Slaughter and May Podcast
Tax News Highlights: July 2021

Zoe Andrews	Welcome to the July 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 this podcast, we will cover the First-tier Tribunal decision in *West Burton* and the Supreme Court's judgment in *Haworth*. We will also bring you the latest on international tax reform and details on the "roadmap" for financial services post-Brexit. This podcast was recorded on the 13th of July 2021 and reflects the law and guidance on that date.
Zoe Andrews	*West Burton Property Limited v HMRC* is an important case on the interaction of accounting and tax computation rules. Although this case involved the calculation of the taxable profits of a property business, the principles in this case can be read across into other accounts-based tax regimes such as trading profits, loan relationships and intangible fixed assets. This FTT decision, carefully reasoned by Judge Beare, looks at what it means for amounts to be recognised, or brought into account as a debit, in calculating the profits shown in the profit and loss account in accordance with section 48 of the Corporation Tax Act 2009. HMRC argued for a very narrow construction, but Judge Beare found there is nothing in the implied language of the legislation which limits the items to be treated as having been brought into account to those items actually set out in the P&L.
Tanja Velling	West Burton Property Limited had incurred revenue expenditure on maintaining the power station which it owned. It had capitalised this expenditure in the accounts in the year in which it was incurred and then amortised this deferred revenue expenditure (DRE) over 4 years. A decision was made to simplify the group's structure which involved the power station being sold to another group company. At the time of the sale, approximately £65m of the DRE remained undepreciated and continued to be reflected in the book value of the power station. As the power station was sold at book value, the P&L recorded a nil amount for the sale. So, the DRE did not itself appear on the face of the P&L, but the judge concluded that it was still brought into account in calculating West Burton Property Limited's profits.
Zoe Andrews	This case shows that you can look behind the face of the accounts to find the component debits and credits making up a single net entry. As Judge

	Beare explained, if HMRC had succeeded in their submissions, it would have driven a coach and horses through the tax system, rendering it incapable of functioning effectively and appropriately.
Tanja Velling	And now let's have a look at the Supreme Court's judgment in *Haworth*, a case involving judicial review proceedings to challenge HMRC's issuance of a follower notice. The key issue in this case was whether the conditions for the issuance of a follower notice had been met. HMRC may issue a follower notice where HMRC contends that a tax advantage claimed by a taxpayer depends on a particular interpretation of the relevant legislation and that a court or tribunal has already decided that that interpretation of the legislation is wrong. HMRC issued a follower notice to Mr Haworth on the basis that HMRC considered his arrangements to avoid nearly £9m capital gains tax using a combination of sections 86 and 77 of the Taxation of Chargeable Gains Act 1992 and the application of the UK/Mauritius tax treaty were, in all material respects, the same as those that had been considered by the Court of Appeal in *Smallwood*.
Zoe Andrews	One of the conditions HMRC had to satisfy was to show that *Smallwood* is a "relevant ruling" for the purpose of Mr Haworth's arrangements. HMRC had to show that they had formed the opinion that the principles laid down, or the reasoning given, in the *Smallwood* decision **would**, if applied to the arrangements of Mr Haworth, deny all or part of the tax advantage he asserted. The question for the Supreme Court was what degree of certainty was required to satisfy this condition. Mr Haworth's application for judicial review was dismissed by the High Court but allowed by the Court of Appeal. The Supreme Court unanimously upheld the Court of Appeal's decision to quash the follower notice. HMRC's opinion **that it was likely** that the ruling in *Smallwood*, if applied, would deny Mr Haworth his tax advantage was not sufficient for the purposes of section 205(3)(b) of the Finance Act 2014.
Tanja Velling	The Supreme Court also found that HMRC had misdirected themselves in their analysis of *Smallwood*. In deciding to issue a follower notice, HMRC proceeded on the basis that, if the seven indicators that they had distilled from *Smallwood* were present in a given case, the place of effective management of a trust would inevitably be in the UK. But HMRC had overstated the conclusion of the Court of Appeal in *Smallwood*. The factual summary from which HMRC had derived the indicators was not intended to set the necessary and sufficient preconditions to establish that the place of effective management of a trust was in the UK **in any other case**. In each case, all relevant facts and

	circumstances must be examined to determine the place of effective management.
Zoe Andrews	This is an important victory for the taxpayer. The effect of the follower notice regime is that the taxpayer must decide whether to accept HMRC's interpretation of the legislation in light of the relevant court or tribunal decision or to continue to challenge HMRC's assessment on the basis of the taxpayer's own different interpretation of the provisions. The downside is that, if the taxpayer chooses to litigate and then loses, they may suffer a substantial financial penalty (of up to 50% of the tax advantage) in addition to the tax due. Another consequence of HMRC issuing a follower notice is that they can also then issue an accelerated payment notice, requiring the taxpayer to pay the tax upfront rather than waiting until the outcome of the dispute. The purpose of the follower notice regime is to deter further litigation on points already decided by a court or tribunal and to reduce the administrative and judicial resources needed to deal with such unmeritorious claims. The threat of a substantial penalty is intended to discourage a taxpayer from pursuing an appeal. So it is an important protection for the taxpayer that HMRC must satisfy the conditions required to give the notice and it is reassuring that the provisions will be interpreted restrictively to produce minimum interference with the taxpayer's right to justice.
Tanja Velling	In our June podcast, we discussed the press coverage of the G7's "deal" on international tax reform which the UK Treasury's press release had described as "seismic" and "historic". What has been the news on international tax reform since then?
Zoe Andrews	The G7 deal was swiftly followed by a statement from the OECD on the 1st of July that 130 of the 139 countries which form the OECD's Inclusive Framework had reached agreement in principle on certain aspects of the international tax reform project. Two further countries have since supported the statement. Of 7 still showing opposition, 3 are EU countries (Ireland, Hungary and Estonia) which will need to be persuaded in order for the EU as a whole to endorse the proposals.
Tanja Velling	That Estonia features among the European rebels may initially look surprising given that I don't think it is generally thought of as a country with a particularly low corporation tax rate. Estonia has, however, been at the top of the Tax Foundation's tax competitiveness index for several years running. The 2020 index highlights as one of Estonia's strengths that its "corporate income tax system only taxes distributed earnings, allowing companies to reinvest their profits tax-free." So, most companies' actual tax base in Estonia is likely to be far smaller than what would be attributed to

	them under the minimum tax rules, meaning that Estonian income may well be regarded as undertaxed for these purposes.
Zoe Andrews	Nonetheless, I think, now that so many countries are on board, we can get excited about international tax reform. In fact, in the communiqué following their meeting on the 9th and 10th of July, the G20 Finance Ministers have expressed their support for the OECD's 1st of July statement and invites the remaining Inclusive Framework members to join the international agreement. The communiqué also calls on the OECD and the Inclusive Framework to address the remaining open issues and finalise outstanding design elements. So let's have a look at some of the things which have been agreed and highlight some of the key issues that are still open.
Tanja Velling	On Pillar 2, the global minimum tax, a rate of at least 15% has been agreed and will be applied on a country-by-country basis to multinationals with global revenues exceeding 750 million euros. There will be a *de minimis* and a formulaic substance-based carve-out to exclude income that is at least 7.5% of payroll and the carrying value of tangible assets. After 5 years, the carve-out percentage will, however, reduce to 5%. On Pillar 1, the new taxing right, market countries would be awarded taxing rights of between 20% and 30% of profit exceeding a 10% margin, of the multinational enterprises with global turnover above 20 billion euros. The US originally proposed that Pillar 1 should catch only the largest 100 multinational enterprises. But how many companies are expected to be caught with the agreed thresholds?
Zoe Andrews	The thresholds which have been agreed limit the number to 78 MNEs, according to research by the Oxford University Centre for Business Taxation, reported in a recent EconPol Policy Brief. This research also shows 64% of the Pillar 1 tax will be attributed to US-headquartered MNEs and only 37 European companies are likely to be affected.
Tanja Velling	Continuing with Pillar 1, the 130 countries also agreed that digital services taxes and other relevant similar measures on all companies will be removed. Did you have any further thoughts on what this might mean for the EU Commission's proposal for a digital levy which was due to be published on the 14th of July? I recall that in our June podcast, we queried whether this would end up being regarded as a "relevant similar measure"…

Zoe Andrews	Interestingly, the EU has suspended work on the EU digital levy until October following pressure from the US. The US sees this levy as an EU-wide unilateral measure which could derail the international agreement, but the EU is insistent that it can coexist with the new international rules and will not target US companies but is instead a levy on all digital sales to raise revenue for the EU.
Tanja Velling	And what are the key areas which still lack technical detail and/or political agreement?
Zoe Andrews	In our June podcast, we mentioned that it seems to be envisaged that Amazon will be within the scope of the rules, but only in respect of one of its business lines. But segmentation rules have not yet been agreed and it is apparently anticipated that segmentation will occur only in exceptional circumstances. One would, however, assume that it would apply not just to Amazon! The re-allocation of the residual profit share to market jurisdictions will require some detailed source rules which have not yet been developed. Further work will also have to be done on a marketing and distribution profits safe harbour which will cap the residual profits available for re-allocation. And then there is tax certainty. It looks like this will not be instant and there will be a period of time when some double taxation is inevitable – which is nothing that anyone wants to hear!
Tanja Velling	In respect of Pillar 2, there are still a number of issues to work out around its co-existence with the US GILTI regime. And, more fundamentally, given the complexity of the rules, mechanisms (such as safe harbours) need to be developed to properly target the rules and avoid disproportionate compliance costs. Hungary also expressed a concern which needs to be worked through, namely that the minimum tax rules may infringe EU law (notably, the freedom of establishment) as *Cadbury Schweppes* famously established that basing subsidiaries in low tax jurisdictions does not, of itself, constitute tax avoidance. So what happens next?
Zoe Andrews	The aim is still for a detailed implementation plan to be finalised by October 2021 in time for the G20 summit in Italy, although work on the application of the arm's length principle to in-country baseline marketing and distribution activities will not be completed until the end of 2022. The new taxing right and the global minimum tax are intended to become effective in 2023.

	But concerns remain about implementation – in particular the logistics of the US passing the relevant legislation – so aiming for these fundamental changes to international tax rules to come into effect in 2023 seems ambitious.
Tanja Velling	Let's move on to the roadmap for financial services post-Brexit which was published on the day of the UK Chancellor's Mansion House speech. The document does what is says on the tin – it sets out the "government's vision for an open, green and technologically advanced financial services sector that is globally competitive and acts in the interests of communities and citizens, creating jobs, supporting businesses, and powering growth across all of the UK". The publication sets out high level policy aims with many buzzwords, but unfortunately without much detail.
Zoe Andrews	It included no new tax measures, but re-confirmed measures that had already been announced. It promises that the Government "will maintain and build on the UK's attractive and internationally respected ecosystem for financial services across both regulation and tax" and notes that, as announced at Budget 2021, the Government will set out in the autumn how it will ensure that the level of taxation on banks remains constant despite the planned increase of the corporation tax rate. The roadmap also refers to the review of the UK's funds regime that is underway and includes "tax and relevant areas of regulation". And now, what is there we can look forward to over the next month?
Tanja Velling	• "L Day" in the UK has been set for the 20th of July when we expect the Government to publish draft clauses for the next Finance Bill, which will largely cover pre-announced policy changes, along with accompanying explanatory notes, tax information and impact notes, responses to consultations and other supporting documents. • The Residential Property Developer Tax consultation closes on the 22nd of July and the call for evidence on simplifying the VAT land exemption closes on the 3rd of August. • Next month, instead of the usual Tax News Highlights, you can look forward to a special edition of this podcast for which I will be joined by Nele Dhondt from our Competition department.
Zoe Andrews	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.