TAX AND THE CITY REVIEW

The Upper Tribunal confirms in *McCabe* that arguments made by HMRC as part of the MAP process do not have to be disclosed by HMRC to the taxpayer in the context of domestic proceedings. HMRC statistics show corporation tax receipts in 2019/20 increased, largely driven by the change in instalment payment deadlines for very large companies but that corporation tax liabilities from the finance and insurance sector for 2018/19 show a decrease of 11%. The FTT reconfirms its decision of ten years earlier that the offshore VAT-saving scheme used in *Newey* is not an abuse of law. ESMA recommends legislative change to enable National Competent Authorities to share information with tax authorities on abusive schemes and recognises that dividend arbitrage, cum/ex, cum/cum and withholding tax reclaim schemes are primarily a tax related issue to be addressed at the level of individual Member States in preference to increasing the supervisory powers of NCAs. The European Commission commits to proposing plans in 2022 for a common, standardised, EU-wide system for withholding tax relief at source.

McCabe: MAP arguments not required to be disclosed in domestic proceedings

The substantive dispute in K McCabe v HMRC UKUT 0266 (TC) involves the location of the taxpayer's tax residence. HMRC determined Mr McCabe as UK tax resident in the relevant years but he disputes this. In 2016, mutual agreement procedure (MAP) proceedings were begun under the UK/Belgium treaty. Mr McCabe argued he was resident in Belgium but in 2017 the MAP process determined him to be UK resident. There is no reasoned judgment for a MAP decision so a taxpayer does not know the rationale for the decision or the arguments put forward by HMRC.

Mr McCabe is now challenging before the First-tier Tribunal (FTT) HMRC's assessment of him as UK resident and has raised concerns that HMRC had taken an inconsistent approach with regard to MAP from the approach it was taking in the substantive appeal. Accordingly, the taxpayer asked the FTT to order HMRC to disclose the MAP papers but the FTT refused the application.

The Upper Tribunal (UT) has dismissed the taxpayer's appeal finding that the FTT was correct to conclude that the documents sought by the disclosure application would have no probative value in relation to the issues to be determined in the appeal and so the FTT was correct to categorise them as of low relevance. The views or arguments of the UK and Belgian competent authorities would shed no light on the primary facts which the FTT will have to determine. To quote the UT: 'The MAP is not part of the appeal to the FTT; it was a collaborative process between the competent authorities of two jurisdictions, the outcome of which Mr McCabe has exercised his right not to accept.'

MAP is, of course, something that more and more groups are going to get exposure to following the widespread adoption of the MLI. For example, we have seen a number of EMTN programmes recently where the group has been looking to add an EU incorporated, but UK tax resident, issuing vehicle to preserve European Corporate Bond eligibility of euro-denominated bonds after the end of the Brexit transition period. Generally, it is no longer enough to secure (sole) UK residence simply to ensure both central management and control and place of effective management are located in the UK. The MAP process usually has to be followed for the incorporation state to cede its taxing rights. In that context it is interesting that the dispute in *McCabe* appears to be a factual one, capable of determination by the FTT. The relevant treaty tie breaker has four hierarchical limbs to it. The first three allocate residence by reference to facts, the fourth is the catch all settlement by mutual agreement. Ultimately, the dispute between Mr McCabe and HMRC appears to be whether the factual conditions to assign sole residence to Belgium are satisfied and, as such, it is not so surprising that the UT found that the UK and Belgian tax

authorities' views as to what the facts were did not need to be disclosed and were a matter for the FTT to determine in the usual way.

What would happen if residence had been determined not by reference to objective factors specified in the treaty but simply as a result of agreement between the tax authorities? Could the taxpayer, if it was quick off the mark, go for judicial review of HMRC's decision and would MAP papers be disclosable in that context as that would be the only basis of finding out how the decision had been reached?

Tax receipts 2019/20

According to statistics released by HMRC in September, corporation tax receipts in 2019/20 increased, largely driven by the change in instalment payment deadlines for very large companies. The report notes a continued growth in capital allowances claims and that five sectors (including the finance and insurance sector) account for over half of capital allowances claims. The main impacts of the pandemic are expected to occur in 2020-21 rather than being shown in the 2019/20 receipts.

The report 'Pay-As-You-Earn and Corporate Tax Receipts from the Banking Sector' shows that PAYE and bank levy receipts have fallen, but corporation tax and bank surcharge receipts increased slightly, both of these increases being driven by the instalment payments timing change. It is not surprising that bank levy receipts have fallen given the reductions in the rates.

In 2018/19, the largest 4,500 companies' liabilities accounted for 55% of the total corporation tax liabilities (up from 50% in 2017/18). Corporation tax liabilities from the finance and insurance sector decreased by 11%, however, in 2018-19 whereas one of the sectors to have seen a significant increase in liabilities is information and communication (up by 13%). In 2017-18 corporation tax liabilities of the finance and insurance sector accounted for 25% of total CT liabilities, but for 2018-19 this has decreased to 22% of the total CT liabilities, reflecting the decrease in gross taxable trading profits for the industry.

Newey: abuse of rights

Paul Newey (T/A Ocean Finance) v HMRC [2020] UKFTT 0366 TC is the latest instalment of this long-running concerning whether a VAT-saving scheme was an abuse of law – and the parties are back to where they were after the original FTT decision ten years previously!

Mr Newey carried on a loan-broking business in the UK trading as Ocean Finance. As the business made exempt supplies, it incurred irrecoverable VAT on advertising and other supplies used for the business. In order to eliminate this irrecoverable VAT, a Jersey company (Alabaster) was incorporated to which Mr Newey transferred his loan-broking business and then provided specialist services to Alabaster under a services agreement. HMRC argued that the arrangements constituted an abuse of law and that, applying the *Halifax* principle, it was entitled to assess VAT by recharacterising the transactions to counteract the abuse (i.e. treating the supplies of advertising as being made to Mr Newey and the supplies of loan-broking being made by Mr Newey).

The FTT found in 2010 that in the relevant period it was Alabaster, not Mr Newey who made supplies of loan brokerage and received supplies of advertising services and that this conclusion was not altered by the principle of abuse of law even though the aim of the structure involving Alabaster was to achieve a tax advantage. When HMRC appealed to the Upper Tribunal (UT), six questions were referred to the CJEU which were addressed without the need of an Advocate General's opinion (which shows how obvious the CJEU thought the answers were!). The approach to the abuse of law test which the CJEU directed should be followed was different from the approach the FTT had applied three years earlier. The CJEU approach required the tribunal to ascertain whether the contractual terms do not genuinely reflect economic reality and whether it is Mr Newey and not Alabaster, who was actually the supplier of the loan broking services and the recipient of the supplies of advertising. The UT concluded that the FTT were entitled to reach the decision they came to even though the FTT had made an error of law in the application of the abuse of law test because this error was immaterial.

In 2018 the Court of Appeal concluded that the FTT had made errors of law, including in its application of the abuse of law test and that the UT had itself then made an error of law in concluding the errors made by the FTT were immaterial. Rather than remake the decision, the Court of Appeal remitted the case to the FTT for further consideration of the facts in the light of the guidance of the CJEU and the Court of Appeal. The FTT has now, 10 years after its first decision and more than 20 years after the disputed transactions took place, reconfirmed its earlier conclusion that although the decision to restructure the business of Ocean Finance in Jersey was purely tax driven, it is not contrary to the purposes of the Sixth VAT Directive.

The FTT 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'. The FTT looked beyond the contractual provisions and 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 did not constitute a wholly artificial arrangement.

So, with hindsight it seems the UT were correct in deciding the errors were immaterial - because they did not in fact affect the decision! But this case shows that when deciding the question of abuse of law, the correct process must be followed and that not following the correct process of analysis is a material error. Applying the test laid down by the CJEU, the tribunal needed to look beyond the contractual arrangements to the business relationships actually entered into and their economic and commercial substance.

Will abuse of law survive the end of the Brexit transition period? Abuse of law (or abuse of rights) is an EU law principle that is expressly preserved in UK law after Brexit by virtue of section 42(4) of the Taxation (Cross-border Trade) Act 2018 so cases on this will continue to be relevant. But from next year there would be nothing to stop the UK amending this rule if it so desires!

Prevention and detection of withholding tax reclaim schemes

The European Securities and Markets Authority (ESMA) has recommended legislative change to enable National Competent Authorities (NCAs) to share information with tax authorities, but abandoned proposals to enhance NCAs' supervisory powers to tackle threats to 'the integrity of the financial markets as a whole'. ESMA published its Market Abuse Regulation (MAR) Review report and its Final Report on Cum/Ex, Cum/Cum and withholding tax (WHT) reclaim schemes on 24 September 2020. Both reports rightly point out that dividend arbitrage, cum/ex, cum/cum and WHT reclaim schemes are primarily a tax related issue to be addressed at the level of individual Member States rather than by increasing the supervisory powers of NCAs.

Tax authorities, rather than NCAs, have the required expertise to identify, assess and, where necessary, counteract relevant schemes. Putting relevant information at the tax authorities' disposal is key, therefore, and this should be done by the European Commission proposing legislation to ensure NCAs can share domestic information with the local tax authority and to enable an NCA to share transactions reports or suspicious transaction and order reports received from another NCA with its local tax authorities.

Having acknowledged that dividend arbitrage schemes are primarily a tax related issue for individual Member States to address, ESMA suggests that Member States should consider amending their laws 'to directly and automatically link any given tax reclaim to the underlying distribution of dividends or entrusting a single entity with responsibilities over collecting the WHT and issuing the relevant certificate'. ESMA also refers to the OECD's Treaty Relief and Compliance Enhancement (TRACE) Implementation Package. Broadly, TRACE envisages that an authorised intermediary may claim WHT relief for its customers on a pooled basis, subject to providing an annual report on the relevant payments and their recipients. The aim of TRACE was to facilitate investors' WHT reclaims in the context of multi-tiered holding environments, but ESMA notes that 'should it be applied correctly, it could minimize costs for all stakeholders and ensure compliance with tax obligations'.

The European Commission is already thinking about how to lower costs for cross-border investors and prevent tax fraud and its Action Plan for a Capital Markets Union published on 28 September, includes a commitment to propose plans for a common, standardised, EU-wide system for withholding tax relief at source. The proposals are to be published by Q4 2022. The Commission's work will take into account TRACE and other EU initiatives, such us the code of conduct on withholding tax.

What to look out for:

- **Not the Autumn Budget which has been postponed until 2021! While the cost of responding to the pandemic continues to rise, and trade deals are still work in progress, it is too hard for the Chancellor to put together a Budget.**

- **The Court of Appeal is due to hear HMRC's appeal in the *Development Securities* case on 13 October on whether Jersey incorporated subsidiaries were centrally managed and controlled by their UK parent and therefore were resident in the UK, or as the UT held, were managed and controlled in Jersey, and therefore resident in Jersey.**

- **On a date between 14-16 October, the Upper Tribunal is due to commence the hearing in the *Warshaw* case. HMRC has appealed against the FTT's decision that cumulative preference shares may, if they are**

also compounding, constitute ordinary share capital for the purposes of section 989 of the Income Tax Act 2007 for entrepreneurs' relief. The term 'ordinary share capital' is also relevant to other parts of the legislation such as group relief, consortium relief and stamp duty group relief so this case has wider application than just for entrepreneurs' relief. HMRC updated its guidance CTM00514 following the FTT's decision, to state HMRC's view that it is finely balanced and may depend on the facts whether preference shares where coupon compounds over time, or a preference share where a rate of interest is added if dividend is unpaid, are ordinary share capital. The guidance describes the FTT's decision in *Warshaw* as of 'persuasive rather than precedent authority'.

- Blueprints for Pillars One and Two of the international tax reform proposals are expected to be published this month.

- Starting between 26-28 October the Upper Tribunal is scheduled to hear the appeals by the taxpayer and by HMRC in *Gallaher* (compatibility of intra-group disposals rules with EU law). HMRC won before the FTT on the 'big money' part of the case (the 2011 disposal) on which Gallaher is appealing. HMRC is appealing the decision in relation to the 2014 disposal because although the legislation was amended by Finance Act 2020 to permit deferral of the exit charge, HMRC would still like to win on the principle to see off any other unlawful exit charge claims.

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