Slaughter and May Podcast
Tax News Highlights: March 2021

Zoe Andrew	Welcome to the March 2021 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.
Zoe Andrew	In this podcast, we will discuss: Highlights from the Budget and the Finance Bill, give an update on certain OECD and EU developments and consider four recent cases, the First-Tier Tribunal decisions in *HFFX* and *Odey Asset Management* on the tax treatment of funds reallocated from the corporate member of a partnership to the individual members, *Imprimatur Capital Holdings* on input VAT recovery, and the Court of Appeal decision in *Eastern Power Networks* addressing the extent to which the First-tier Tribunal should use its discretion to decide substantive tax points in a procedural application. This podcast was recorded on the 16th of March 2021 and reflects the law and guidance on that date.
Tanja Velling	As you will all know, the UK Budget took place on the 3rd March of this year, and Budget announcements were confined to those measures to be legislated in Finance Bill 2021 (which was published on the 11th of March). On the 23rd of March, a day that has come to be known as "Tax Day", we can then expect policy announcements of changes to be legislated in later Finance bills, including consultations on capital gains tax and environmental taxes.
Zoe Andrew	As expected, the Budget was dominated with announcements of COVID-related support measures to boost economic recovery. Inevitably the give-aways now means there will have to be tax rises - but not immediately.
Tanja Velling	From April 2023, the UK's headline corporation tax rate is set to increase from 19 to 25 per cent. In order to maintain the differential between the corporation tax rate and diverted profits tax rate (and ensure that DPT remains an effective deterrent), the DPT rate will increase commensurately from 25 to 31 per cent at the same time. In the past, when the headline rate was lowered, the UK's corporation tax take did not actually decrease. This was because rate decreases were accompanied by measures to widen the tax base. So, will this rate increase be accompanied by measures to narrow the tax base?
Zoe Andrew	It seems not, the Red Book predicts that corporation tax revenues will jump from 48.8 billion pounds in the 2022/23 tax year to 71.3 billion pounds in the 2023/24 tax year. That's a significant increase in the corporation tax take. Especially in combination with Brexit, there is a risk that this could dampen the appetite for investment in the UK – although, in the short term, the effect could be balanced out by the additional tax reliefs that there announced alongside the rate increase. In the longer-term, good tax

	administration is likely to play an important part in the UK's competitiveness and in attracting investment in the UK – and improvements in tax administration may counterbalance the dampener which the corporation tax rate increase may put on inward investment.
Tanja Velling	So it is good to see that the Red Book announced that there will be a review of large businesses' experiences of UK tax administration to see what the challenges are and what improvements can be made as HMRC continues to progress its ten-year tax administration strategy and wider tax administration framework review. According to the Red Book, the review will include the degree to which HMRC provides businesses with early certainty where appropriate, ensures the efficient resolution of disputes in accordance with the law, and promotes a collaborative and constructive approach to compliance with the law.
Zoe Andrew	It can only be hoped that the result of the review will include improvements to the way in which diverted profits tax disputes are dealt with. At least, it seems likely that the decision to undertake this review would have been influenced by the existence of a number of long-running DPT enquiries where HMRC's internal governance processes caused stumbling blocks in settling the issues expediently. But back to the potential impacts of the increase in corporation tax rates.
Tanja Velling	It is also a truism that the cost of all taxes is ultimately borne by individuals. Companies may pass on the cost of the corporation tax increase to shareholders in the form of lower dividends, to customers in the form of higher prices and to workers in the form of lower or stagnating wages – with the latter being, arguably, the most likely.
Zoe Andrew	The corporation tax rate increase will be accompanied by the re-introduction of variable corporation rates. You may be young enough to not have had to deal with it, but practitioners of my age will recall the small profits rate. Until April 2015, there used to be a small profits rate. It was one percentage point lower than the headline corporation tax rate and applied to companies with profits up to £300,000. Marginal relief was available for companies with profits between £300,000 and £1.5 million. So, only companies with profits over £1.5 million paid tax at the full headline rate. From April 2023, we will go almost full circle. A new small profits rate will be introduced. It will be set at the current corporation tax rate of 19% and apply to companies with profits up to £50,000. A similar system of marginal relief will apply to companies with profits between 50,000 and a quarter of a million pounds. This is clearly less generous than the pre-2015 version of the rules, but it still enabled the Chancellor to announce that only the 10% most profitable companies would pay tax at the new higher headline rate. But there is yet another wrinkle. What about banks?

Tanja Velling	Well, that is yet to be determined. At the moment, banks are subject to an 8% surcharge, meaning that they effectively pay corporation tax at 27%, being the existing 19% rate plus the 8% surcharge. Continuing to add the 8% surcharge to the corporation tax rate following the increase of that rate to 25% would lead to an unsustainable and uncompetitive level of taxation for banks. And the Government has acknowledged this. It will undertake a review of the surcharge, with the aim of announcing this autumn how it intends to ensure that the level of taxation of banks will not increase substantially from its current level. That this is indeed the Government's intention is supported by the announcement that the rate of diverted profits tax on banking profits will remain unchanged at 33%.
Zoe Andrew	And there was some good news in the Budget for business. To provide support now, the carry-back of trade loss relief will be made more generous for losses made in financial years 20/21 or 21/22. Currently, losses can be carried back one year, in an unlimited amount (subject to there being sufficient profits to offset against). Under the new rules, losses can be carried back a further 2 years (so a 3 year carry back in total). But the extended carry back is capped at £2m per financial year. If a company is a member of the group, the £2m cap applies on a group basis. There is an anti-avoidance rule preventing groups from degrouping companies to increase the amount of relief available.
Tanja Velling	There is a distinction between de minimis and non-de minimis claims. A de minimis claim is less than £200,000 and can be made at any point in the accounting period, rather than having to wait to be made in the tax return. A claim in excess of this is a non-de minimis claim and must be made in a tax return and, in the case of a group, must be supported with a loss carry back allocation statement for the group showing how much of the £2m cap is allocated to each company which has made non-de minimis claims. When applying the £2m cap to a group, both non-de minimis and de minimis claims count towards it. Regulations will be made providing more details about the submission of allocation statements.
Zoe Andrew	Based on the Red Book costings, however, the loss carry back is net positive over the forecast cycle presumably because losses will be used at the 19% rate of corporation tax, rather than carried forward for use at the 23% rate in future. But many businesses will be grateful for the cashflow benefit of a repayment of tax now, rather than waiting to use the losses when the Corporation Tax rate increases. Another favourable change for businesses concerns capital allowances, and I quite enjoyed some of the press coverage on what is billed as the super-deduction which asked whether certain shares might be "super-charged by the super-deduction".

Tanja Velling	Looking at the Finance Bill, this actually speaks of super-deductions, plural. Indeed, it provides for three types of enhanced capital allowances. The first is what the legislation actually calls super-deduction. Enhanced capital allowances of 130% of the expenditure incurred between April 2021 and March 2023 on plant and machinery – other than special rate assets such as long-life assets and integral features. The deduction does not apply if the relevant plant and machinery is used wholly or partly for an oil and gas trade. If the plant and machinery is, however, only used partly for such a trade, capital allowances equal to 100% of the expenditure could be claimed – that's the second type of enhanced capital allowances. The third type of super-deduction referred to in the draft legislation as the "SR allowance" provides for a deduction of 50% of expenditure on long-life assets incurred between April 2021 and March 2023. This deduction also seems to apply in respect of oil and gas trades.
Zoe Andrew	All three super-deductions apply only in respect of expenditure on assets that are unused and not second hand. In this way, it seems that the Government may be trying to encourage upgrading and innovation. I was, however, somewhat surprised that the Government does not appear to have wanted to try and kill more birds with this particular stone. For instance, the Government could have tried to boost British manufacturing or push the move towards carbon neutrality by placing further limitations on the eligible expenditure (although business will, no doubt, welcome that this has not been done – not least because of the uncertainty around the eligibility of particular expenditure for the super-deductions that such criteria might cause). It should, however, be noted that the legislation discourages holding the super-deduction assets for only a short period through the introduction of correspondingly super-charged balancing charges.
Tanja Velling	Another surprising way in which I saw a tax measure included in the Budget described in the news was that the repeal of the UK's legislation implementing the Interest and Royalties Directive was described as the Government's taking a step towards closing tax loopholes. Under the Interest and Royalties Directive, EU Member States are required to ensure that, if certain conditions are met, intra-EU payments of interest and royalties are not subject to withholding tax – even if the relevant double tax treaty does not provide for an exemption from withholding tax.
Zoe Andrew	There is an equivalent directive relating to dividend payments, but that is clearly less relevant in the UK context, given that the UK does not generally impose a withholding tax on dividends.
Tanja Velling	That's right, and the issue with the interest and royalties directive is that the UK is now neither an EU Member State nor treated as such. So, payments of interest and royalties from an EU country to the UK should be subject to withholding tax at the relevant treaty rate – which may not be zero. As long as the UK legislation implementing the Interest and Royalties Directive remains on the statute books, payments going the other way

	would be exempt from withholding tax – even where the treaty rate is not zero. It seemed quite clear to me that the repeal of the implementing legislation would be intended to address this mismatch and ensure that EU countries are not treated in a way that is more advantageous than other countries with which the UK has a double tax treaty.
Zoe Andrew	And that must be right. The repeal will take effect from the 1st of June. So, payments made before that date should still be able to benefit from the withholding tax exemption unless they are caught by the anti-forestalling provisions.
Tanja Velling	Now onto some international developments. After the success of two pilots (in which the UK took part), the International Compliance Assurance Programme (ICAP) is now up and running and the OECD has published a handbook for tax administrations and MNE groups containing information on the programme reflecting on the experience and feedback of the pilot groups. The voluntary programme for multilateral cooperative risk assessment and assurance is intended to provide increased and earlier tax certainty for MNE groups and give tax authorities assurance that tax risks have been identified. Issues which may be dealt with under the programme are those international issues agreed between the MNE and the tax authorities to be covered such as transfer pricing, permanent establishment, hybrid mismatch arrangements, withholding taxes and the application of international treaties. And Zoe, you attended the latest OECD tax talks on the 4th of March, didn't you?
Zoe Andrew	I did indeed. But, unfortunately, I can't report that there were any ground-breaking developments. The talks covered the OECD's COVID-19 response which we previously mentioned on this podcast and confirmed a development in respect of their international tax reform project that had already been announced, namely, that the US is dropping the idea of Pillar One being a voluntary/safe-harbour. This should allow discussions to progress more smoothly. The OECD talks also summarised the consultation responses – so may be of interest to someone who did not attend the public consultation hearing. The recording and slides are available on the OECD's website.
Tanja Velling	In some ways the UK Budget could be regarded as a more interesting development in respect of the international tax reform project. Given the planned increase in the UK's headline corporation tax rate, it is not inconceivable that the UK may be content with, or even advocate for, a higher minimum tax rate than the 12.5% assumed by the OECD for the purpose of preparing the economic impact assessment that was published alongside the Pillar Two Blueprint in October 2020. But there have also been some EU developments.

Zoe Andrew	During an informal video conference on the 25th of February, the EU's internal market and industry ministers exchanged views on the proposal to introduce public country-by-country reporting, one of the priorities of the Portuguese Council presidency. The press release that followed confirmed that a clear majority of ministers supported the latest compromise proposal which will be taken forward through negotiation with the European Parliament as a transparency and internal market measure, and not as a tax measure. This means that a unanimous Council decision will not be required for the adoption of the directive; a qualified majority will be sufficient.
Tanja Velling	It is also worth noting that the European Commission has recently launched a number of consultations. The Commission intends to publish a Communication during the second quarter of this year, setting out "a vision for business taxation in the EU and a medium-term agenda for the Commission's action in this area". Based on the preparatory roadmap for business taxation for the 21st century on which stakeholders may comment until the 1st of April, the Communication will consider the role of tax policy in promoting sustainable economic recovery following the COVID-19 pandemic, also taking into account longer-term systemic challenges such as Europe's aging population, climate change and the digitalisation of the economy.
Zoe Andrew	During the third quarter of 2021, the Commission intends to publish Recommendations to the Member States on how to improve the rights of taxpayers involved in cross-border activities. The related public consultation designed to collect information on direct taxes, meaning primarily personal income tax, and certain VAT issues, especially those affecting small and medium-sized enterprises, is open for comment until the 2nd of June.
Tanja Velling	Also open for comments until the 2nd of June is a public consultation on enhanced tax authority cooperation and the gathering and exchange of information in respect of crypto-assets and e-money. The Commission intends to adopt the related measure in the third quarter of this year. It is likely that this will take the form of a directive proposal to further amend the Directive on Administrative Cooperation in the Field of Taxation, commonly referred to simply as "the DAC", unless the Commission can be persuaded that soft-law in the form of guidance addressed to Member States' tax administrations and crypto-assets and e-money operators will be sufficient.
Zoe Andrew	And now on to some recent cases. No one would say partnership taxation is simple. The recent FTT cases of Odey and HFFX are the latest to illustrate the complexity in this area. Like Bluecrest (an FTT decision from last year), these latest cases concerned management incentivisation structures. In Odey, an asset management limited liability partnership introduced a corporate member which would reinvest its allocated profits in the partnership as "special capital" which it would then allocate, at its discretion, to individual members. The facts of HFFX were similar.

Tanja Velling	The question before the FTT in each case was when and how should the members be taxed in relation to this “special capital”. The first option was taxation in the year of allocation under section 850 ITTOIA. The FTT in both cases said “no” to this because there was no entitlement to the payment in a legal sense and there was no scope for the composite approach taken in the Rangers case. The facts in HFFX were particularly helpful in showing that the exercise of discretion by the corporate member was not “merely theoretical”. Now, the second option. Should it be taxed in the year of receipt as miscellaneous income under s687 ITTOIA? The FTT in both cases said yes. The third option was for amounts received to be taxable under the sale of occupation income rules in s773-778 ITA 2007. Although it was not necessary to answer this question given the decision on the miscellaneous income charge, the FTT on both cases answered it nonetheless. In Odey the FTT said no but the FTT in HFFX said yes. These cases show the problems in identifying what constitutes a partner’s share of the profits, although the FTT helpfully confirmed in HFFX that there is no such thing as an unallocated reserve in a partnership. I doubt that this is the end of the matter – I understand that there are further cases in the pipeline and appeals to the Upper Tribunal can be expected.
Zoe Andrew	Imprimatur Capital Holdings is another case on holding companies and the recovery of input VAT and the decision of the First-tier Tribunal might be described as a tie between the taxpayer and HMRC.
Tanja Velling	The Imprimatur group invested in companies spun out from, and seeking to commercialise intellectual property developed by, universities and other institutions. The holding company provided management services, such as advice on how best to exploit the intellectual property, to these portfolio companies. It also provided services to group companies and third parties, for example, organising a peer review of a university’s knowledge and technology transfer programme. In providing these services, the holding company incurred costs, including input tax which it sought to recover.
Zoe Andrew	The Tribunal was satisfied that the services provided to third parties were taxable supplies and associated input tax could consequently be recovered. Unfortunately, the evidence before the Tribunal was that whether, when and/or how much portfolio and group companies were charged varied depending on their ability to pay. Therefore, these services were not taxable supplies and associated input tax was irrecoverable. The Tribunal left it to the parties to agree an appropriate attribution of the total input tax to the two-types of supplies.
Tanja Velling	Clearly, the decision is another reminder of the difficulties associated with the recovery of input tax by holding companies. It also showcases the importance of keeping accurate records and preserving documents. The

	Tribunal commented that it found a spreadsheet of fee income attached to one of the witness statements not “completely reliable” given discrepancies with other records. It also seems that the Tribunal thought it unfortunate that only a small number of sample agreements were included in the trial bundles. And, during cross-examination, one of the witnesses could neither explain a particular discrepancy nor identify the basis on which the holding company was entitled to charge particular fees with any degree of specificity.
Zoe Andrew	The Eastern Power Networks case involved an application for a closure notice in the context of enquiries into claims for consortium relief following a restructuring.
Tanja Velling	HMRC had raised enquiries to determine whether the conditions for consortium relief were satisfied or whether the purpose of the restructuring was to exploit the consortium relief rules in order to maximise the relief available. If the latter, the anti-avoidance provision would apply to reduce or negate the claim. The taxpayers were successful before the FTT in getting a direction for a closure notice, because the FTT decided the point in respect of the anti-avoidance rules in the taxpayers’ favour. The Upper Tribunal, however, set aside the FTT’s decision and the Court of Appeal has now upheld the Upper Tribunal’s decision.
Zoe Andrew	The Court of Appeal found there was an arrangement within the anti-avoidance provision and concluded that HMRC must continue their enquiries to determine the purpose of the arrangement. The Court of Appeal warned that where a statutory provision sets out a number of cumulative conditions to be satisfied, some of which require information to determine if they are met, taxpayers should not pick and choose the information they provide and then ask the tribunal to decide the applicability of one element in the hope that a “quick win” will halt the rest of the enquiry. It certainly backfired in this case – all that the taxpayers have achieved is a stalling of the enquiry for four years while it worked its way up to the Court of Appeal! But now, what’s there to look forward to?
Tanja Velling	Most importantly and as already mentioned, we expect an update on ongoing consultations and some new consultations on tax changes on “Tax Day”, the 23rd of March. The 30th of March is the closing date for the consultation on VAT and value shifting. Anyone planning to respond to that should note that the consultation document was recently updated to make a correction and add a couple of example scenarios.
Zoe Andrew	That leaves me to thank you for listening. If you have any questions, please contact Tanja 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