Slaughter and May Podcast
Tax News Highlights: February 2021

Zoe Andrews	Welcome to the February 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. In comparison with the surge of developments covered in our last podcast, it almost feels as if nothing much has happened during the last few weeks.
Zoe Andrews	Yes, it does seem as if everyone is holding their breath waiting for Budget Day to arrive on the 3rd of March!
Tanja Velling	Well, everyone except the tax department! We are huffing and puffing our way through an exercise challenge for charity. As a team, we are trying to exercise for 28,000 minutes during the 28 days of February. And we're doing that in support of the Charlie Waller Trust, a leading mental health charity in the UK. I admit that, being just over half way in the challenge, I am already quite tired.
Zoe Andrews	So, on to some exciting tax news?
Tanja Velling	Definitely. In this podcast, we will discuss: HMRC's conclusions from the evaluation of its implementation and operation of powers and obligations introduced since 2012, the review of the UK funds regime, the OECD's updated guidance on tax treaties and the impact of the COVID-19 pandemic, the First-tier Tribunal decision in the Wilmslow VAT case, the European Commission's public consultation on VAT and financial services, HMRC's updated guidance on the payment scheme for deferred VAT and the European Commission's grounds for appealing the General Court's decision in the Apple state aid case. This podcast was recorded on the 16th of February 2021 and reflects the law and guidance on that date.
Zoe Andrews	Since 2010, the Government has introduced 40 reforms which strengthened HMRC's powers to administer the tax system. In July 2019, the Financial Secretary to the Treasury called for a review of the implementation and operation of powers and obligations introduced since 2012. The resulting evaluation was published on the 4th of February.
Tanja Velling	"Implementation and operation" as well as "since 2012" are important limitations.

	To carry out the review HMRC established a Powers Evaluation Forum made up of HMRC and external representatives. The external representatives would have preferred if the review had also covered policies underpinning HMRC powers and pre-2012 powers. The government, however, considered that pre-2012 powers had been adequately addressed by a previous review. Similarly, a consideration of underlying policies would not be necessary, given that the powers had been – and I quote here - "properly scrutinised before being granted by Parliament and the Government's view is that they remain necessary and appropriate". So, the scope of the review was not extended and anyone looking for a recommendation that Accelerated Payment Notices, Follower Notices or the Diverted Profits Tax should be abolished will be disappointed.
Zoe Andrews	It is, in some sense, curious and, yet, not all that surprising that DPT was included in the scope of the review. Curious because the review looks at powers and obligations introduced in order to ensure that businesses and individuals pay the right amount of tax – which I would read as tax under the existing rules. But DPT is an entirely new tax. Conceptually, it seems odd to consider a separate new tax as a power to enhance compliance with existing taxes. Yet, it reflects exactly the purpose for which DPT was introduced – namely to encourage multinational enterprises pay what HMRC perceives to be the right amount of corporation tax in the UK. With short notice periods and the requirement to pay up front, DPT was structured so as to inject some urgency into TP enquiries. Whether this is really a good and principled way of designing a tax system would, in my view, have been a worthwhile question for the Powers Evaluation Forum to consider.
Tanja Velling	But, as I said before, policy decisions underpinning relevant powers were outside the scope of the review which focussed on 10 legal reforms and two general themes. It resulted in 21 commitments of which I wanted to highlight a few. Commitment 6 relates to the continued improvement of HMRC's guidance. Acknowledging that guidance is not always up-to-date, HMRC intends to work with its new Guidance Forum to inform strategic priorities for revisions and raise awareness of ways in which users can provide feedback on guidance – for instance, by clicking the "there is something wrong" button at the bottom of the relevant web page.
Zoe Andrews	The report also mentioned that, in response to a recommendation from the Office for Tax Simplification, HMRC are carrying out a consultation on the circumstances in which a taxpayer can rely on published guidance and the

	extent to which a taxpayer will be subject to interest, penalties and the tax in dispute where guidance is found to be unclear or incorrect. This latter point is quite a thorny issue. It raises rather tricky public law issues around the question whether government bodies are able to bind themselves to act outside their powers or unlawfully.
Tanja Velling	Other commitments to highlight are 7 and 8. HMRC will continue to raise awareness of the corporate criminal offence and review how to clarify the scope of the obligation to publish a tax strategy. Commitment 10 envisages that HMRC's compliance with its Charter will be reviewed quarterly and an annual report published. The Charter sets out "the standards of behaviour and values to which HMRC will aspire when dealing with people in the exercise of their functions." Commitment 14 commits HMRC to exploring how awareness can be raised around its internal governance processes, including in respect of the powers underpinning the DPT. And finally, returning to the start, commitment 1 envisages further work on powers and safeguards in the context of the government's 10-year strategy to build a trusted, modern tax administration system which was published last July. The Government has committed to publishing a call for evidence to help identify and prioritise potential reforms.
Zoe Andrews	And now onto the review of the UK funds regime. The UK's asset management industry is the largest in Europe and the second largest globally, contributing significantly to tax revenue and employment. UK funds and asset management firms are key to the management of savings and pensions and support the process of raising capital and providing funding at all stages of the life cycle of a business. The government has been informed that the UK's overall strength in asset management could be improved by addressing barriers to establishing and running funds within the UK. Accordingly, the government has embarked upon a wide-ranging review of the UK funds regime to make the UK a competitive place for funds. There are several strands to this review and they are moving at different paces.
Tanja Velling	The first strand looks at the tax treatment of asset holding companies in alternative fund structures. One of the consequences of the BEPS project, particularly Action 6 on treaty abuse, is investors seeking to locate fund management activity and the asset holding companies themselves in the same place. So now is the

	time to make the UK the location of choice for new asset holding companies. In December, a consultation response and second consultation was published on detailed design features of a new regime for asset holding companies that will close on the 23rd of February 2021. The consultation also considers targeted priority changes to the REIT – real estate investment trust - regime. Draft legislation will then be published during 2021, allowing for a period of technical consultation ahead of its inclusion in the Finance Bill 2022.
Zoe Andrews	The second strand is the wider review of the UK funds regime. A wide-ranging call for input has been published, requesting responses by the 20th April 2021. The goal is to make improvements to the tax and regulation of the UK funds regime to make the UK a more attractive location to set up, manage and administer funds. The new regime should enable a wider range of efficient investments better suited to investors' needs, unleash investment into productive and green technologies and grow the number of funds located in the UK to level up the economy by supporting jobs outside London. The document notes that it will not be possible to make all of the changes under consideration and seeks views on which reforms should be taken forward and how these should be prioritised. Any reforms must be compatible with the government's robust approach on avoidance and evasion and with the UK's international commitments and must ensure the UK can effectively exercise taxing rights over UK source income.
Tanja Velling	So that's not going to be easy. Well, the third strand is the review of the VAT treatment of fund management fees which the government intends to take forward this year. The government is aware that the UK approach to VAT on fund management services can create incentives to locate funds outside the UK. Assessing the correct VAT treatment is currently complex, leading to high administrative burdens and significant volumes of litigation. Leaving the EU presents an opportunity to deliver simplifications and other potential reforms here. The government is looking to take initial views and is currently conducting research, ahead of potentially conducting a separate formal consultation on the options at a later stage.
Zoe Andrews	Separate from the funds review, but important in the context of investment policy, is the Department of Work and Pensions' consultation on making it easier for Direct Contribution pension schemes to invest in long-term assets. The outcome of this consultation will be published in Spring 2021 alongside regulations seeking to increase consolidation of the DC pensions

	market and to increase investment by pension schemes in “illiquid” assets. This builds on work driven by the government’s Patient Capital Review.
Tanja Velling	The message of the OECD’s updated guidance on tax treaties and the impact of the COVID-19 pandemic in respect of questions around the creation of permanent establishments and changes in tax residence is broadly similar to the views expressed in the earlier April 2020 version. The OECD has, however, expanded its commentary and included further examples of national guidance and some notes of caution. The updated guidance reiterates that, where public health measures force employees to exceptionally and temporarily work from their home in a different jurisdiction to the one in which their employer is based, this should not create a permanent establishment for the employer in the employee’s home jurisdiction. Similarly, if exceptionally and temporarily board meetings have to be held in a different jurisdiction than the one where a company is normally managed, this should not trigger a change in the company’s tax residence.
Zoe Andrews	But now comes the note of caution. The updated guidance makes clear that companies’ tax positions could, however, be affected when temporary changes take on a more permanent character. This would, in particular, be the case where an employee continues to work from their home jurisdiction after the public health measures which prevented that employee from travelling to their normal workplace in a different jurisdiction have been lifted. This situation seems relatively clear. But what about situations where restrictions themselves eventually end up being much less temporary than one would expected or hoped? With the development of new COVID-19 variants and doubts on the efficacy of vaccines to protect against them, it seems that some travel restrictions may be here to stay. Will there come a point when tax authorities and the OECD are going to regard the restrictions (and corresponding changes in working practices) as no longer extraordinary or temporary?
Tanja Velling	In our December podcast, I spoke about the long-running Newey case in which, after 10 years, a referral to the CJEU and going all the way up to the Supreme Court and back to the FTT, the FTT reconfirmed its original decision that the offshore VAT-saving scheme is not an abuse of law. The HMRC VAT appeals list now shows no further appeal has been made in Newey. So the FTT’s decision is finally final.

Zoe Andrews	It is interesting to compare Newey (where the taxpayer won) with Wilmslow, another FTT case concerning a loan broking company and arrangements to avoid irrecoverable VAT on advertising services, but which was decided in favour of HMRC.
Tanja Velling	The FTT in Newey had applied the test set out by the CJEU of 'whether the arrangements reflect economic and commercial reality, or instead constitute a wholly artificial arrangement which does not genuinely reflect economic reality'. Looking beyond the contractual provisions, the FTT concluded that the business relationships entered into between Mr Newey, Alabaster, the Jersey advertising company, and third-party lenders did reflect economic and commercial reality, and they did not constitute a wholly artificial arrangement.
Zoe Andrews	Wilmslow involved a similar set up but used a company in Gibraltar, rather than Jersey. A key difference in Wilmslow, however, was that all the marketing, processing and provision of vetted applications for loans was provided by Wilmslow in the UK, bypassing the directors of the Gibraltar entity. Although the Gibraltar company formally held the contracts with lenders, the commercial reality was that Wilmslow had the relationship with them. The facts were such that the FTT found the arrangements were highly uncommercial, did not reflect the economic or commercial reality and were contrived to result in a tax advantage. The FTT held the essential aim was to avoid irrecoverable VAT and that the structure of the arrangements was contrary to the purpose of VAT by its artificiality. In order to eliminate the abusive advantage, the FTT redefined the arrangements to treat Wilmslow as the supplier of loan broking services and the recipient of advertising services at all material times. This shows that the success or failure of a VAT scheme depends on the facts and whether the court or tribunal is persuaded that the facts represent economic reality or if they determine they constitute a wholly artificial arrangement.
Tanja Velling	Continuing with VAT, the European Commission has published a public consultation asking for feedback on the operation of the current VAT exemption for financial and insurances services and for views on options for reform. The potential options for reform under consideration include a full or partial abolition of the VAT exemption for financial and insurance services or the introduction of a fixed rate of input tax deduction for providers of financial and insurance services.

	The consultation is open for comments until the 3rd of May 2021 and it is envisaged that the European Commission will publish a policy proposal during the third quarter of 2021.
Zoe Andrews	The rules in the UK changed from 1st of January 2021 to allow input tax recovery on costs associated with specified supplies of financial services and insurance exported to EU customers, bringing such supplies in line with supplies to the rest of the world.
Tanja Velling	Any businesses that have deferred VAT payments between the 20th of March and the 30th of June 2020 and have not yet paid the deferred amounts will be interested to learn that HMRC's guidance on the payment structure for such amounts has been updated. HMRC will make available an online service between the 23rd of February and the 21st of June 2021 which will allow businesses to opt into an instalment payment regime. Businesses will be able to choose the number of instalments, up to a maximum of 11, depending on when they join the scheme.
Zoe Andrews	As we mentioned in our December podcast, the Commission has appealed to the CJEU against the decision of the General Court in the Apple State aid case. Apple's EUR13 billion dispute is about the fact that two Apple companies incorporated in Ireland but not Irish tax resident were generating tens of billions of euros in profit each year but paying an effective tax rate of 1% in 2003, declining to 0.005% by 2014. Each company had an Irish branch, but only profits attributable to the Irish branch were subject to Irish tax. Apple had obtained rulings from the Irish tax authority agreeing how much of their profits should be treated as attributable to the Irish branches, and therefore subject to Irish tax, and how much should be attributable to their "head offices" – i.e. not the branches – and therefore outside the scope of Irish taxation. In its decision in August 2016, the Commission ruled that the rulings gave Apple a tax advantage and were unlawful State aid which Apple was ordered to repay. Apple and Ireland appealed to the General Court to annul the Commission's decision.
Tanja Velling	In its judgment, the General Court made clear that the mere fact that a ruling may be light on information or methodology does not make it State aid. The Commission has to show that taxable profits went untaxed because of the ruling and the General Court held the Commission had failed to do this.
Zoe Andrews	The Commission has now put forward its grounds of appeal to the Court of Justice. In brief, the Commission argues that the General Court committed several errors of law in rejecting the Commission's Decision. These include that the General Court failed to properly consider the structure and content

	of the Decision and the Commission's written submissions explaining the functions performed by the head offices and the Irish branches and that this failure is a breach of procedure. The Commission also argues that the General Court showed contradictory reasoning, which is a failure to state reasons. Further legal arguments include that the General Court violated the separate entity approach and the arm's length principle by taking into account functions performed by Apple Inc. to reject the Decision's allocation of the Apple IP licenses to the Irish branches. So watch out for the Court of Justice hearing for the next instalment of this high profile dispute!
Tanja Velling	It is likely that we will have to wait a while for that hearing, but there are plenty of other things to look out for during the next few weeks. Most importantly and as already mentioned, the Budget will be held on the 3rd of March and Finance Bill 2021 is expected to be introduced shortly afterwards.
Zoe Andrews	There has been a lot of speculation in the press around measures that might be included in the Budget. A number of companies are reported to have called for an online sales tax to level the playing field between online retailers and bricks and mortar businesses. As we previously reported, there have also been rumours that capital gains tax rates may be raised or even a wealth tax introduced. Others have, however, urged the Chancellor not to raise taxes at this point in time for fear it may harm economic recovery.
Tanja Velling	I suppose that we will just have to wait and see. And the Budget is not the only development to look forward to. Also around the 3rd of March, the Supreme Court is scheduled to hear the appeal in *HMRC v Tooth* concerning the conditions for a discovery assessment under section 29 of the Taxes Management Act 1970. And the 5th of March is the closing date for comments on the consultation of extending Making Tax Digital to corporation tax. This project could bring changes beyond a mere digitisation of current processes such as the alignment of filing dates for company law and tax purposes by bringing forward the time limit for filing company tax returns.
Zoe Andrews	Maybe we will also start to get some further insight into how the US will "reassert American economic leadership in international tax matters", as Dr Janet Yellen stated in her confirmation hearing as US President Joe Biden's Treasury Secretary. In terms of US domestic tax policy, we understand that the Biden/Harris administration intends to increase the US corporate tax rate from 21% to

	28%. It also intends to increase the global intangible low-taxed income, GILTI for short, tax rate from 10.5% to 21%.
Tanja Velling	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. It recently featured an excellent overview of President Biden's potential tax proposals. And you can also follow us on Twitter - @SlaughterMayTax