SLAUGHTER AND MAY/

CLIENT BRIEFING

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Revised draft guidance on large business notification of uncertain tax treatment encourages early engagement with HMRC and elaborates on what constitutes HMRC's 'known position'. The Court of Appeal in *Embiricos* agrees with the Upper Tribunal that HMRC cannot be required to give a partial closure notice without quantifying the tax due to give effect to HMRC's conclusion that Mr Embiricos was domiciled in the UK. The UK government consults on the implementation of the global minimum tax rules. Changes are to be made to allow UK securitisations and insurance-linked securities arrangements to operate more effectively.

Revised UTT guidance

When the large business notification of uncertain tax treatment rules (UTT) were first proposed for consultation in March 2020, many people questioned whether HMRC really need another disclosure rule or whether this just added another layer of, ironically, uncertainty, to the compliance obligations of large taxpayers. The legislation as it now stands in Finance Bill 2022 is narrower in scope than the original draft legislation of July 2021 and the revised draft guidance published on 18 January offers comfort that this regime is not going to be as onerous to comply with as first appeared. In many cases, taxpayers will not be required to notify under the UTT because they will already have provided the relevant information to HMRC. For those who have not already provided the information, the draft guidance provides helpful clarification on what HMRC's 'known position' is so they can determine when this trigger to notify is met.

The general exemption from notification applies where it is reasonable for the taxpayer to conclude that HMRC already has available to it all, or substantially all, of the information relating to the amount that would have been included in the notification if it had been required to be given (Finance Bill 2022, Schedule 15, paragraph 18). Information is taken to be available to HMRC if it is provided in dealings with HMRC, or pursuant to another regulatory requirement (there is a list in paragraph 18(2), that can be amended by the Treasury, of disclosure regimes which constitute regulatory requirements).

The draft guidance provides that where a taxpayer (or their agent) approaches HMRC via the Customer Compliance Manager, if they have one, or through the MSB Customer Support Team for those without, to provide information and discuss an uncertain tax issue, HMRC will confirm whether this general exemption is met. As a matter of good practice, taxpayers should make clear that the discussion is to avoid the requirement to notify and the discussion should be documented. If there are any changes to the transaction or to the tax treatment of it after this discussion, they must be notified to HMRC because such changes would invalidate the exemption.

A clearance application also makes HMRC aware of the uncertainty and so, if the taxpayer treats the transaction in accordance with how it was outlined in the clearance request, it need not notify even if it does not follow HMRC's known position as the general exemption will be met.

The revised draft guidance provides more detail on HMRC's known position and which documents do (or do not) indicate this which may be relevant where the general exemption does not apply. It is helpful that HMRC recognises that there is a large volume of published material and the draft guidance states that the UTT regime is not intended to 'act as a series of tripwires' leading to penalties where a business took a reasonable approach to establishing HMRC's position. Business is expected to have a level of familiarity with HMRC's published material and factors to be considered to show whether a business took a reasonable approach include:

- whether the guidance is easy to find (for example,. by being in a relevant HMRC Manual);
- whether HMRC's published view pops up if a search is done using relevant search terms on the issue; and

- whether the tax issue is novel, contentious, high-value or high-risk such that a careful examination of HMRC's view is warranted.

In practice, this might mean a greater emphasis on capturing information on the searches conducted and materials reviewed in trying to establish HMRC's view.

Embiricos: partial closure notices

The Court of Appeal's judgment in *Embiricos v HMRC* [2022] EWCA Civ 3 is important in defining the scope of taxpayers' rights (and HMRC's procedures) in resolving preliminary issues. HMRC had opened an enquiry into a number of Mr Embiricos' self-assessment returns, forming the view that he was UK domiciled and consequently not entitled to claim the remittance basis. HMRC then requested certain additional information in order to be able to assess the additional tax consequently due. The taxpayer argued that it was not reasonable for HMRC to require such information until the question of his domicile was determined. Mr Embiricos applied to the First-tier Tribunal (FTT) for a direction requiring HMRC to issue a partial closure notice (PCN) setting out its conclusions on Mr Embiricos' domicile status and remittance basis claim.

The key question before the FTT, Upper Tribunal and Court of Appeal was whether HMRC could issue a PCN without stating the amount of tax due. The FTT concluded that HMRC could and that the amount of tax could be treated as a separate matter from the question of domicile. This conclusion was overturned by the Upper Tribunal and the Court of Appeal unanimously upheld this decision.

The Court of Appeal concluded from a review of the consultation materials prior to the introduction of the PCN regime that the purpose of the PCN regime is to make the enquiry process more efficient and flexible for both HMRC and the taxpayer by enabling early resolution of one or more aspects of an enquiry while other matters continue to be investigated. The PCN regime is also intended to provide greater finality by early resolution of discrete matters at the enquiry stage, accelerating the payment and collection of tax. The Court of Appeal found that the primary target of the PCN regime is discrete areas of dispute in multiple open enquiries rather than, as is the case here, separate constituent elements of an enquiry into a single aspect.

If, as the taxpayer argued, the PCN could remove his entitlement to claim the remittance basis without quantifying the tax thereby brought into charge, this would not provide any finality as regards the substantive tax effect of that conclusion. Separating the two issues out in this way has the potential to prejudice HMRC's collection powers through permitting delay in providing documents and information relating to quantification. It also has the potential to prevent HMRC from continuing to enquire into the quantification issue until the conclusion of any appeal against the PCN has finally been resolved.

The Court of Appeal emphasised that a PCN will not always make amendments to the return by specifying the tax payable in order to give effect to HMRC's conclusion. It will obviously depend on the matter in issue and on the nature and effect of HMRC's conclusion.

The Court of Appeal's decision is a blow to taxpayers as it confirms the limited scope of the PCN regime. In practice, it will be difficult, save for in scenarios like the disallowance of carry forward losses which have no impact on the tax in the return in which they are claimed, for a taxpayer to benefit from the regime. It is more likely to operate in HMRC's favour in complex, multiple enquiry disputes where HMRC identifies a discrete matter for which it has adequate information to calculate the tax and seeks to accelerate payment of tax in respect of that matter while enquiries continue into other matters.

Tax reform for UK securitisations and insurance-linked securities arrangements

Following on from the March 2021 consultation on the reform of taxation of securitisation companies and the November 2021 response to it, the consultation on draft regulations allowing UK securitisations and insurance-linked securities arrangements to operate more effectively closed on 10 January. The draft regulations are to be laid before Parliament and take effect shortly after Finance Bill 2022 receives Royal Assent (expected Spring 2022).

Assuming the final regulations reflect the draft regulations, changes will be made in three areas. First, the rules will be amended to more easily facilitate retained securitisations (those where more than 50% of the securities issued in a securitisation are acquired and retained by the originator). The test of independence, currently based on the definition of control in CTA 2010 s450, will instead be tested by reference to control of an entity's affairs through the holding of shares, possession of voting rights, or powers given by articles of association (i.e. the CTA s1124 definition but without the 'or other document regulating that or any other body corporate' wording). This change is intended to ensure that an originator is generally treated as independent from the SPV in commercially driven retained securitisations. While the amended test should be simpler to apply, careful structuring will still be required to ensure the independence test is met.

Second, the note issuance threshold will be reduced from £10m to £5m on the basis of feedback from the charity and social impact organisations sector that £10m unduly restricts access to the regime.

Third, there will be new stamp duty/SDRT exemptions for the transfer of standard notes issued in securitisation arrangements, rather than expanding the loan capital exemption or dealing with this in guidance as was initially proposed. The concern here is that the loan capital exemption may not apply to the transfer of notes issued in a securitisation due, primarily, to the characteristic of having a right to interest which is determined by reference to the results of a business or value of any property. The new exemption will not generally cover notes which are convertible into other securities, but will cover situations where the notes can only be converted into another capital market investment issued as part of a capital market arrangement by the same note-issuing securitisation company.

There will also be an equivalent exemption for notes issued by qualifying transformer vehicles such as insurance linked securities SPVs which broadly offer a means of transferring insurance risk to capital market investors and therefore offer an alternative form of risk mitigation for insurance and reinsurance companies.

The government decided not to expand the loan capital exemption to cover transfers of loan assets to a securitisation company but HMRC will explore further whether updated guidance could be helpful in removing uncertainty in relation to the stamp duty and SDRT treatment of transfers of pools of loan assets into and within securitisation arrangements.

Updated guidance covering these changes will be published in the Corporate Finance Manual at CFM72000 and the Stamp Taxes on Shares Manual when these changes come into effect.

What's not changing in the near future

One of the things the consultation did not address is the complexity of the current VAT rules for securitisations and the extent to which irrecoverable VAT creates a cost. Some respondents appear to have raised this and their comments have been 'noted' by the government.

It has been decided for now not to broaden the category of qualifying assets covered by the regime. The government intends to consult informally more broadly on the activities test in the rules and whether the securitisation regime is available to the appropriate range of sectors and investors, including reflecting on how it will fit with the new qualifying asset-holding companies regime (the QAHC regime). This may lead to a second formal consultation focussed on these points.

International tax reform

Originally, the two pillars of international tax reform were intended to form a package but the second pillar, which includes the global minimum tax (GloBE), is moving at a faster pace with model rules having been published by the OECD at the end of 2021. Although there is an exemption for financial institutions from Pillar One (the reallocation of taxing rights of some of the profits of the largest and most profitable MNEs to market jurisdictions), there is no such exemption from Pillar Two so in scope financial institutions will be monitoring the progress of Pillar Two.

On 11 January, the UK launched a consultation on implementing the GloBE model rules. The UK intends to adopt an income inclusion rule (IIR), similar to a traditional CFC rule but broader in scope, which will apply to MNEs whose consolidated annual revenues are greater than €750m. It will apply to all such MNEs headquartered in the UK and to UK intermediate parent entities of foreign headquartered groups where entities are more than 20% owned by minority investors or controlled by parent entities that are not located in a jurisdiction that has implemented Pillar Two. The UK IIR will impose a top-up tax on these UK parent entities based on their interests in overseas subsidiaries and branches located where the MNE has an overall effective tax rate in the jurisdiction below 15%.

By introducing an IIR in the UK, UK headquartered groups will not be subject to the backstop undertaxed profits rule (UTPR) in respect of their foreign profits and will only be subjected to the IIR at the level of foreign intermediate parent entities in relatively limited situations where those entities are partially owned by third parties.

The UK is also considering introducing a domestic minimum tax (DMT) which would allow the UK to impose top-up tax rather than a foreign jurisdiction charging top-up taxes in relation to any low-taxed profits of a group's entities in the UK. As far as business is concerned the same amount of tax is paid, but it is paid to the UK Exchequer rather than lining another country's coffers.

On the face of it you might think UK financial institutions should be well above the 15% effective minimum rate on UK profits, paying UK tax at a headline rate of 27%, rising to 28% from 1 April 2023. However, to measure effective tax rate (ETR) the OECD has developed the GloBE tax base to be applied uniformly by implementing countries rather than using the domestic tax base which differs from jurisdiction to jurisdiction. The way that deferred tax is taken into account for ETR purposes means that in a particular year a financial institution with a headline rate of 27% in the UK could still have a GloBE ETR of less than 15% and be subject to a top up tax. So you can see why a DMT appeals to the UK.

It is understandable that the UK wants to adopt the GloBE rules in order to pocket as much of the Pillar Two additional tax as possible. It also makes the UK's increase in headline corporation tax look less anti-competitive if Pillar Two effectively puts a floor on global tax rates. But there is considerable uncertainty at the moment about which jurisdictions will implement Pillar Two and when they will be able to do so, the US in particular. So why is the UK pushing ahead with the consultation?

The UK needs input from business to ensure, so far as possible whilst keeping to the model rules, that the impact of the rules does not create a massive administrative burden. It will be an additional cost for in scope businesses to have to keep running the numbers to check if, depending on the accounting in a given year, the ETR in a jurisdiction drops below 15%. So the safe harbours, when the OECD releases the details, will be looked at carefully to see if they will cut down on compliance costs for those in scope.

What to look out for:

- **The consultations on business rates review and corporation tax: response to accounting changes for insurance contracts close on 22 February.**
- **Guidance from the OECD on the Pillar Two model rules is expected in the coming weeks.**
- **Final guidance on uncertain tax treatment is expected by 28 February.**

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