TAX AND THE CITY REVIEW FOR AUGUST

BlackRock loses its European appeal on VAT on management fees. The EU is proposing to modernise the VAT rules on financial services. Draft regulations are published defining loss absorbing instruments for bank levy purposes. The draft legislation for Finance Bill 2021 includes the ability for HMRC to issue third party notices to financial institutions without FTT approval. The operation of IPT remains under review.

BlackRock: VAT exemption for management of SIFs

VAT uncertainty in the financial services space is particularly unfortunate because low recovery rates often mean input tax is an absolute cost for the business. Unfortunately, it is also not uncommon. And in delivering its judgment in Case C-231/19 *BlackRock Investment Management (UK) Ltd v HMRC*, the Court of Justice of the European Union ("CJEU") has again raised as many questions as it answered.

BlackRock Investment Management (UK) Ltd ("BlackRock"), a UK based fund manager, received services from BlackRock Financial Management Inc, a US based company in the same group. The services comprised a combination of hardware, software and human resources, provided through a platform known as "Aladdin". BlackRock managed both special investment funds ("SIFs") and non-SIFs and argued that the Aladdin services should be exempt from VAT to the extent they related to management of SIFs, the management of SIFs being exempt under Article 135(1)(g) of the VAT Directive.

The First-tier Tribunal ("FTT") had held that the Aladdin services were "management", so capable of falling within Article 135(1)(g) (the "exemption issue") but that the consideration for the single supply of those services could not be apportioned between SIFs and non-SIFs and as the majority of funds managed (by both number and value) were non-SIFs that single supply was standard rated (the "apportionment issue"). The Upper Tribunal ("UT") agreed with the FTT on the exemption issue. Moreover, the UT declined HMRC's request to refer the exemption issue to the CJEU on the basis that the concept of management of a SIF was clear from existing case law and was readily applicable. However, because the UT considered it arguable that apportionment was permissible under Article 135(1)(g), they referred to the CJEU the question whether a "single supply of management services" is subject to a single rate of tax or whether the consideration can be apportioned between a taxable supply and an exempt supply.

The CJEU held that the treatment of the supply must be determined by the nature of the supply itself and not by the uses to which it is put. It cannot be determined by the nature of the majority of the funds managed otherwise if they had comprised a majority of SIFs, the non-SIFs would effectively have benefited from the SIF exemption. The CJEU found that because the Aladdin services had been designed for the purpose of managing investments of various kinds and could be used in the same way for the management of SIFs and non-SIFs, the service could not be regarded as specifically for the management of SIFs and so the single supply fell outside Article 135(1)(g) by its nature.

This leaves open a number of questions. Would two contracts have saved the day? Potentially not on the CJEU's approach if the service supplied under each is fundamentally the same and the service under the SIF contract is not, in some way, specifically tailored. Does any non-SIF use, however small, preclude the exemption applying? Hopefully not and HMRC will apply a sensible approach.

EU Commission Action Plan Action 18 - Update VAT rules on financial services

That brings us, unusually neatly, to Action 18 on the European Commission's 25 point "Action plan for fair and simple taxation supporting the recovery strategy".

"To simplify the life of taxpayers operating in the Single Market" (and who doesn't want a simpler life?), in 2020/21 the Commission is proposing to update the VAT rules on financial services. The Commission rightly notes that the financial services exemption dates back to the introduction of VAT in 1977 and the provisions are now outdated. As the *Blackrock* case shows, the financial services world is now a very different place and a proposed modernisation to take account of the rise of the digital economy and the increase in outsourcing of input services by financial and insurance operators is surely overdue.

The update should increase the certainty of the VAT treatment of modern financial services, which would be welcome, within the EU. But for Brexit, it would surely have been the death knell for the UK's version of the intermediaries exemption which HMRC has long acknowledged in published guidance (VATINS5210) is too wide, following the 2005 decision of the European Court of Justice in Case C-472/03 *Andersen*, but is very useful in structuring outsourcing arrangements. Whether, and the extent to which, the outcome of Action 18, is reflected in UK VAT post-31 December 2020 remains to be seen.

Bank levy draft amending regulations

The rescoping of the bank levy from global balance sheets to UK balance sheets is, finally, nearly here. The original consultation was launched in December 2015 and the primary legislation included in Finance Act 2018, but only to take effect for chargeable periods ending on or after 1 January 2021.

As part of the rescoping, it was accepted that loss absorbing instruments issued by a UK entity to fund a loss absorbing instrument issued by an overseas entity should be out of scope. The framework for achieving this was put in place by Finance Act 2018. Paragraph 15X was added to Schedule 19 to the Finance Act 2011 to provide for the determination of two amounts which, from next year, will be used to reduce chargeable equity and liabilities at step 3 in paragraph 15N.

The first is the amount of the tier one capital equity and liabilities of overseas group members which satisfy a "loss absorbing or recapitalisation requirement" and which are held by a member of the UK group, capped at the amount of tier one capital equity and liabilities of the UK group which are not already excluded. Since all such equity and liabilities should already be excluded under paragraph 30 (the Treasury has not yet exercised its power to extend the definition of tier one capital equity and liabilities for these purposes beyond the paragraph 30 definition), that cap is currently nil.

Of (much) more (current) use is the second amount which is the amount of any other instruments issued by overseas group members which satisfy a loss absorbing or recapitalisation requirement and which are held by a member of the UK group, capped at the amount of other instruments of the UK group which satisfy a loss absorbing or recapitalisation requirement.

When the Finance Act 2018 was being drafted, the relevant regulatory requirements had not been set and so the Treasury was given the power to make regulations setting the conditions to be a "loss absorbing or recapitalisation requirement". The draft Bank Levy Loss Absorbing Instrument Regulations 2020 were published for consultation on 13 July, 2020, together with an explanatory memorandum and draft HMRC guidance. Under the draft regulations the condition is that the requirement is imposed by the Bank of England either (i) by a direction given under section 3A of the Banking Act 2009; or (ii) for the purpose of complying with the duties set out in Part 9 of the Bank Recovery and Resolution (No. 2) Order 2014, or is imposed by an overseas regulator under a comparable scheme for a comparable purpose.

Although ostensibly published for consultation, by the time you read this, the consultation will have already closed with the deadline being (a rather precise) 11:45pm on 10 August 2020!

Draft legislation for Finance Bill 2021

The draft legislation published for comments (by 15 September, 2020) includes provision for HMRC to issue a new type of information request, a "financial institution notice". It would allow HMRC to issue a notice to a financial institution (essentially a financial institution for Common Reporting Standard purposes or a credit card issuer), requiring the institution to provide information or to produce a document where, in the reasonable opinion of the officer giving the notice, it would not be onerous for the institution to do so and it is reasonably required for the purposes of checking the tax position of an identified taxpayer or collecting a tax debt.

Currently, HMRC cannot issue a third party notice under paragraph 3 of Schedule 36 to the Finance Act 2008 without the approval of either the taxpayer or the FTT. And the FTT cannot give approval unless it is satisfied that HMRC are justified in issuing the notice, the third party has been told the information or documents are required and given the opportunity to make representations to HMRC, and the FTT has been given a summary of any representations. Indeed, the main driver for the introduction of the financial institution notice is to sidestep those safeguards in order to expedite the process. HMRC say that they are expected to reply to information requests from overseas tax authorities within 6 months and they cannot do so where they need to issue a third party information notice under the current system since that takes, on average, 12 months.

However, the new notice is not limited to being used only in such circumstances. So, this should be seen in substance as simply removing the requirement to obtain taxpayer agreement or FTT approval for the issue of a third party notice to a financial institution. In practice, the requirement that compliance should not be onerous is rather neutered by that only needing to be in the "reasonable opinion" of the relevant HMRC officer. Financial institution notices will, however, be subject to the other existing safeguards for notices such as not requiring the provision of privileged information.

It will be interesting to see whether the ease with which HMRC will be able to issue such notices in the future will lead to a marked increase in requests for information to financial institutions. And whether, if abandoning the FTT safeguard for third party requests to financial institutions is deemed a success, there will be a push to abandon it across the board in future.

The operation of Insurance Premium Tax ("IPT")

Alongside the draft legislation for Finance Bill 2021, HMRC published a number of new consultations and responses to closed consultations, including a summary of the responses to the June 2019 call for evidence on the operation of IPT. More specifically, they were looking for evidence on (i) how the administration and collection of IPT could be modernised, to provide optimal efficiency for both business and HMRC, and (ii) the extent to which there are emerging practices leading to unfair tax outcomes and how these might be addressed.

If the consultation responses were homework then this is the equivalent of the government handing it back with "must try harder" scrawled in biro across the top. The conclusion drawn is that, whilst the responses do not clearly indicate changes which could be made to improve IPT, the government thinks improvements can be made in those two areas and so is going to collect further evidence through a consultation on improving the administration of IPT and preventing unfair outcomes. And that that consultation may ultimately result in the government bringing forward legislation to enact the conclusions reached. So, it is clear that the government has some changes in mind, but not yet what they are!

What to look out for:

There's not usually a lot to look out for in August but, because many consultation response deadlines were extended in light of the pandemic, several consultations are now due to close in August including:

- **on 19 August, the review of UK investment funds (which includes the direct and indirect tax treatment of funds);**
- **on 27 August notification of uncertain tax treatment by large business;**
- **on 28 August the consultation on the taxation impacts arising from the withdrawal of LIBOR; and**
- **on 29 August, the consultation on certain aspects of the hybrid mismatch rules.**

This article was first published by Tax Journal on 6 August.

CONTACT

Mike Lane
PARTNER
T: +44 (0)20 7090 5358
E: mike.lane@slaughterandmay.com

Zoe Andrews
HEAD OF TAX KNOWLEDGE
T: +44 (0)20 7090 5017
E: zoe.andrews@slaughterandmay.com