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TAX AND THE CITY REVIEW

The government is consulting on a fundamental redesign of the stamp taxes on shares framework to create a new, single, self-assessed tax on securities. As part of the wider review of the UK funds regime, there is a consultation on the proposed scope and design of a new type of investment fund called the 'Reserved Investor Fund (Contractual Scheme)'. The FTT reaches a surprising conclusion in the *Buckingham* case on how much of a US dividend should be treated as income for UK tax purposes. The Court of Appeal agrees with the High Court in *McClean v Thornhill KC* that counsel did not owe a duty of care to the investors but, if there had been a duty of care, the Court of Appeal found (as obiter) that the unequivocal advice that the scheme 'no doubt' worked would have been negligent.

Tax administration and maintenance day (TAMD): new consultations

Stamp taxes on shares modernisation

The consultation on proposals to modernise and rationalise the framework for stamp taxes on shares runs until 22 June. The Office for Tax Simplification report in 2017 first recommended the modernisation and digitalisation of stamp duty and since November 2021 an industry working group has been considering the detail of the shape of the reforms with HMRC following the 2020 call for evidence.

The proposal is for a mandatory, single tax, on equity and debt with equity-like features, to replace the current framework of stamp duty and SDRT. The consultation does not, however, consider the 1.5% charge as that will be dealt with in a separate consultation if modernisation is taken forward. Any new tax would be self-assessed. Transactions that would currently have their tax collected through CREST under SDRT would continue to have their tax collected through CREST as this system works well and it is important that any disruption to the markets caused by the modernisation project is minimal.

Transactions not undertaken through CREST would be notified to, and payment made through, a new online portal to HMRC. There would not be a statutory pre-clearance system for the new tax but as is currently the case where there is uncertainty about whether stamp taxes are payable, taxpayers would have access to the non-statutory HMRC clearance service.

The intention is that the online portal would enable swift processing of the new tax providing the ability to input the transaction, claim relief or pay the tax online and for a unique transaction reference number (UTRN) to be issued immediately once any due tax has been paid. The link to company registrars would be maintained but registrars should be able to register ownership upon immediate receipt of the UTRN, enabling same day registration.

The charging point for the new single tax would be the point of agreement or, where the agreement is conditional, the date when those conditions are fulfilled, with an overall two-year time limit. The tax would then be due 14 days from the charging point.

The current SDRT geographical scope rules would apply to the new tax. Industry has highlighted the importance of how geographical scope is defined in relation to where electronic share registers are kept. The current definition of 'chargeable securities' relies on there being a register in the UK. Rather than defining where an electronic share register is kept for the new tax, the intention is to use whether shares are in a UK incorporated company or not as the key factor for whether they are in scope.

Reliefs from stamp duty that do not currently exist for SDRT (such as group relief, reconstruction relief and acquisition relief) would feature in the new tax with legislative improvements to increase clarity.

Consideration is being given to removing the loan capital exemption as an exemption and including its parameters in the overall rules for the scope of the new tax instead to simplify the new tax. If the government is unable to achieve this, the loan capital exemption would be kept as it is but improvements to the language would be considered to improve clarity.

The current SDRT definition of consideration of money or money's worth would be used for the new single tax but there would be a number of exceptions to avoid bringing certain transactions into scope of the new tax where they are currently out of scope. For example, a relief or exemption is proposed to ensure obligations to pay pension benefits do not become liable to the new charge and cause disruption to the pensions market. Likewise, to avoid disruption to insurance markets, it is proposed that life insurance policies should receive a relief or exemption so that consideration given in the form of issuance of a life policy will not result in a liability.

The existing SDRT rules for uncertain and unascertainable consideration would apply to the new tax but with the addition of a 2-year time limit for deferral. Certain reliefs or exemptions would be removed, including the £1,000 de minimis that currently exists for stamp duty. Provisions identified as redundant will not be included within the new single tax (such as the group relief anti-avoidance provision in FA 1967 section 27(3)(b) which has been rendered redundant by rules in SDRT/SDLT).

It is an ambitious project but one worth doing to improve the attractiveness of the UK as a location to invest and to ensure an efficient and modern tax stamp system. It is a shame, though, that dealing with the 1.5% charge is not also part of the consultation at this stage.

Reserved investor fund

As part of the wider review of the UK funds regime to enhance the UK's attractiveness for asset management and fund domicile, the government is consulting until 9 June on a new type of investment fund called the 'Reserved Investor Fund (Contractual Scheme)' (RIF). This is the new name for what was originally called the 'Professional Investor Fund' (PIF). The government believes RIF more accurately describes the target investors that the fund is reserved for, although one of the consultation questions is whether this is the most appropriate name.

The RIF would be structured as an unauthorised co-ownership contractual scheme. The consultation focuses on the proposed scope and design of the tax regime. The RIF is in response to industry demand for a UK-based unauthorised contractual scheme with lower costs and more flexibility than the existing authorised contractual scheme. The government's objectives for the RIF tax regime are tax neutrality, certainty and protection against risks to the Exchequer (particularly ensuring there can be no loss of tax from non-UK resident investors on disposals of UK property).

Proposed features include that the RIF would not be a taxable person for direct tax purposes meaning that income received by the RIF would arise directly to the investors (the RIF operator would be required to communicate to investors all information necessary to fulfil their tax obligations).

Certain rules applicable to the Co-ownership Authorised Contractual Schemes or CoACS (on income from investments in offshore funds, capital allowances, SDLT, stamp duty) would be replicated; the CGT treatment of CoACS (no look-through to fund assets; units in the scheme treated as the CGT assets) would also be replicated, where this does not conflict with the government's policy of taxing non-UK resident investors on gains on disposal of UK property. VAT would apply to the management of RIFs as it does to the management of other funds.

Buckingham: UK taxation of US dividend

In John Buckingham v HMRC [2023] UKFTT 00358 (TC) the FTT held that a large US dividend, which was treated as split roughly 30:70 between income and capital for US tax purposes, is also split 30:70 between income and capital for UK tax purposes. This is a surprising decision and appears to be based on the treatment of the dividend on the US tax forms rather than, as required by the relevant case law, whether the dividend was treated as income or capital for US corporate law purposes.

The taxpayer had held shares in a US company, DPSG. In 2018, DPSG merged with another US company, on terms that former DPSG shareholders would hold a 13% stake in the combined group and receive a special dividend equal to $103.75 per share (to be declared immediately prior to closing and paid on the business day after closing). For US tax purposes, roughly 30% of the amount was treated as income, the rest as capital.

The taxpayer initially filed his self-assessment return on the basis that the dividend was 100% capital for UK tax purposes but before the FTT he argued that the US income: capital split of roughly 30:70 should be followed for UK tax purposes while HMRC contended that 100% of the dividend should be treated as income. The FTT found in favour of the taxpayer.

The FTT referred to the relevant case law establishing that the capital vs income nature of a foreign dividend is to be determined by reference to the foreign company law (and more precisely, the mechanism through which the dividend is paid, rather than its source). The FTT had to determine, as a question of fact, whether the special dividend paid under Delaware law was income, capital, or part income and part capital.

The FTT did acknowledge that answering the US company law question really needed expert advice but decided to proceed without it in this case because the cost of expert evidence would be disproportionate to the amount at stake, would further delay a final decision and would not be binding on any other taxpayers receiving the same special dividend.

The FTT decided that the US corporate law treatment must be the same as the treatment for US income tax purposes on the basis that 'it is not remotely credible that the Special Dividend was split in a way which was inconsistent with the Delaware law under which it was incorporated' and 'it was also not credible that the IRS would have signed off on a capital/revenue split which was not in accordance with the applicable company law'. It might not have been credible to the FTT, but it should have been. US tax does not slavishly follow the corporate form. A dividend, for US tax purposes, is defined as any distribution of property by a company out of relevant earnings and profits (E&P) and E&P also has its own tax definition. This should have been clear to the FTT from the IRS form before it and referred to by the FTT in its judgment which recorded that the dividend was treated as a dividend for US tax purposes to the extent it was paid out of E&P and as a non-dividend distribution as to the balance, without regard to the legal form. Indeed, had the FTT thought about it they might have noted that there are similar discrepancies between UK company law and UK capital/revenue treatment. For example, if a UK incorporated company were to buy back some shares, that is likely to be split into income and capital too despite its legal form based on the extent to which it is treated as a repayment of capital (which is a tax concept, not a legal one).

There is also an interesting procedural point in this case that might come back to bite the taxpayer if HMRC wins in an appeal. HMRC had issued a discovery assessment that 30% of the dividend was income. An HMRC review of the discovery assessment then purported to increase the assessment to 100% income, but this was found to be invalid as the review officer missed the 45-day time limit for notifying the taxpayer of the outcome of the review. However, because the taxpayer appealed, TMA s50(7)(c) came into play allowing the FTT to increase the assessment to 100% income if the FTT determined 30% income was undercharging the taxpayer and effectively giving HMRC another bite at the cherry! So, instead of appealing the substantive decision to the FTT, the taxpayer should have informed HMRC that the review decision was invalid and just accepted the original discovery assessment of 30% income. Easy with hindsight!

McClean v Thornhill KC: negligence claim for advice tax scheme 'no doubt' worked

The Court of Appeal in David McClean and others v Andrew Thornhill KC [2023] EWCA Civ 466 held that the High Court had not made an error of law in deciding Mr Thornhill KC did not owe a duty of care to the investors in a failed film finance tax scheme. The investors had brought a negligence claim against Mr Thornhill KC in respect of the unequivocal advice he had given to the scheme that there was 'no doubt' the scheme would work to obtain the tax benefits. The tax disclosure in the investment document expressly told the investors they had to take their own advice, and the tax analysis was expressed to be a statement of belief based on current understanding of the law.

However, the Court of Appeal considered the High Court was wrong to conclude, as obiter, that had such a duty of care been owed to the investors, it would not have been breached. The Court of Appeal held (as obiter) that if there had been a duty of care to the investors, Mr Thornhill KC's advice would have been negligent because it was expressed in unequivocal terms and did not draw attention to the risks that it was wrong.

This case is a warning to tax advisers to take care when giving tax advice to flag the risk of a successful HMRC challenge.

What to look out for:

- **It was announced in the TAMD summary that a consultation will be published this month on simplifying and updating the diverted profits tax regime, transfer pricing (related parties) and the rules for taxing permanent establishments to ensure clarity and consistency with underlying policy intention, international standards and the UK's bilateral treaties.**
- **It was also announced at TAMD that there will be a consultation later this year on the use and effectiveness of the employee ownership trust tax regime.**
- **The Court of Appeal is scheduled to hear the appeal on 17 May in *Royal Bank of Canada v HMRC* concerning corporation tax on payments relating to UK oil which the bank received pursuant to the receivership of a debtor.**
- **The Indirect Taxes (Notifiable Arrangements) (Amendment) Regulations 2023 come into force on 1 June 2023. These regulations amend the DASVOIT regime to ensure that the description of certain VAT avoidance arrangements concerning offshore supplies include transactions between members of the same VAT group.**

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