TAX AND THE CITY

CLIENT BRIEFING

April 2025

The FTT's decision in *Hastings* that for the periods in question, the Offshore Looping Regulations are ineffective to prevent VAT recovery has significant implications for the insurance industry but is also of interest for its consideration of the post-Brexit application of the UK VAT rules. A new clearance process to provide advance certainty for major projects sounds like a great idea in principle, for the dozens of taxpayers who meet the eligibility criteria, but as ever, the devil will be in the detail. The government's response to the review of the tax treatment of cost contribution arrangements is to offer clearance through APAs using existing legislation. Financial service providers and card service providers should take note of the proposed increased data obligations and a modern penalty regime for non-compliance set out in HMRC's consultation on improving the quality of data acquired from third parties as HMRC focuses on getting the 'right data, of the right quality, at the right time'.

Hastings: VAT recovery on supplies to non-EU insurer

The First-tier Tribunal (FTT) in *Hastings Insurance Services Limited v HMRC* [2025] UKFTT 275 (TC) allowed the taxpayer's claim to recover £16m of input tax incurred in the period from 1 January 2019 to 31 December 2022. Although the case is specific on its facts, and is important to the insurance sector, it is also of more general interest for the light it sheds on how UK VAT legislation which differs from the Principal VAT Directive (PVD) may be interpreted by the UK courts and applied by them post-Brexit.

Hastings is an insurance intermediary established in the UK which made supplies of insurance broking, underwriting support and claims handling to an affiliated insurer based in Gibraltar, Advantage, and arranged for Advantage to insure persons in the UK. If Hastings had arranged for a UK insurer to provide the same insurance then the input tax it incurred in making such supplies would have been irrecoverable but because Advantage belonged outside the EU for VAT purposes, Hastings claimed that input tax was recoverable. HMRC had already challenged this arrangement before the FTT in 2018, arguing that the supplies were made in the UK on the basis that Hastings constituted or created a UK fixed establishment of Advantage. Hastings won that case following which the UK introduced the 'Offshore Looping Regulations' (SI 2018/1328) with effect from 1 March 2019. The stated purpose of these regulations was to prevent input tax recovery on exempt financial services 'looped' through a non-EU territory and then supplied to final consumers in the UK. The impact assessment from the introduction of the Offshore Looping Regulations expected the measure to raise £400m over the 5-year period from 2019/20 to 2023/24 (taking into account businesses changing structure in response to the measure). The stated rationale being to prevent groups that used such an arrangement from 'gaining a competitive advantage over purely UK based companies'.

In the current case, however, Hastings successfully challenged the Offshore Looping Regulations as being incompatible with Article 169(c) of the PVD and therefore ineffective. Article 169(c) PVD requires the UK to allow the deduction of input VAT on supplies used by insurance brokers/agents to make supplies of services related to insurance and reinsurance transactions where the customer is established outside the EU. Hastings successfully argued that the word 'customer' in Article 169(c) should have its ordinary meaning as the direct recipient of a supply rather than, as HMRC contended, the 'final consumer'. The FTT agreed that the 'customer' of the services supplied by Hastings to Advantage for the purposes of Article 169(c) is Advantage and not the person it insures.

HMRC had sought to argue that Hastings' preferred construction of 'customer' in Article 169(c) PVD was in conflict with other Articles of the PVD, in particular Articles 131 and 273, which permitted Member States to lay down conditions for 'preventing any possible evasion, avoidance or abuse' because preventing avoidance was the UK's aim in enacting the Offshore Looping Regulations and 'customer' in Article 169(c) had to be interpreted in that context. Not only did the FTT think HMRC's argument was wrong on the basis neither Article 131 nor Article 273 was applicable in Hastings' case, even if HMRC's argument had been correct it would not have helped HMRC because the FTT agreed with Hasting's counsel that their arrangements 'did not amount to avoidance and [therefore] even if Article 169(c) PVD were capable of the restricted construction advanced by [HMRC's counsel], it would not, in the absence of avoidance, be applicable in this case'.

In doing so the FTT noted that it was 'clear from [*Le Crédit Lyonnais Ministre du budget, des comptes publics et de la réforme de l'État* Case C-388/11 EU:C:2013:120], at [46] and [48], that taxable persons such as Hastings are "generally free to choose the organisational structures and the form of transactions which they consider to be most appropriate for their economic activities and for the purposes of limiting their tax burdens' and to choose to structure their 'business in such a way as to limit his tax liability".' An observation that will be of interest to financial services businesses watching the various cases addressing the VAT grouping of overseas group services companies with a UK fixed establishment (*Barclays Service Corporation and others v HMRC* [2024] UKFTT 785 (TC), *HSBC Electronic Data Processing (Guangdong) Ltd and others v HMRC* [2022] UKUT 41 (TCC) and other cases sitting behind them). The FTT went on to find that the Hastings' arrangements were consistent with the objective of Article 169(c) PVD which was to ensure that in providing services to a non-EU customer such as Advantage, it was not at a competitive disadvantage (in the form of suffering irrecoverable input tax) compared to a non-EU person supplying Advantage with a similar service.

The FTT then turned to whether Article 169(c) has direct effect (so that it can be relied on by Hastings) and concluded that it is unconditional and sufficiently precise to confer direct effect. The FTT then considered whether Article 169(c) either: (i) has been recognised by the CJEU or any UK Court or Tribunal as having direct effect before 1 January 2021 (i.e. before the end of the Brexit implementation period); or (ii) is 'of a kind' that has been so recognised in a case decided before 1 January 2021. The FTT concluded that the direct effect of Article 169(c) had been recognised by both the CJEU and the UK's FTT before the end of the Brexit implementation period but, if it was incorrect on this point, concluded it is of a kind that has been recognised as such. Therefore, Hastings could continue to rely on the direct effect of Article 169(c) for the disputed periods even though one was after the end of the Brexit implementation period.

What next?

There is a significant amount of tax at stake and HMRC will no doubt be frustrated by the finding that the UK's attempt to block input tax recovery by an insurance intermediary in this scenario was ineffective, so an appeal is likely. Other insurance intermediaries who have applied the Offshore Looping Regulations before 1 January 2024 to restrict input tax recovery in similar situations to Hastings will surely be seeking to claim refunds in light of this decision if they have not already done so.

What would happen if the regulations were challenged in respect of a period post 1 January 2024? This is a murkier area. Since 1 January 2024, Finance Act 2024 section 28 curtails the direct effect of EU law and so it is not possible for UK legislation relating to VAT or excise law to be quashed or disapplied after this date on the basis that it is incompatible with the PVD. However, section 28 preserves the obligation to interpret UK legislation, so far as possible, consistently with retained EU law and so arguments about interpreting domestic law consistently with EU rights and principles may be helpful in situations where direct effect can no longer be relied upon. Whether such conforming interpretation of the Offshore Looping Regulations would be possible remains to be seen but it is likely we have not seen the end of this debate yet!

Advance tax certainty for dozens of major projects

As promised in the corporate tax roadmap, the government is now consulting until 17 June 2025 on a new process to be implemented in 2026 to provide major investment projects with increased tax certainty in advance. This service will be available only for the largest, most innovative, most complex, major investment projects entailing significant expenditure but, to enable taxpayers more generally to benefit, the government is considering publishing summarised and anonymised clearances. Other taxpayers would not be able to rely on the clearance (because it will be specific to the facts), but the consultation suggests such summaries would help to 'clarify HMRC's position, address legal interpretation uncertainty, and improve policy understanding and consistency'.

One of the proposed eligibility criteria is that the entity directly undertaking major investment projects is, or will be, subject to corporation tax. There will also be a quantitative threshold. Bearing in mind HMRC's capacity to deliver the new service, it is anticipated that the quantitative threshold will initially be set at such a level (likely to entail qualifying expenditure in the hundreds of millions) that it would entail dozens, rather than hundreds, of projects being serviced per year but this initial threshold would be open to review. Recognising that a quantitative threshold alone may exclude projects that are nevertheless still 'major' (for example of national or strategic importance), the consultation invites suggestions of other supplementary criteria which are objective and measurable.

The process will not require the demonstration of genuine uncertainty, unlike the non-statutory clearance process but it will (at least initially) be limited to corporation tax although the government is open to exploring the case for expanding it to include, for example, VAT, stamp taxes and employer duties. The scope of the clearance is also not yet clear but it may be narrower than taxpayers would like as the consultation states: 'Any clearance will need to provide the maximum certainty possible without undermining anti-avoidance rules, and this is likely to be reflected in any final scope with regards to main purpose tests.'

The clearance application must set out a specific question rather than asking more generally about tax matters or asking hypothetical questions. The clearance will then be a binding decision as to HMRC's application of the law to the facts on a specific tax matter (assuming full disclosure and no misrepresentation). The consultation envisages a maximum lifespan of five years for the clearance, but a clearance renewal may be possible for taxpayers with projects extending beyond five years. The problem with getting clearance in advance of a transaction, particularly years in advance, especially on a major project, is that the project might still be developing and so the clearance will be underpinned by a series of key facts and assumptions that the project would have to be consistent with in order for the clearance to be valid.

The clearance will be binding on HMRC (subject to change of law), but will it be binding on the taxpayer? This is one of the questions raised. If the clearance is not mutually binding and the taxpayer disagrees with HMRC's technical interpretation, the consultation asks how taxpayers might notify HMRC where they have chosen not to rely on the clearance.

It sounds like a great idea in principle, for the dozens of taxpayers who meet the eligibility criteria, but as ever, the devil will be in the detail. It will be a missed opportunity if the level of tax certainty which can be achieved under the clearance is not enough to merit the resources (both time and money) of going through the process to obtain the clearance, which may be the case if the clearance cannot give certainty in key areas such as on the application of main purpose tests.

Outcome of review of cost contribution arrangements

Cost contribution arrangements are contractual arrangements for MNEs to share costs and risks of developing assets such as intellectual property. There is significant enquiry activity in this area and concerns about unresolved double taxation because different views have been taken by HMRC and other tax authorities as to when a CCA can be an acceptable pricing mechanism under the OECD's Transfer Pricing Guidelines. The corporate tax roadmap promised that the government would review the treatment of CCAs and explore a solution.

The outcome of this review has now been announced (in Chapter 5 of the consultation document: 'Advance certainty for major projects'). Rather than adopting a new legislative solution (which initially looked like the direction HMRC favoured), the government intends to offer clearance on the treatment of CCAs through Advance Pricing Agreements (APAs) using existing legislation. Such unilateral APAs would provide certainty that CCAs will be respected by HMRC as the framework for pricing CCA transactions and can apply to periods where returns have already been filed as well as in relation to future periods.

An updated Statement of Practice will be published which will set out the conditions to be satisfied for the clearance to be granted which will likely include factors such as the commerciality of the CCA and the expected profitability of the UK participant over its term.

The latest HMRC statistics (published January 2025) showed that, for 2023-24, 27 APAs were agreed during the year and that the average time taken to agree an APA was 53 months. It is hoped that HMRC can provide adequate resourcing of the APA team to cope with additional demand from taxpayers seeking clearance on CCAs!

Consultation on third party data: more onerous obligations on financial services

Following round tables with industry bodies on updating HMRC's information and bulk data gathering powers, HMRC is consulting until 21 May 2025 on opportunities for improving the quality of data acquired from third parties. HMRC already acquires datasets relating to financial account information and card sales and is 'testing early thinking' regarding collecting new data from financial institutions on dividend income and other income from investments.

The focus of the consultation is getting the 'right data, of the right quality, at the right time' in relation to the two datasets it already receives. HMRC intends to move away from the current, inefficient notice-based approach (HMRC currently sends thousands of notices each year to financial institutions and providers of card acquiring services requesting data) towards modern standing reporting obligations where quality data is provided closer to real-time. This would enable HMRC to use the data to pre-populate tax returns to reduce customer administration burdens but would also help to close the tax gap as better and more real-time data would allow HMRC to track down those taxpayers misrepresenting income or hiding assets.

The government is committed to working with industry to design a proportionate solution that is compatible with business processes. In order to collect the right data, the government is considering options to introduce and implement set schemas for third-party data to be reported to HMRC (most likely tailoring the CRS schema), modernise the data sharing method; and require third-party data suppliers to collect tax references (such as NI numbers or CRNs) to support improved data matching. HMRC intends to introduce due-diligence requirements for data suppliers and adopt a modern penalties regime based on the approach for international bulk third-party data, including associated safeguards.

There is a lot in this consultation for financial service providers and card service providers to digest and consider how the proposals will impact their business. There will inevitably be significant costs for updating processes, obtaining additional information such as tax references, and passing data on to HMRC on a more frequent (most likely monthly) basis and ensuring the data is correct. In the longer term, however, it is hoped there will be benefits for data suppliers of streamlining the process and aligning domestic reporting obligations more closely with international reporting obligations, with tailored adjustments where required.

What to look out for:

- The UK has revoked the UK/Belarus and UK/Russia double tax conventions with effect from 1 April 2025 for corporation tax and from 6 April 2025 for income tax and capital gains tax.
- On 30 April, the Court of Appeal is scheduled to hear the Appeal in the *Marlborough* case on disguised remuneration.
- HMRC has applied for permission to appeal *ScottishPower* to the Supreme Court. The Court of Appeal determined that the relevant energy providers could get tax relief for payments made in lieu of penalties.

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