up to the task. It has published a consultation on a “new EU system to avoid double taxation” which is open for comments until the 26th of June 2022.

	The Commission seeks views on the extent to which withholding tax refund procedures hinder cross-border investment in the EU securities market and the nature of the problems with existing refund procedures and their consequences. It queries to what extent harmonization at the EU level would add value and whether it should take the form of relief at source, an improved refund procedure or a combination of both, and apply only to dividends of listed companies or also to other types of dividends and income streams. In terms of the practical administration of the harmonized system, a one-stop-shop web portal is suggested as an option – which I would suspect many respondents are likely to regard as attractive. The consultation also includes specific questions about the role of financial intermediaries such as: whether only EU, or also non-EU, financial intermediaries should be required to report the relevant information on the correct withholding tax rate to the withholding agent and the relevant information on the payment to the investor, and whether financial intermediaries making withholding tax refund claims on behalf of non-resident investors should be liable for underreporting to the investment country. And now, what do we have coming up?
Zoe Andrews	• In the EU, there will be an ECOFIN meeting on the 24th of May, but it seems unlikely that the Pillar Two implementing Directive will be agreed at that meeting. • In the UK, the Treasury Committee has launched an inquiry into the venture capital market which, amongst other things, invites written comments on "the operation and effectiveness of the tax incentives such as the Enterprise Investment Scheme, the Seed Enterprise Investment Scheme and Venture Capital Trusts". The closing date for comments is the 7th of June. • On international tax reform, the 20th of May is the closing date for comments on the OECD's consultation on the financial services exemption from Amount A of Pillar One. • The 20th of May is also the closing date for comments in respect of the UK's online sales tax consultation.
Tanja Velling	And that leaves me to thank you for listening. If you have any questions, please contact Zoe or me, or your usual Slaughter and May contact. Further insights from the Slaughter and May Tax department can be found on the European Tax Blog – www.europeantax.blog. And you can also follow us on Twitter – @SlaughterMayTax.