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In *Burlington*, the FTT considers, for the first time, the purpose test which often appears in double tax treaties. The UT dismisses HMRC's appeal in *Aozora GMAC* confirming that unilateral relief is available for US withholding tax on interest paid to a UK resident that was not a qualified person within the LOB article of the UK/US DTT. Draft regulations are published to help mitigate the tax consequences of the adoption of IFRS 17 from 1 January 2023. In *eMerchantPay*, the FTT holds that supplies were exempt supplies of intermediary services and not taxable payment processing services. A Bill is introduced to Parliament to abolish the special status of retained EU Law in the UK statute book with a sunset date of 31 December 2023 (which may be extended to 2026 for some specified pieces of retained EU law) by which all remaining retained EU Law will either be repealed, or assimilated into UK domestic law.

Burlington: purpose test in double tax treaties

In *Burlington Loan Management DAC v HMRC* [2022] UKFTT 00290 (TC), HMRC had refused a refund of withholding tax on the basis of the purpose test in Article 12(5) (Interest) in the UK/Ireland double tax treaty. The FTT decided in favour of the taxpayer that Article 12(5) did not apply to prevent relief from withholding tax on interest. The case involved the secondary market in claims against Lehman Brothers International (Europe). One such claim was sold by SICL, a Cayman company, to a broker for £82.4m and from the broker to an Irish resident company, Burlington Loan Management (BLM), for £83.55m.

Both SICL and BLM knew that SICL would suffer 20% withholding tax on interest payments made directly to it but BLM would not (because of the UK/Ireland DTT) and the pricing effectively split the benefit of the gross payment (after deducting the broker's turn). HMRC treated this as, in substance, a conduit or treaty shopping case which should fall within Article 12(5) because, in economic terms, SICL was taking advantage of Article 12(1) by selling to BLM for a greater sum than it could have realised itself.

Article 12(5) provided: '*The provisions of this Article shall not apply if it was the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt-claim in respect of which the interest is paid to take advantage of this Article by means of that creation or assignment.*'

The FTT concluded that Article 12(5) did not apply. This was a very sensible decision and feels like the right place to draw the line. It is an important decision for the smooth running of secondary debt markets. In general, an outright sale of an asset to an unconnected person who is entitled to treaty benefits in respect of it by a person who is not and where both parties are aware of that fact and that is reflected in the pricing of the sale ought not to fall foul of a treaty purpose test. The outcome would be different if the purchaser had been established in the relevant jurisdiction in order to benefit from the relevant tax treaty or there is an adjustment mechanism to the consideration dependent on whether or not treaty relief is actually obtained.

This decision is instructive and timely as tax authorities, taxpayers and tax advisers alike are going to have to spend more time in the future considering when an arrangement or transaction might be considered to have a principal purpose of obtaining a treaty benefit in light of the principal purpose test in article 7 of the OECD's Multilateral Instrument.

Aozora GMAC: unilateral relief available where LOB provision denied treaty relief

The sole issue in *HMRC v Aozora GMAC Investment Limited* [2022] UKUT 258 (TCC) was whether ICTA 1988 s793A(3) (since rewritten as TIOPA 2010 s11(3)) denies Aozora entitlement to unilateral relief in the UK in respect of US withholding tax on interest received by Aozora on loans it made to its US subsidiary. The UT concluded, as had the FTT, that unilateral relief was available to Aozora.

Aozora, a UK subsidiary of a Japanese bank, had applied to the IRS for a refund of the withholding tax under the US/UK double tax treaty but the IRS refused to grant Aozora access to benefits under the treaty on the ground that Aozora was not a qualified person within Article 23 (limitation on benefits (LOB)). Aozora then applied to the US competent authority for discretionary treatment under Article 23(6) but this was refused as it could not be determined that the establishment, acquisition or maintenance of Aozora and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under the treaty. It appeared before the FTT that lowering the group's overall tax liability was critical to the way the loans were structured (the loans were made from the UK rather than direct from Aozora Japan because the rate of tax on interest received in Japan was 41%). Because Aozora was denied the benefits of the treaty by the LOB clause, it was not entitled to claim under the treaty for a credit against UK tax for the US tax it suffered on the interest payments.

Having been denied treaty benefits, Aozora made claims in its tax returns for unilateral relief by way of credit under ICTA 1988 s790 against the UK tax due on the interest which brought the amount of corporation tax self-assessed to nil. But HMRC assessed Aozora to tax of nearly £4.5 million on the basis that s793(A) applied to prevent unilateral credit relief. HMRC calculated the tax for the relevant accounting periods on the basis that Aozora was entitled to relief by way of deduction under ICTA 1988 s811 and suffered UK corporation tax on the net amount received (after deduction of the US withholding tax).

The FTT had found that in order for s793A(3) to have effect in relation to the exclusion of credit relief, the terms of the double tax treaty must be explicit as to the cases and circumstances in which the credit relief is not available. The FTT found that the US/UK tax treaty is not so explicit, and in particular Article 23 is not 'an express provision to the effect that relief by way of credit shall not be given'. Consequently, s793A(3) did not apply to prevent unilateral relief in respect of the US withholding tax imposed on the interest received by Aozora.

On appeal to the UT, HMRC argued that the FTT wrongly gave s793A(3) a narrow, literal construction when it should have applied a purposive construction. The UT duly adopted a purposive approach, concluding that the purpose of s793A(3) is not to prevent a claim for unilateral relief whenever there is a double tax treaty but rather that s793A(3) captures a situation where the 'cases or circumstances' in which credit is denied are 'specified or described' in the treaty provision. As Article 23 did not contain an express provision that, or words to the effect that, credit will not be available to a non-qualified person if they do not fall within Article 23(3) or (4) and discretion is not exercised, it did not fit the statutory description so s793A(3) did not apply to deny relief.

The UT concluded that credit relief for non-qualified persons who do not obtain benefits as a result of the Article 23 process is simply outside the scope of the treaty, rather than 'expressly precluded'. HMRC had sought to argue that non-qualified persons who are residents are within the scope of the treaty but are taken out by Article 23 whereas non-residents do not fall within the scope of the treaty in the first place. The UT found that HMRC's interpretation gives rise to undesirable uncertainty which 'it is unlikely that the 'reasonable legislature' referred to by Lord Hodge [in *R (PRCBC) v Home Secretary*] would have intended'.

This decision is a helpful reminder of the interaction of unilateral credit relief and treaty relief although it also shows the difficulty in determining whether unilateral relief is available when treaty relief is not. Although in this case, on the wording of the US/UK treaty, the conclusion was that the LOB provision was not within s793(a)(3), the conclusion might differ for another treaty with a differently-phrased LOB provision.

IFRS 17: draft tax regulations

IFRS 17 represents a complete overhaul of accounting for insurance contracts. It applies a current value approach to measuring insurance contracts, using updated estimates and assumptions that reflect the timing and any uncertainty of cash flows, and recognises profit when services are provided to policyholders, rather than when premiums are received. IFRS 17 will become mandatory for UK companies reporting under International Account Standards (IAS) for accounting periods beginning on or after 1 January 2023.

Following a consultation on the design of tax regulations to help mitigate the tax consequences of the accountancy change, draft regulations were published for consultation until 7 October. The draft regulations ensure that certain amounts that would otherwise be subject to corporation tax on the adoption of IFRS 17 are brought into account by insurance companies over 10 years rather than immediately upon transition.

The consultation also looked at whether the seven year spreading for BLAGAB acquisition expenses required under FA 2012 s79 should be repealed generally (not just for those insurers reporting under IAS) as commercial changes in the life insurance market mean that the need for spreading has reduced in recent years. Repealing s79 and following instead the timing of acquisition expenses in the accounts is intended to simplify matters for life insurers. The repeal of s79 was legislated for in FA 2022 Schedule 5 Part 2 from a date to be appointed. The draft regulations appoint 1 January 2023 as the effective date from which the repeal of s79 applies. There is a saving of spreading under s79, however, for acquisition expenses referable to an accounting period beginning before that date.

eMerchantPay Ltd: VAT exemption for financial intermediary services

The FTT in *eMerchantPay Limited v HMRC* [2022] UKFTT 0334(TC) concluded the supplies made to the appellant, EMPL, by EMPO (a Bulgarian member of the same corporate group) should be characterised as a single composite supply of intermediation services and not, as HMRC had argued, as taxable payment processing. The supplies were therefore exempt within VATA 1994 Schedule 9 Group 5 Item 5. EMPO provided financial intermediation services to EMPL to enable EMPL to carry on the business of a payment services provider providing businesses with the ability to accept card payments.

EMPL interposes between a merchant and a card acquirer (which interfaces with card institutions) to match them with each other. As EMPL had no employees to carry out this service, it sub-contracted the services to another member of the group, EMPO. The FTT concluded on the facts that the core of the services provided by EMPO relate to the elements essential in bringing credit acquirers together with merchants so the former can provide financial services to the latter. The FTT disagreed with HMRC's view that the principal feature of the supplies was payment processing.

The application of the exemption for financial intermediation services is currently heavily dependent on the interpretation of CJEU case law. It will be interesting to see how this area develops once The Retained EU Law (Revocation and Reform) Bill 2022 is enacted (see below) and whether there will be any significant changes to VAT on financial services.

The Retained EU Law (Revocation and Reform) Bill 2022: impact on tax law

The Retained EU Law (Revocation and Reform) Bill will abolish the special status of retained EU Law in the UK statute book on 31 December 2023 and will enable the Government, via Parliament, to amend more easily, repeal and replace retained EU Law. The Bill will also include a sunset date of 31 December 2023 by which all remaining retained EU Law will either be repealed, or assimilated into UK domestic law. The sunset may be extended for specified pieces of retained EU Law until 2026.

The legislation will, among other things, provide domestic courts with greater discretion to depart from retained EU case law, and provide new court procedures for UK and devolved law officers to refer or intervene in cases involving retained EU case law.

According to the press release announcing the introduction of the Bill, all required legislation relating to tax and retained EU law will be made via the Finance Bill (or subordinate tax legislation) and there will be a bespoke legislative approach for retained EU law concerning VAT, excise, and customs duty in a future Finance Bill. This approach will revoke any remaining retained direct EU law that was not repealed in the Taxation (Cross-border) Trade Act 2018, and make clear that UK Acts of Parliament and subordinate legislation are supreme.

What to look out for:

- **The Chancellor has promised to outline, in October, regulatory reforms to ensure the UK's financial services sector remains globally competitive.**
- **The Court of Appeal is scheduled to hear the appeal in *Centrica Overseas Holdings Ltd v HMRC* (expenses of management) on 25 or 26 October.**
- **Although the Chancellor announced closure of the OTS, it will take effect from Royal Assent of the next Finance Bill and so in the meantime, the OTS report on the taxation of property income is expected to be published in October and its call for evidence as part of its review of hybrid working closes 28 October.**
- **The Upper Tribunal is scheduled to begin the appeal hearing in *M Group Holdings Ltd v HMRC* (substantial shareholding exemption) on 7, 8 or 9 November.**

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