SLAUGHTER AND MAY/

Slaughter and May Podcast
Tax News: September 2024

Zoe Andrews	Welcome back after our summer break to the September 2024 edition of Slaughter and May's "Tax News" podcast. I am Zoe Andrews, PSL Counsel & Head of Tax Knowledge.
Tanja Velling	And I am Tanja Velling, Tax PSL Counsel. We will discuss the government's tax policy announcements, updates to HMRC's MTT and DTT guidance and three recent cases, two on VAT and the Supreme Court's decision in *Centrica*. We will also share with you some HMRC statistics. The podcast was recorded on the 3rd of September 2024 and reflects the law and guidance on that date. Back in the July edition of this podcast, we mused what Labour's landslide election victory might mean for tax. Since then, we've had some more tangible indications through Chancellor Rachel Reeves' "statement on public spending inheritance" on the 29th of July. What did you take from that?
Zoe Andrews	Well, overall (and this will not have come as a particular surprise to anyone) the message was that public finances are not in a good place. So, in addition to the cancellation of certain projects announced by the previous government, the Chancellor announced measures to increase tax revenues. These weren't much of a surprise, either, but largely reflected what was in the manifesto. So, for instance, the VAT exemption for the provision of education (other than nursery class) and vocational training by private schools (and associated board and lodging) will be removed from the start of 2025, subject to certain anti-forestalling provisions. Private schools will also cease to be eligible for charitable rate relief from business rates. Draft legislation for the VAT measure was published alongside the statement. It will be included in a Finance Bill to be published following Labour's first Budget. The change to business rates would sit in a Local Government Finance Bill. That would also be published following the Budget, but the Ministry of Housing, Communities and Local Government is leading on it.
Tanja Velling	Does that mean we have a date for the Budget?
Zoe Andrews	Yes! The Labour government's first Budget will be on the 30th of October – rather an annoying date on two counts: it means our prediction of the

	second half of September was out by at least a month and I had planned to be on holiday during the week of the 30th of October!
Tanja Velling	And now you won't be? You moved your holiday to follow the Budget? That's dedication!
Zoe Andrews	Well, as I've mentioned in a previous podcast – I've now worked in tax at Slaughter and May for over two decades, and during that time, I haven't missed a single Budget. I couldn't possibly break that streak now!
Tanja Velling	I guess, that's fair enough – although not necessarily what I would have chosen. But anyway, what can we expect from the Budget? Do you think the promised business tax roadmap will be published then?
Zoe Andrews	That's possible. There's, of course, a lot of speculation as to what could be in the Budget – especially after Prime Minister Keir Starmer said on the 27th of August that "There's a budget coming in October. and it's going to be painful. We have no other choice given the situation that we're in. So those with the broadest shoulders should bear the heavier burden." What exactly this means is anyone's guess – most seem to think there may be changes to capital gains tax and pensions tax reliefs, but it's hard to predict. And it is likely that large business will also be expected to shoulder some of the extra tax burden – although Labour's manifesto pledged not to increase the corporation tax rate above 25% and to retain full expensing. The Chancellor's statement on the 29th of July reiterated a different manifesto promise: not to increase the rates of VAT, income tax or national insurance. But it's not entirely clear whether the latter refers to all national insurance contributions, so including employer NICs. The manifesto had prefaced the commitment by saying that "Labour will not increase taxes on working people". That might leave room to say that employer NICs were not covered, but let's not speculate further!
Tanja Velling	All right, I won't ask for more predictions then. And I also sort of side-tracked us here – there were a few more things of interest in that 29th of July statement that it might be good to mention, weren't there?
Zoe Andrews	Yes. I'll highlight three. Labour's manifesto had made reference to "closing [the] carried interest tax loophole". So, the publication of a call for evidence on the tax treatment of carried interest was unsurprising. It seeks evidence on current market practice, how to match the tax regime to the interest's economic characteristics and lessons from other countries. For the moment, the Treasury seems to be in listening mode; it wouldn't be a surprise if a policy decision was included in the Budget.

	Changes to the Energy (Oil and Gas) Profits Levy were also announced as foreshadowed in the manifesto. The end date will be extended to the end of March 2030 and the rate will increase by 3 percentage points from the 1st of November 2024, bringing the headline rate of tax on upstream oil and gas activities to 78%. In addition, the main investment allowance will be removed and the use of capital allowance to reduce levy profits may be restricted, with further details to be set out in the Budget. In the July podcast, we discussed how the tax gap (and raising funds from closing it) was one of the pre-election hot topics. Alongside the Chancellor's statement, it was confirmed HMRC will be funded to hire around 5,000 additional staff to recover more tax revenues, and recruitment has already started. We can also expect the Budget to include measures to "close the tax gap". Based on "Labour's Plan to Close the Tax Gap" which was published alongside their election manifesto, these could include extending the scope of DOTAS and enhancing HMRC's powers to require pre-payment of disputed tax. Anything else you wanted to mention, Tanja?
Tanja Velling	Yes – two points related to Pillar Two. The transitional country-by-country reporting (or CbCR) safe harbour allows companies to use their CbCR information to calculate tax rates in each jurisdiction if they meet certain criteria. But there was then a concern that groups could use hybrid arbitrage arrangements to exploit differences between tax and accounting and get into the safe harbour. So, the December 2023 Administrative Guidance identified three hybrid arrangements for exclusion from the safe harbour calculation. The previous government had committed to implementing these anti-avoidance provisions with effect from the 14th of March 2024. It was confirmed that the Labour government will proceed with this and draft legislation for inclusion in the Finance Bill was published. It was also confirmed that the UTPR will be implemented with effect from the 31st of December 2024. No draft legislation was published for this, but I suspect it would look very similar to what was published by the previous government last year. And speaking of Pillar Two, Zoe, do you want to talk about HMRC's updated guidance on the multinational top-up tax and the domestic top-up tax?
Zoe Andrews	HMRC's detailed Manual guidance on multinational top-up tax (MTT) and domestic top up tax (DTT) is work in progress and is being released in parts for consultation. HMRC published further draft guidance in December 2023 for consultation providing an overview of the MTT and DTT and the administration measures including new sections on calculating the effective tax rate and applying MTT/DTT to particular types of entity. HMRC is

	reviewing the responses to the consultation which will be fed into future guidance. Further draft guidance has been promised in the coming months on other aspects of the legislation including a section on determining top-up tax amounts (covering chapters 6 to 8 of Part 3 of Finance (No. 2) Act 2023) and more guidance about particular types of entities and structures. In the meantime, the shorter guidance note on how to prepare for the MTT and the DTT has been updated. This sets out the practical steps (including online registration and filing requirements) needed to comply with MTT and DTT in the UK and the adoption of Pillar Two in other jurisdictions. Online registration is now available and, in late 2024, the second stage of the online service will be implemented to allow payments on account and authorise agents to carry out future tasks on their behalf. The final stage will then enable submission of UK Pillar Two returns using existing third-party software products. HMRC has sought to dispel common misconceptions in the latest guidance, hasn't it?
Tanja Velling	Yes. The updated guidance emphasises that, if a business is in scope of MTT or DTT, there are still UK reporting obligations even if there is no tax liability. For every accounting period that the group is within scope of MTT and DTT (or DTT only, if the group is a domestic-only group), the filing member will need to submit a UK Pillar Two self-assessment return and a GloBE Information Return to HMRC. I'll refer to the GloBE Information Return as "GIR". Which brings us to a major complaint of business that the cost of compliance is vastly disproportionate to the amount of tax at stake. The OECD's consultation on the GIR has shown that the complexity of the GIR and the compliance burden to complete it are big issues for in-scope MNEs because of the volume of data required to be collected and reported for each constituent entity. In response to the consultation, the Business and Industry Advisory Committee at OECD (BIAC) has contrasted the modern approach with respect to corporate income tax based on risk assessment with the current design of the GIR which does not balance compliance burden with risk. BIAC urges the OECD to develop further simplifications to the GIR and has asked for a more streamlined approach for cases where there is no top-up liability. And things will get worse, not better, because for the first three years of the transitional (CbCR) safe harbour there are some simplifications in place, but once these expire BIAC is concerned that neither MNEs nor tax audit teams will be able to cope with the full complexity of the rules.

	Concerns about the significant implementation and compliance costs of Pillar Two are also borne out in the UK in responses to the Large Business Customer Survey 2023, aren't they?
Zoe Andrews	Yes, they are. Businesses that do not have an MTT/DTT liability will still incur costs complying with the UK reporting obligations, so it is no surprise that the survey revealed that some businesses felt that the amount of work required to adhere to the Pillar Two legislation was not proportionate. According to the Executive Summary, "Businesses tended to report that Pillar Two would have no or a negligible impact on the amount of UK taxes they pay. However, they said during qualitative interviews that the amount of work required to understand the legislation, demonstrate that they are not required to make top-up tax payments, and the annual reporting requirements bring a considerable amount of administrative burden." Tanja, you have been looking at how some of the no or low corporate tax rate jurisdictions plan to implement Pillar Two haven't you?
Tanja Velling	Yes, I have. I had thought, when the Qualifying Domestic Minimum Top-up Tax (QDMTT) first appeared, who wouldn't want to have one? The advantages of a QDMTT are that a jurisdiction ensures it collects top-up tax on any undertaxed profits in its jurisdiction rather than ceding taxing rights to another jurisdiction to collect the tax under an income inclusion rule of a parent, or intermediate company where applicable, or under the UTPR if no IIR applies. At the end of the day, top-up tax on undertaxed profits must be paid somewhere so why would a jurisdiction not introduce a QDMTT to increase its tax take? But it has become apparent to me that some jurisdictions (particularly those with historically low or no corporate taxes) have other concerns and, instead of implementing a QDMTT, they plan to introduce a new corporate income tax regime that ensures there are no undertaxed profits in their jurisdiction in the first place. I'm talking in particular about Jersey and Bermuda who are each implementing a new standalone multinational corporate income tax (MCIT), alongside an IIR because the MCIT is more favourable to US-headed MNE groups.
Zoe Andrews	I understand the reasoning behind this decision is that a QDMTT applies in priority to credit for foreign taxes levied on a parent company further up the chain (under CFC regimes, including the US GILTI regime) whereas the MCIT gives credit for such foreign taxes levied higher up the chain where the CFC regime has a threshold for low tax that is less than 15%. The CFC tax credit available under the Jersey MCIT is subject to an overall cap of 7.5% of the group's net Jersey income that is taxable under MCIT for the fiscal year. In effect, Jersey is ceding primary taxing rights to jurisdictions such as the US with a CFC regime with a low tax threshold of less than

	15%. This ensures that the level of tax in Jersey is sufficient to result in an ETR of 15% so no liability to top-up tax arises in the first place. Jersey has also announced it is not going to implement a UTPR – which again will curry favour with the US which is, understandably, opposed to the UTPR as it would result in other jurisdictions taxing US profits. By way of contrast, Guernsey (which is expected to publish legislation in September/October) has decided not to go down the MCIT route but to adopt a QDMTT. Like Jersey, Guernsey is targeting a 1st of January 2025 implementation date.
Tanja Velling	It goes to show that there is no “one size fits all” approach, and the approach to implementation in different jurisdictions is based on their unique economies, client bases, and administrative considerations. Of course, we also expect changes to be made following the US election, irrespective of who wins, to certain aspects of the US international tax regime, including GILTI, and such changes may impact on how GILTI interacts with the Pillar Two rules. Shall we now discuss the cases before we move on to statistics?
Zoe Andrews	Yes! I’m sure you will have heard of the “man on the Clapham omnibus”; a hypothetical ordinary and reasonable person conjured up by the English courts. Lord Reed more recently discussed this legal fiction in 2024, in the first few paragraphs of the Supreme Court’s decision in *Healthcare at Home v The Common Services Agency*. Lord Reed notes that this fictional bus has, in fact, many passengers, including, for example, “the right-thinking member of society, familiar from the law of defamation”. Now, defamation is not the topic of this podcast. So, who might be taking that fabled omnibus for tax purposes? At a stop marked “VAT”, you may well see the bus be boarded by a “broad-minded VAT payer”. This illustrious character featured in the First-tier Tribunal’s decision in *Bottled Science*. It concerned the question whether a collagen drink, marketed as skincare from within, was food for VAT purposes and, therefore, zero-rated. The FTT concluded that “a broad-minded VAT payer, who has heard the evidence and tasted the product” would not consider it food. Ultimately, it seems that the crucial factor here was that the product was not distributed or marketed in a way that food would normally be.
Tanja Velling	My favourite part of this type of case is usually the FTT’s discussion of its experience sampling the product. Here the drink was found “palatable” but

	"neither of us would rush to drink [it] for its own sake". I can neither confirm nor deny this assessment.
Zoe Andrews	Staying with VAT, in *Finanzamt T*, the CJEU confirmed that supplies between members of a VAT group are not subject to VAT – even where the recipient could not have recovered VAT on the supply had it been made outside a VAT group. The consequences may be a loss of tax, but that is inherent in the concept of VAT grouping permitted by EU law and, therefore, unobjectionable. In the future, we are likely to see fewer CJEU decisions on VAT. In order to reduce its caseload, the CJEU is transferring jurisdiction to hear preliminary rulings on VAT to the General Court from the 1st of October. Given the volume of cases, that does seem a sensible solution. But let's go back to the UK for an exciting Supreme Court decision.
Tanja Velling	*Centrica Overseas Holdings* concerns the deductibility of advisers' fees on a share sale as expenses of management. COHL was an intermediate holding company in the Centrica group and it wholly owned the unsuccessful Dutch "Oxxio" investment. The group's parent decided in mid-2009 that Oxxio should be sold and it was henceforth accounted for as "held for sale". Between mid-2009 and early 2011 when Oxxio was finally sold, COHL incurred bank, accountancy and lawyers' fees for matters ranging from strategic advice on how best to dispose of the business to drafting the sale documentation.
Zoe Andrews	The case originally raised two questions. Are the relevant fees expenses of management? And are they revenue in nature? In order for the fees to be deductible for corporation tax purposes, both questions had to be answered "yes". The first question had been answered mostly "yes" at the previous instances, and this point was not appealed to the Supreme Court. So, the only question before the Supreme Court was whether the fees were an expense of a revenue nature, and the Supreme Court answered that question with a "no".
Tanja Velling	Whether an expense is of a revenue or capital nature is a pure question of law (in contrast, whether something is an expense of management involves a factual determination with a more limited scope for challenge on appeal). The revenue versus capital test applicable to management expenses is the same as that for trading expenses; so, the case law on trading expenses is equally applicable here.

	In general, the objective purpose of the expenditure is going to be an important indicator; "the starting point is to assume that money spent on the acquisition or disposal of [a capital] asset should be regarded as capital expenditure", unless there are circumstances to displace that assumption. Overall, there is then little hope for a corporation tax deduction for deal fees. So, it's perhaps best to move on to a different topic. It's that time of year again when HMRC publish its annual report and accounts. What is there of interest to us this year?
Zoe Andrews	Total revenues for 2023/2024 were £843.5bn (an increase of 3.6% on the previous year). This increase was largely driven by additional income tax due to the freezing of bands and thresholds and corporation tax due to the rate increase. Although there was much focus pre- and post-election on closing the tax gap, the compliance yield for 2023/24 was £41.8bn, up from £34bn in 2022/23. And this was £1.3bn above HMRC's target. This can be broken into downstream compliance (revenue from enquiries etc.) which contributed £28.1bn and £13.7bn from upstream compliance activities (such as prevention of errors and measures to promote compliance). I'm always interested to see the tax litigation decisions to see who is winning most cases. What does this year show us?
Tanja Velling	In 2023/24, HMRC won 87% of the decided tax appeals (this is down from 92% the previous year), although winning here means either the decision is in HMRC's favour or substantive elements of HMRC's case succeeded. The decrease is largely because the previous year included the FTT striking out a group of approximately 1000 VAT appeals. HMRC's success at the Supreme Court was down from 100% in 22/23 to winning 3 out of the 5 cases in 23/24. But in such a small sample set you cannot read too much into the Supreme Court statistics. There is a separate report on tax avoidance litigation decisions which distinguishes between cases where the substantive issue considered was tax avoidance and those which relate to procedural rules that have a wider application to other avoidance cases. For the purpose of reporting these statistics to you, we haven't questioned HMRC's categorisation of the cases. The report shows that out of 23 substantive decisions on tax avoidance, HMRC won 17, partly won 1 and lost 5 – a success rate of 78% (if you include the partial win as a "success"; otherwise, it's 74%). For the procedural cases on avoidance, HMRC's success rate is 92% (again counting one partial win; without it, the rate would be 83%) and when it comes to DOTAS cases, HMRC won all 4 of the cases.

Zoe Andrews	That's quite interesting. But we should probably start to wrap things up. So, let's have a look at what's coming up in September. • The 10th is the closing date for Budget representations, and the CJEU is due to release its decision in the *Apple* State aid case. • On the 11th, the European Commission's consultation on ATAD closes for comments. • On the 15th, the consultation on draft clauses for the Finance Bill closes. • And on the 19th, the CJEU is due to release its decision on the group financing exemption in the UK CFC rules. The draft terms of reference for the UN Framework Convention on International Tax Cooperation will be put to a vote by the General Assembly during the 79th session this September. The draft terms envisage that the Convention and two early protocols would be negotiated between 2025 and 2027 to be presented to the General Assembly during its 82nd session in September 2027. One early protocol would cover the "taxation of income derived from the provision of cross-border services in an increasingly digitalized and globalized economy"; the topic for the other is yet to be decided. The draft terms were approved by the Ad Hoc Committee, by 110 to 8 votes (with 44 abstentions) on the 16th of August. The UK and the US were among the states that voted against.
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 X – @SlaughterMayTax.