Slaughter and May Podcast
Tax News Highlights: December 2021

Zoe Andrews	Welcome to the December 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 cover three highlights from the UK's Tax Administration and Maintenance Day, some key takeaways from the IFA virtual event on international tax reform and HMRC's latest Report and Accounts and the Tax Receipts statistics for 2020 to 2021. We will also discuss the Upper Tribunal's decision in *Assem Allam* and the First-tier-Tribunal's decision in the *Hargreaves Property Holdings* on withholding tax. This podcast was recorded on the 7th of December 2021 and reflects the law and guidance on that date. So, Zoe, whatever happened to the notion of a single fiscal event per year?
Zoe Andrews	Well, at least for this year, it feels like we've had so many "tax events" that we deserve a pay rise! After the Autumn Budget (which was the second Budget and third fiscal event, if you count the September Health and Social Care Levy announcement, of the year), we had another day set aside for tax publications (a trend which seems set to continue). And this time, it was called "Tax Administration and Maintenance Day". More than 30 documents – consultation responses, new consultations, reports and ancillary documents – were published, but we shall highlight only a few: the reform of taxation of securitisation and insurance-linked securities, the Government's response to the OTS review of CGT and the report on the large business review.
Tanja Velling	In my post on the European Tax Blog, I also noted that draft regulations have been published to replace the UK's scaled-back implementation of DAC6, but which are not generally intended to change the substantive scope of the reporting obligation, and that the Government plans to legislate on transfer pricing documentation to require that a master and a local file are maintained, but shelved the proposal to introduce a requirement to maintain an international dealings schedule. I don't propose that we discuss these in more detail here. So, Zoe, do you want to start with the reform of taxation of securitisation and insurance-linked securities?

Zoe Andrews	Yes. The consultation which closed in June 2021 identified several areas where the tax rules should be updated to reflect developments in the securitisation market. Two sets of draft regulations have been published for consultation until the 10th of January to implement, with effect from Royal Assent of Finance Bill 2022 (which is expected in the Spring), the Government's policy decisions in relation to three areas. The first measure addresses uncertainty and complexity in the application of the securitisation tax regime to "retained securitisations", which are those where more than 50% of the securities are not issued to third parties but are acquired and "retained" by the originator. It does so by amending the independence qualification condition so that independence is tested by reference to the control of an entity's affairs through the holding of shares, possession of voting rights or powers given by the articles of association. The revised qualification condition is intended to have the effect that an originator is generally treated as independent from the SPV in commercially driven retained securitisations.
Tanja Velling	The second policy decision is to widen access to the securitisation tax regime by reducing the threshold limit per capital market arrangement from £10 million to £5 million. The third measure creates a new exemption from stamp duty and SDRT for the transfer of capital market investments issued as part of capital market arrangements by note-issuing securitisation vehicles and qualifying transformer vehicles. This means reliance on the loan capital exemption is no longer necessary in this context. The original consultation had asked whether updated HMRC guidance on the loan capital exemption would resolve the uncertainty, but it is much better to have this dealt with in secondary legislation as a new exemption to provide certainty. It can only be hoped that HMRC take this approach to heart in other areas, too, where it would be better to have more precise legislation than clarification through guidance.
Zoe Andrews	Areas which continue to be explored by the Government in informal consultations include whether the scope of assets which can be securitised should be expanded beyond financial assets and whether the securitisation regime is available to the appropriate range of sectors and types of investor, including reflecting on how the regime fits with the new qualifying asset holding company regime. One area that is not currently under consideration, however, is the complexity of the current VAT rules and the extent to which irrecoverable VAT creates a cost in the securitisation context, but the Government has

	noted the comments received on this, so perhaps they will be taken into account at some point. What is of interest in the Government's response to the OTS review of CGT?
Tanja Velling	The response indicates which changes are or may be taken forward and those which are not on the agenda right now. Many entrepreneurs will be relieved that the Government is not currently considering any fundamental change such as more closely aligning CGT rates with income tax rates. But some of the measures we expect to see in the pipeline will be of interest.
Zoe Andrews	For example, one of the suggestions which the Government labels as "under consideration" is enabling an irrevocable provision in the documentation for a corporate bond to specify that it is subject to CGT and for the absence of such a provision to mean it is exempt. As a result, it would no longer be necessary to include particular features in the drafting to ensure a bond either is or is not a qualifying corporate bond and so exempt from CGT. The Government also notes that the bond market and tax rules have changed considerably since the introduction of the CGT exemptions for both corporate bonds and gilts and the Government will consider this point further within the context of a wider review into the purpose and functioning of those exemptions.
Tanja Velling	One of the recommendations the Government agrees with is that HMRC guidance should be improved in specific areas, including when a debt is a debt on a security and when business asset disposal relief could apply to farmers or others looking to retire over a period of time. What can you tell us about the report on the review of large businesses' experience of UK tax administration?
Zoe Andrews	The Government announced this review at Spring Budget 2021 to complement the wider tax administration framework review. The report is the result of discussions between HMRC, HMT and stakeholders. The review focused on tax risk and certainty; compliance, enquiries and disputes; and the co-operative compliance and CCM model. As a result of the review the Government has announced action in three key areas: mitigating uncertainty through new "Guidelines for Compliance" and improved guidance; changes to help address long-running enquiries and improvements to the co-operative compliance experience. HMRC will also improve the systems and processes relating to the issuing of certificates of residence, including further digitalisation.

	The new "Guidelines for Compliance" and improved guidance sound helpful, don't they?
Tanja Velling	I think so. HMRC will develop new guidelines following the success of the practical guidance piloted to support the Profit Diversion Compliance Facility. The guidelines will show what HMRC regards as higher or lower risk and the associated response. HMRC's technical guidance will also be improved and stakeholders will be invited to identify priority areas for guidance improvement or expansion. This activity will also align with the work on the notification of uncertain tax treatment proposals where it is in HMRC's interest to make sure its "known position" is clear. Products are expected to be delivered by mid to late 2022. Indeed, we have already seen an example of improved guidance. The guidance on HMRC's approach for large business was updated on the 30th of November to include a new section on the framework for co-operative compliance. This sets out what is expected from HMRC and from large businesses in relation to working professionally, business governance and tax planning and risk management. It states that HMRC will prioritise resources to work with large businesses in areas of absolute risk or genuine uncertainty or commercial urgency. Do you want to add something on long-running enquiries and co-operative compliance?
Zoe Andrews	Sure. HMRC will establish new, objective indicators of long-running enquiries and a clear and transparent process to accelerate their resolution. Where indicators are present, businesses will be able to challenge long-running enquires or facilitate their conclusion. Work on the indicators and process is expected to take place in early 2022. Co-operative compliance principles continue to underpin HMRC's approach and, in response to the feedback that the experience could sometimes be inconsistent and could be improved, HMRC will work with businesses in 2022 to consider how co-operative compliance best practice can be delivered more consistently and provide more clarity and transparency on the governance processes and the role of the CCM in resolving disputes and taxpayer questions.
Tanja Velling	So, there will be a quite a bit of further work on tax administration. But what about one other substantive measure which was mentioned at the Budget – did we get the promised consultation on an online sales tax?
Zoe Andrews	We have to wait until the new year for that one. The command paper published on the 30th of November explained that the Government continues to explore the arguments for and against a UK-wide online

	sales tax. This is unsurprising; I suspect the Government is awaiting the outcome of further technical work on the OECD's international tax reform proposal. As we mentioned during the November podcast, the OECD/IF statement of the 8th of October stressed that the multilateral convention to bring into force Pillar 1 will commit signatories to roll back existing, and not enact further, digital services taxes "or other relevant similar measures" and designing an online sales tax to fall outside this is likely to be rather difficult. This message was reiterated by a panellist's suggestion during last week's IFA virtual event on the global tax agreement that the definition of "relevant similar measures" will be a key point in ongoing OECD/IF technical work. Anything else you wanted to highlight from the IFA event?
Tanja Velling	It brought together lots of different perspectives on the international tax reform project. Pillar 1 is running at a slower pace than Pillar 2. A draft multilateral convention to implement Amount A of Pillar 1 is not expected until Spring 2022 and work on Amount B will not be completed before the end of 2022. On Pillar 2, the OECD missed its November deadline for the publication of the model rules, but work continues apace. The European Commission plans to publish a draft EU Directive to implement Pillar 2 on the 22nd of December with the aim of having it finalised in time for the French elections in April 2022 and so as to give member States some time (although less time than is usual) to implement the Directive. There will be a key difference between the OECD model rules and the EU directive, however – in order to avoid infringing the principle of freedom of establishment, the EU version of Pillar 2 will extend the rules to subsidiaries and constituent entities in the same member State as the parent – there will be no requirement for a cross border element.
Zoe Andrews	Another key theme I noticed during the IFA talks was businesses' concern that, in the rush to overhaul and stabilise the international tax system, there won't be time to consult further on the details of Pillar 2 – either at OECD or EU level. In the absence of prior stress-testing, the rules are likely to require tweaks to make them work as intended which will be hard to make, given the level of international cooperation required. There is also a concern that, because some details are not expected until later in 2022 (for example on administrative procedures, safe harbours and on the co-ordination of the different tools which form part of Pillar 2 and how they interact with existing domestic rules), businesses will not have sufficient information to build the IT systems to

	ensure compliance if the rules come in as planned in 2023. US headquartered groups whose systems are already set up to deal with GILTI will be in a better position than non-US headquartered groups who have not previously needed tools to track ETR in different jurisdictions.
Tanja Velling	It sounds a bit like the story of our hybrid mismatch rules – but on a much grander scale. What did you make of the HMRC's latest Report and Accounts and the Tax Receipts statistics for 2020 to 2021?
Zoe Andrews	HMRC collected £583.9 billion in taxes in 2020 to 2021, a decrease of 7.8% from the year before, but higher than expected earlier in the pandemic. There's a section in the Report and Accounts on how HMRC is tackling non-compliance which states that HMRC is currently carrying out around 100 investigations into multinationals – the total amount of tax at stake was £3.8 billion at the end of March 2021. We know that corporation tax and VAT receipts have increased as a result of the diverted profits tax. The data about tax appeals also always makes for an interesting read. HMRC's success rate for all decided appeals across all tribunals and courts was 86% (up from 82% in 2019 to 2020). HMRC's success rate before the Supreme Court, was, however, only 40% suggesting that, if a taxpayer makes it that far, the taxpayer is more likely to win before the Supreme Court than HMRC. Included in the figures were 38 tax avoidance cases, 35 of which (that's 92%) were decided wholly or partially in HMRC's favour protecting tax revenue of around £1.7 billion (the same amount of revenue as in 2019 to 2020). Overall, tax protected through litigation was £9.8 billion.
Tanja Velling	The Upper Tribunal's decision in *Assem Allam* concerned three separate appeals on a number of different procedural and substantive issues. One of these related to the definition of "trading company" for the purpose of what is now business asset disposal relief (and was at the relevant time entrepreneurs' relief), but the same definition is used throughout the TCGA, including in respect of the substantial shareholding exemption. For these purposes, "trading company" is defined as a "company carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities", and HMRC's Manuals contain a helpful statement indicating that "substantial" would be taken to mean "more than 20%".

Zoe Andrews	This statement has unfortunately been called into question. The UT stated that "[i]t is not appropriate to apply any sort of numerical threshold as suggested by HMRC's guidance." Instead, all of the company's activities have to be identified. Then the significance of the non-trading activities has to be considered in the context of the company's activities as a whole and, in this assessment, physical human activity as well as financial measures of activity should be taken into account. The Upper Tribunal considered that holding investments and collecting rent would be activities for the purposes of the test and that the capital employed in non-trading activities can be taken into account in considering their significance.
Tanja Velling	The Upper Tribunal was also critical of the weight placed on the absence of physical activity in the First-tier Tribunal's decision in *Potter*, another entrepreneur's relief case, which had generally been regarded as a helpful indication that the built-up and investment of significant cash reserves does not necessarily prejudice a company's trading status. The company in *Potter* had built up reserves of £1 million when the financial crisis hit. £800,000 was invested in a six year bond and the remainder retained as working capital. Despite the owner's attempts to rekindle the business, it did not recover and the company went into liquidation in 2015. The FTT considered that the trading company test had been satisfied for the one year period up to the 12th of November 2012, the date three years before liquidation, as required for entrepreneur's relief to apply. The end result was that the taxpayer in *Allam* was less fortunate than the one in *Potter*: the Upper Tribunal upheld the FTT's decision in HMRC's favour on the trading company point.
Zoe Andrews	The case of *Hargreaves Property Holdings Ltd* concerns the question whether payments of interest were subject to withholding tax. A simplified version of the facts is that the UK-resident parent of a group which derived the entirety of its revenue from investing in UK real estate attempted to restructure the group's loan finance so as to receive tax deductions for the interest but escape UK taxation on it. The FTT, however, upheld HMRC's withholding tax assessments with only minor variations. There are three points we wanted to highlight (we shall ignore a fourth point around beneficial ownership for the purposes of this podcast). In considering whether the interest has a UK source, the FTT concluded, quite unsurprisingly, that no weight should be attached to the fact that the creditor is non-UK resident, that very little weight should be attached to the governing law and that the fact that payments were required to be

	made, and proceedings would have had to have been brought, outside the UK cannot outweigh the crucial factor pointing to a UK source, namely that the debtor was a UK resident company carrying on a business exclusively in the UK. That was the first point.
Tanja Velling	The second point concerns the question of what constitutes “yearly” interest. In *Hargreaves*, the loans were repayable on demand and were, in fact, repaid within a period of around one year with advances from the same related lenders. The FTT considered that, on the facts, the loans had the character of an investment with a sufficient measure of permanence to give rise to yearly interest. The FTT made explicit that it reached this conclusion without re-characterising the individual loans as a single long-term loan. So, what can we learn from the decision? That yearly interest alarm bells should go off where a long-term funding need is met by rolling short-term loans from related parties. The final point relates to the importance of procedure. Even where treaty relief would have been available, the borrower was not entitled to pay gross because HMRC had not issued a direction to that effect. A direction is a necessary pre-condition and should be applied for in good time before interest payment dates, using the more straightforward route under the Double Taxation Treaty Passport Scheme, where available.
Zoe Andrews	Whilst the understandable temptation is to switch to holiday mode at this time of year, there is still a lot to look out for, in particular on international tax reform. The OECD’s Pillar 2 rules which were expected at the end of November have, at the time of recording, yet to be published and the European Commission intends to publish its draft Pillar 2 implementing directive on the 22nd of December. At the IFA event, it was also reported that the EU is considering making Pillar 1 an own resource – in which case there would need to be a directive to implement Pillar 1 as well. It is expected that this will be confirmed by the EU in the coming weeks.
Tanja Velling	And that leaves me to thank you for listening and wish you a lovely holiday season. 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 Twitter – @SlaughterMayTax.