Slaughter and May Podcast
Tax News Highlights: September 2023

Zoe Andrews	Welcome to the September 2023 edition of our tax news highlights podcast. I am Zoe Andrews, PSL Counsel & Head of Tax Knowledge.
Tanja Velling	And I am Tanja Velling, Tax PSL Counsel. After a bit of a break over the summer – I hope, unlike me, our listeners weren't too badly affected by the recent flight chaos – we have quite a range of news items to cover in this podcast. We will discuss four recent cases, the Upper Tribunal's decisions in *JTI Acquisitions Company*, *Hotel La Tour* and *M Group Holdings* and the First-tier Tribunal's decision in *Wilkinson*. We will also consider certain legislation day developments and provide an update in respect of international tax reform. This podcast was recorded on the 12th of September 2023 and reflects the law and guidance on that date. I suggest we leave the update on international tax reform to the end and ease ourselves in with some cases.
Zoe Andrews	Sounds good to me. Let's start with *JTI Acquisitions Company* on the loan relationships unallowable purpose rule. The Upper Tribunal agreed with the FTT's conclusions on the application of the rule whilst identifying some non-material errors in its approach. The facts are fairly simple, a funding structure was put in place by a US-headed group for the acquisition of another US-headed group. As part of a 9-step structure plan, a UK acquisition vehicle, JTI, was formed to acquire the target group with debt being pushed down from the US. Around £40m of non-trading loan relationship interest debits were then claimed as group relief. There is around £9m of corporation tax at stake. Does this case tell us anything new about the scope of the rule or is it more of the same?
Tanja Velling	Well, some might view it as broadening the rule to take account of group purpose, but I prefer to view it as merely clarifying the scope of the facts and circumstances that are relevant to a company's purpose. All the facts and circumstances surrounding the loan relationship must be considered, not just the transaction which is the loan relationship itself. The Upper Tribunal took the same approach to the unallowable purpose rule as it did in both *BlackRock* and *Kwik-Fit*. This does not require substituting a company's purpose with a group's purpose but rather, on the facts, the decision to acquire the US target group had been made by the US

	parent and so, when looking at the purpose of JTI in being party to the loan relationship, it was part of the relevant facts and circumstances to take into account what the wider group was trying to achieve.
Zoe Andrews	So, whilst it is the company's own subjective purposes (expressed primarily through its directors) that matter, the group's perspective is also relevant as it "informs the determination of the particular taxpayer company's purpose". The Upper Tribunal decided that the question "why is a taxpayer party to a loan relationship?" requires consideration of why that *particular* taxpayer was party to the loan relationship rather than someone else. JTI was unable to convince the First-tier Tribunal or the Upper Tribunal that there were any commercial reasons for the acquisition being made by JTI, and so the unallowable purpose of obtaining loan relationship debits was found to be the main purpose for which JTI was a party to the loan relationship. It was fatal that the acquisition was "parked" in the UK, not for commercial reasons, but to obtain loan relationship debits. Both *BlackRock* and *Kwik-Fit* are scheduled to be heard by the Court of Appeal next Spring and so it will be interesting to get the Court of Appeal's take on this subject.
Tanja Velling	The Upper Tribunal's decision in *Wilkinson* concerns a different purpose test, namely the one in the capital gains tax reorganisation rules. If certain conditions are met, reorganisation treatment applies, for example, to an exchange of shares for loan notes. The effect is that the loan notes are treated as the same assets, acquired at the same time and for the same amount, as the shares. There is no capital gains tax charge on the exchange; instead, any latent gain in the shares is rolled over into the loan notes. But this reorganisation treatment does not apply where the exchange formed "part of a scheme or arrangements of which the main purpose, or one of the main purposes, is avoidance of liability to capital gains tax". So, what happened in the case?
Zoe Andrews	Well, the shareholders of a logistics company, five individuals, decided to dispose of it to a third party for around £130 million in cash and loan notes. Two of the individuals were Mr and Mrs Wilkinson, husband and wife, who owned 58% of the company between them and undertook some capital gains tax planning. Essentially, the planning was to make use of the entrepreneurs' relief lifetime allowance (which was £10 million at the time) of each of their three daughters. The planning involved transferring some of Mr and Mrs Wilkinson's shares in the target to their daughters before the transaction. The purchaser's cooperation was required in order to ensure that the daughters could meet the conditions for the relief. And, crucially, the planning could only work if

	reorganisation treatment applied on the exchange of their shares in the target for loan notes issued to the daughters by the purchaser. HMRC argued that reorganisation treatment was not available because the exchange formed part of the Wilkinson's capital gains tax planning which was a scheme or arrangements with a main purpose of avoiding capital gains tax. The "exchange" for these purposes would be the entire exchange of all shares in the target by all the shareholders – including those representing 42% of the shares and who had no interest in the Wilkinson's tax planning.
Tanja Velling	The First-tier Tribunal concluded – rightly in my opinion – that the exchange did not form part of the Wilkinson's tax planning. The exchange was clearly part of a different, larger arrangement: the disposal of the target to a third party. The FTT considered that the tax planning was bound up in that larger arrangement, so it did not exist as a separate scheme of which the exchange could form part. Alternatively, the FTT considered that, even if the tax planning was a scheme in its own right, the exchange did not form part of it because the exchange was wider than the scheme. In particular, the Tribunal cautioned against regarding an earlier case by the name of *Snell* as authority that, if part of an exchange forms part of a scheme, the whole exchange should be regarded as forming part of that scheme. The FTT considered it wrong to posit part-related, subsidiary schemes where there was one clear arrangement (such as the third-party acquisition here) to which the exchange related.
Zoe Andrews	Having decided that the exchange formed part of a scheme constituted of the third-party acquisition, the First-tier Tribunal went on to consider whether that "scheme" had a main tax avoidance purpose. It is unsurprising that the Tribunal concluded that it did not. It took into account the size of the tax saving as compared to the deal value and what Mr and Mrs Wilkinson stood to receive, and the fact that there was no legal obligation on the purchaser to cooperate in obtaining the tax saving (although it had done so) and that Mr Wilkinson would not have jeopardised the deal for the tax saving. Overall, the case serves as a reminder that the delineation of the scheme or arrangement is crucial to the application of the purpose test in the capital gains tax reorganisation rules. It also points towards sensible limits as to when one thing can be said to form part of another.
Tanja Velling	And now for a yet another purpose case, the VAT case, *Hotel la Tour,* which brings good news for input tax recovery on services used for transactions to raise funds. The taxpayer, HLT, was a holding company which sold shares in a subsidiary to raise capital for the building of a new hotel as part of

	HLT's downstream taxable activity. It had incurred input VAT on various advisers' fees in relation to the share sale. The share sale in this case was an exempt transaction, and this would normally break the link between a supply and a taxable person's economic activities. But, following the approach to input tax recovery adopted by the Court of Justice of the European Union in *SKF*, as interpreted by the Supreme Court in *Frank A Smart*, this chain-breaking effect does not apply where the purpose of an exempt, or an outside the scope, transaction is to raise funds for the taxpayer's economic activity. In such a case, the input tax on the services is immediately deductible, even if the taxpayer is later unable to use the funds for the intended purpose. In *Hotel La Tour*, the funds had in fact been used to build the new hotel and so there was solid objective evidence of the purpose of the fund raising. But what if the purpose is not achieved and the funds are used for something else? For example, if the plan to build fell through and the funds are returned to shareholders as a dividend.
Zoe Andrews	This does not switch off input tax recovery as a matter of law but does make it more difficult for the taxpayer to discharge the burden of proving that it had the requisite intention to use those funds to make taxable supplies. The longer the gap and the greater the effort made by the taxpayer to use those funds in its business, the better chance it will have of convincing the tribunal of its original purpose to fund its economic activity. The right to deduct the input VAT on the advisers' fees would be lost, however, if the cost of the services were incorporated into the price of the shares sold. This is an interesting point. As the Upper Tribunal acknowledged, it would be very unusual to see the cost of the professional fees being reflected in the price paid for the shares in a standard sale agreement. Obviously, as a commercial point, a seller will be thinking about how much it will make from the share sale after paying all the costs so as to determine whether the sale makes financial sense. But the emphasis here is on the purchaser's perspective – has the price been ascertained by common share valuation techniques or has the price been influenced by the professional fees incurred by the seller, which in most cases is unlikely. The Upper Tribunal refers to the price being determined on a "cost plus basis" (a margin above cost) or for the costs of the share sale to be specified as a component of the price, which is not something we see in practice.
Tanja Velling	And now for our final case, moving away from purpose tests*, M Group Holdings* concerns the application of the substantial shareholding exemption and, more specifically, the question in what circumstances can paragraph 15A of Schedule 7AC to the Taxation of Chargeable Gains Act 1992 extend the requisite holding period? Let's start with an outline of the facts. An individual had conducted a trade through M Group, which was then a standalone company, and decided to

	sell up. Given past liabilities, the advice was to set up a new company for the deal. So, in June 2015, M Group set up Medinet Clinical Services Limited (or MCS, for short). In September 2015, M Group transferred its trade and assets to MCS and, in June 2016, M Group sold MCS to a third party. Except for the minimum 12-month holding period, the conditions for the application of the substantial shareholding exemption were fulfilled when M Group disposed of its shareholding in MCS. The question then was whether the holding period could be extended under paragraph 15A to meet the required minimum.
Zoe Andrews	Broadly, paragraph 15A can extend the holding period to the required minimum where the target uses assets in its trade that it acquired from a group member where that group member previously used those assets in its own trade. The question here was whether paragraph 15A could extend the holding period back to May 2015, so back to a time when M Group was carrying on its trade as a standalone company before MCS had been incorporated so as to bring a group into existence. The FTT and now also the Upper Tribunal decided that it could not. Paragraph 15A applies in respect of groups; its purpose is to extend the holding period where a trade has been carried on within a group. So, it could not apply here. If there had been a pre-existing group – if M Group had already had a subsidiary prior to the incorporation of MCS – the outcome would have been different.
Tanja Velling	The Upper Tribunal was unimpressed with the taxpayer's argument that this could result in treating two companies in economically equivalent circumstances – namely, a standalone company and a company that has one dormant subsidiary – differently. There is no general principle that economically equivalent structures should be subject to the same tax treatment. The taxpayer had also sought to argue (somewhat valiantly) that a standalone company could constitute a "group" for the purposes of paragraph 15A, given that there was no statutory definition of the term and, in some contexts, "group" could colloquially be used where there is only one member – for instance when dividing a class of schoolchildren into smaller groups, one of those groups could be made up of a single child. I should clarify here that this is not an example that I made up, but which (according to the Upper Tribunal) taxpayer's counsel "placed much reliance on". The Upper Tribunal nevertheless concluded that, on its ordinary and natural meaning, the term "group" required more than one member, and it considered that the statutory context supported that this was the right meaning to apply.

Zoe Andrews	Overall, I think the first sentence of paragraph 80 neatly summarises the fundamental problem in this case and the Upper Tribunal's conclusion: "The fact that the appellant sold its substantial shareholding a month too early to qualify for relief is not a reason to adopt a strained interpretation of the provision." For the taxpayer, this is regrettable; but it does seem the better view on the legislative wording.
Tanja Velling	Speaking of legislation, let's talk about L-day. On the 18th of July, the government published certain draft legislation for inclusion in the Finance Bill 2023-24. But this did not include anything on the proposed reform of the transfer pricing, diverted profits tax and permanent establishment legislation – which is unsurprising, given that the relevant consultation ended on the 14th of August, so after L-day. The consultation stated that the "government's intention is to legislate any changes in a future Finance Bill", so not necessarily this upcoming Finance Bill. Indeed, I would have thought it rather ambitious to have the drafting ready in time, in particular, for the proposed merger of DPT with corporation tax, but I may be proved wrong on this. It seems likely that we will find out during the Autumn Statement – now scheduled for the 22nd of November – whether, when and in what form the proposed reforms will go ahead.
Zoe Andrews	A somewhat curious development is that the government has published draft legislation for a single merged regime for tax relief for R&D (which looks quite similar to the current RDEC regime principally applicable to larger companies), when it has not yet been decided whether the government wants to go ahead with this policy. The policy paper explicitly states that the draft legislation was published "in order to keep open the option of implementing a merged scheme from April 2024", but a "final decision on whether to merge schemes will be made at a future fiscal event" – possibly the Autumn Statement. You may also recall that the government had planned to restrict relief for overseas R&D expenditure. Draft legislation for this had been published in July 2022. But, during the Budget back in March, it was announced that the application of this restriction would be postponed from April 2023 to April 2024 to "allow the government to consider the interaction between this restriction and the design of a potential merged R&D relief". I could not find an equivalent to the provisions from July 2022 in the draft legislation for the merged regime, but it would seem imprudent to take this as an indication that the government has decided against introducing the restriction. And one final point on timing – even if the government decides to implement a merged regime (which, as I said, is not yet clear) – it may not apply from April 2024 as stakeholders have called for more time to get to grips with the new provisions.

Tanja Velling	And now, as to international tax reform, everyone's favourite topic (or perhaps it is your least favourite for which I wouldn't judge you). In any event, the OECD published a number of documents this summer on the two pillars of international tax reform. Although some progress is reportedly being made on Pillar One, particularly in respect of Amount B (a streamlined approach to the transfer pricing of certain baseline marketing and distribution activities), we will concentrate in this podcast on Pillar Two as the UK has already enacted legislation to implement it, with further legislation to follow. This is an area where simplification would have been welcome from the outset, but the rules are based on the OECD's Model Rules which are themselves inherently complex as they seek to meet the demands of many competing interests. Indeed, this is illustrated by the two sets of Administrative Guidance that are required to elaborate on the Model Rules and the Commentary. A revised Commentary on the Model Rules, taking in the changes made by the Administrative Guidance, is expected to be published later this year. The UK is (again) one of the first jurisdictions to push ahead with implementing the rules and to provide draft guidance on their operation. Going early on international measures has its disadvantages as we have seen with previous international initiatives such as the hybrid mismatch rules, but also potential advantages. In the case of the Pillar Two rules, it has enabled the UK Government to feed points raised by business into the international discussions and it does give business more time to work out how the rules will apply to them and put systems in place. But, as the rules are still themselves being developed at the international level and the intention is that the UK rules will reflect the Model Rules – as interpreted in accordance with and supplemented by the Commentary and further commentaries or guidance published by the OECD relevant to the implementation of the Model Rules – businesses (and their advisers!) have the added challenge of having to keep on top of the evolving UK rules. So where are we up to with UK legislation?
Zoe Andrews	The legislation for the UK's implementation of the income inclusion rule (the multinational top-up tax or MTT) and the domestic top-up tax (or DTT) was enacted in parts 3 and 4, respectively, of Finance (No. 2) Act 2023. Both new taxes apply for accounting periods beginning on or after the 31st of December 2023. Shortly after Royal Assent, on L-Day, a further 30 pages of draft legislation for inclusion in the next Finance Bill were published to make changes to the MTT and DTT to ensure the UK legislation remains consistent with the Model Rules. This includes draft legislation for the undertaxed profits rule (UTPR) which is a back-stop rule to collect any untaxed top-up amounts. The UTPR is to apply from a commencement date to be provided for in regulations but with effect no earlier than accounting periods beginning on or after the 31st of

	December 2024. But the US is not happy about the extra-territoriality of the UTPR is it?
Tanja Velling	Certainly not. In fact, partly to appease the US, a transitional UTPR safe harbour has been agreed (in the second tranche of Administrative Guidance) although we do not yet have draft UK legislation to implement this. The safe harbour would limit the application of UTPRs until the end of 2026 by effectively disapplying them in respect of the parent jurisdiction provided that the jurisdiction has a corporate income tax rate of at least 20% (which would be the case in respect of the US). But US Republicans have introduced legislation to retaliate against jurisdictions that apply the UTPR. This is not expected to pass, but the sentiment behind it can be expected to remain and to influence future policies. But what else is included in the draft L-day legislation in respect of the MTT and DTT?
Zoe Andrews	There are various other changes we do not have time to go into here, such as the application of the rules to partnerships and simplified calculations for non-material members. But there is a significant piece of the puzzle still to come which is the UK legislation to give effect to the Qualified Domestic Minimum Top-up Tax (QDMTT) safe harbour set out in the second tranche of the Administrative Guidance. What did the Administrative Guidance say about this new permanent safe harbour? I had great hopes it would trump the GloBE rules and avoid all that complexity.
Tanja Velling	Unfortunately, it does not bring as much simplification as we had hoped for! It would operate to deem the GloBE top-up for the relevant jurisdiction to be nil, meaning that, for the jurisdiction, the group would have to undertake only the QDMTT, and not also the GloBE calculation. Without the safe harbour, the QDMTT is applied as a credit against top-up tax due under an income inclusion rule. It's obviously a good thing not to have to do both calculations, but the QDMTT calculation itself is not simple. For example, the UK's domestic top-up tax, which is drafted so as to be a QDMTT under the Model Rules, applies the same calculation rules as for the MTT (with some modifications) to calculate the DTT. In fact, the safe harbour can be seen as bringing in even more complexity because not every QDMTT will qualify for the safe harbour! Because of the greater latitude afforded to jurisdictions in the design of their QDMTTs (as compared to their implementation of the GloBE Rules), the guidance sets out three additional criteria that QDMTTs will need to meet in order to qualify for the safe harbour which will be assessed pursuant to a peer review process by reference to the relevant legislation and its practical administration. According to the Administrative Guidance, the QDMTT safe harbour would need to be elected into, and the election will only be available where the QDMTT would have otherwise reduced an IIR top-up. This allows for a complex situation where a QDMTT charge is challenged, for instance on the basis of its being unconstitutional or contrary to a tax stabilisation

	agreement. The Guidance envisages that, where a QDMTT charge is challenged, the QDMTT cannot reduce the IIR top-up. So, in those circumstances, the QDMTT safe harbour would be unavailable as well.
Zoe Andrews	And now for what's coming up: • The feedback period on the directive proposal for a common EU-wide system for withholding tax on dividend and interest payments ends on the 18th of September. • The consultation on tax incentives for employer occupational health investment closes on the 12th of October. • And – this is a bit further in the future, but worth mentioning again – it was also recently announced that the Autumn Statement will take place on the 22nd of November.
Tanja Velling	And 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. And you can also follow us on Twitter – @SlaughterMayTax.