Slaughter and May Podcast
Tax News Highlights: March 2022

Zoe Andrews	Welcome to the March 2022 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 will consider the Chancellor's Spring Statement, look at the latest developments in the two-pillar process towards international tax reform and consider how the possibility of the UK introducing an online sales tax sits with the international obligations. We will also cover some recent cases: • the Upper Tribunal's decision in *Royal Bank of Canada* which found the bank to be in receipt of payments subject to UK corporation tax because the payments were linked to an oil field; • the Court of Appeal's decision in *SKAT v Solo Capital Partners* on the admissibility of the Danish tax authority's claims in relation to withholding tax refunds alleged to have been obtained through misrepresentation; • the First-tier Tribunal decision in *Cider of Sweden* on third party access to documents related to proceedings before the Tribunal; and • the FTT decision in *Scottish Power* as contrasted with its earlier decision in *BES Commercial Electricity* on the deductibility of compensation payments following regulatory failings. This podcast was recorded on the 29th of March 2022 and reflects the law and guidance on that date. Zoe, do you want to share some highlights from the Spring Statement?
Zoe Andrews	Sure. The increase in national insurance contributions from April 2022 (and the introduction of the health and social care levy the following year) is going ahead as planned. The Chancellor, however, announced that, from July, the income threshold above which employee and self-employed National Insurance Contributions become payable will be increased to align with the income tax personal allowance. The threshold for employer contributions will remain the same, though. Another key announcement was the promise of a one percentage point cut in the basic rate of income tax from 20% to 19% from April 2024.

	The government will also bring forward the introduction of certain business rates reliefs and intends to engage with business on potential capital allowances changes between now and the Autumn. These would be intended to incentivise investment after the expiry of the super deduction.
Tanja Velling	I thought it rather curious that we got something which looked very much like a Budget Red Book. It almost looked as if the Treasury may have been preparing for a full-blown Budget, but then pulled the plug. Anyway, moving on to international tax reform, do you also feel like almost every day we get yet another piece of the puzzle?
Zoe Andrews	Yes, it certainly seems that way. But it gives business more time to consider the details as they evolve, rather than being presented with a complete package too late in the day to change anything. Taking the second pillar first, let's look at three developments on the GloBE rules which introduce a global minimum rate of tax of 15% per jurisdiction. First, the OECD Commentary on the GloBE model rules was published on the 14th of March providing tax administrations and taxpayers with guidance on the interpretation and application of those rules. The Commentary (which runs to more than 200 pages) is intended to promote a common and consistent interpretation of the GloBE rules.
Tanja Velling	Second, a consultation was launched on the Implementation Framework which is intended to "facilitate the co-ordinated implementation and administration of the GloBE Rules. It will provide agreed administrative procedures, such as filing obligations, and multilateral review processes as well as consider the development of safe-harbours to facilitate both compliance by MNEs and administration by tax authorities". Further work on co-existence of the model rules with US GILTI will form part of the framework discussions. The consultation might be a bit disappointing for anyone expecting more detail at this stage as it is more of a scoping document asking questions of stakeholders to see what the framework should cover. Comments are requested by the 11th of April. Third, to ensure consistency and to avoid contradicting EU law, the EU intends to implement the GloBE rules by way of a directive. The Commission published a directive proposal last December, just 2 days after the OECD had published the model rules, but a revised draft has since been published which, amongst other changes, delays the commencement date by a year for each of the IIR and UTPR. The revised Directive also includes a new Article to permit a Member State with no more than ten in-scope ultimate parent entities resident there to temporarily opt out from the GloBE rules. The revised draft Directive now rebrands the UTPR as the

	"Undertaxed Profits Rule" rather than the "Undertaxed Payments Rule" which makes it consistent with how this term is used in the UK consultation. When is the directive likely to be passed?
Zoe Andrews	The directive requires unanimous agreement in the Council and it seems that four member states still need to be brought on board. No political agreement on the revised draft could be reached at the ECOFIN meeting on the 15th of March. So a revised compromise text will likely be on the agenda in April. One objection, raised in particular by Poland, is that the two Pillars should not be separated at the EU level. Sweden, on the other hand, was concerned that it's too early to agree on a directive given that the technical work at the OECD/IF level is still ongoing. These are valid objections. Why rush to adopt the directive when so much is yet to be agreed and it is not clear when or whether, for example, the US will implement the two pillars? It makes me wonder if the UK will delay implementation too. We should find this out in the summer, when draft legislation for implementation of the IIR will be published but at the moment, the UK is working towards implementing the IIR from April 2023. Tanja, what's the position on Pillar 1?
Tanja Velling	We haven't yet heard much on Amount B which refers to the simplification of the application of the arm's length principle to in-country baseline marketing and distribution activities (and is arguably the more straightforward of the two elements that make up Pillar 1). A public consultation on the Amount B rules is expected in mid-2022, to be finalised by the end of 2022. Amount A, the new taxing right for market jurisdiction over 25% of the residual profit of the largest and most profitable MNEs, has been distilled by the OECD into several individual building blocks and consultations are being published on a rolling basis. So far this year, we have had consultations on nexus and revenue sourcing, and on the tax base determination. The turnaround time for responses to each consultation is necessarily short so that the comments can inform the continuing discussions and the impact can be reflected in the other components and fed into the negotiations on the multilateral convention needed to implement Amount A. Following the agreement on international tax reform reached on the 8th of October 2021, the UK has agreed to remove the digital services tax once Amount A is in place and not to introduce any new "relevant similar measures". How does the possible introduction of an online sales tax sit with that commitment?

Zoe Andrews	That's a good question. The Treasury is consulting on the pros and cons of introducing an online sales tax (or **OST**) and I find it difficult to see why this would not count as a prohibited "similar measure". The purpose of the OST would be to rebalance the taxation of the retail sector. At the moment, retailers operating from valuable retail premises, for example, high street shops, have to pay higher business rates than their online competitors operating a business model with lower commercial rents and lower business rate burdens. Abolishing business rates altogether is not an option because it raises over £25bn a year and there is no alternative with widespread support to raise sufficient revenue to replace it. So the intention is that an OST at a low rate of 1% or 2% would fund business rates relief for the retail sector in England and block grants to the devolved administrations.
Tanja Velling	The government is keen to present the OST as a completely separate beast from the UK's digital services tax which is a tax on revenues from certain digital services including social media, search engines and online market places. The government will have to ensure that an OST would not fall within the definition (still to be agreed under Pillar 1) of "relevant similar measures". I am not convinced that tying the OST to a reduction of business rates for retailers, or labelling it as a sales tax, will be enough to persuade the US, in particular, that the OST is not a "similar measure" to a DST when it will be a revenue-based tax which will apply to in-scope sales to UK customers regardless of where the seller is based. But if the UK does get around that hurdle, what would an OST look like?
Zoe Andrews	As the consultation document itself states, "[i]f an OST were adopted, its design would not be straightforward". It will be challenging to design the tax and to define the necessary terms. Even the starting point of how you distinguish between online and offline activity raises complex issues. For example, should the definition of online sales include all remote sales or only internet-mediated sales? Then which goods and services should be in-scope and what about digital equivalents of physical goods (for example, e-books) and online media services? What thresholds or allowances should apply and what exceptions should there be?
Tanja Velling	It is clear from the consultation that the government is minded to limit the OST to sales made to household consumers. This is partly because of the lack of connection between online business to business sales and the objectives of an OST. In addition, any OST incurred by businesses would likely be passed on and there would be potential for multiple layers of

	taxation to occur in supply chains which would create wider economic distortions. Regarding the question as to who would be liable to pay OST, the starting point is that it should be the seller (and not the consumer). But other players such as online marketplaces or intermediaries may sometimes need to be liable for the OST or be involved in assisting in its administration and collection, for example where the seller is overseas. As the cost of the OST is expected to be passed on to consumers, foreign tax credit issues should not arise for overseas sellers. And what happens next?
Zoe Andrews	The initial consultation looks at the case for and against an OST and understandably asks more questions than it answers. The consultation closes on the 20th of May and, depending on the responses, the government may decide to proceed with an OST, in which case there will be a technical consultation on the design features. As the consultation notes, there is little existing precedent internationally for a tax akin to an OST, and given the complications, technical and political, of designing and implementing such a tax, I think it is unlikely that the government will proceed with this any time soon, if at all. Shall we look at some cases now?
Tanja Velling	Let's start with *Royal Bank of Canada*, where RBC, a Canadian tax resident, found itself in receipt of payments subject to UK corporation tax under the ring-fence trade regime in Part 8 of the Corporation Tax Act 2010 because the payments were linked to an oil field. I suspect that is not what RBC would have expected when it became entitled to the payments as part of the receivership arrangements of a Canadian debtor.
Zoe Andrews	RBC had advanced a loan to Sulpetro, a Canadian company, which, together with its UK subsidiary, carried on oil exploration and exploitation activities in the Buchan Field, within the UK continental shelf. Sulpetro went into receivership and the amount outstanding on the loan, CAD185 million, was written off by RBC as a bad debt. Under a court order, a right to payments which Sulpetro owned in respect of all production from the Buchan Field was assigned to RBC. RBC treated the payments received as income of its Canadian banking business, accounted for them as recovery of the bad debt and did not report them in any UK tax return. Discovery assessments were subsequently made by HMRC on the basis that the payments are subject to UK tax under the ring-fence trade regime. The Upper Tribunal agreed with the First-tier Tribunal that the UK/Canada double tax treaty conferred taxing rights on the UK in respect of the

	payments on the basis that they were income from immoveable property. The Upper Tribunal also agreed that section 1313(2)(b) of the Corporation Tax Act 2009 applied to charge the payments to UK corporation tax because RBC had rights to the benefit of the oil won from the Buchan Field. RBC argued that it should be able to offset the losses incurred by it on the original loan against the payments received but the Upper Tribunal agreed with the FTT that there was no right to offset. There were several reasons for this.
Tanja Velling	The reasons were: • that the court order for the assignment of the right to the payments expressed the consideration to be CAD1, not the amount of any unpaid part of the loan; • that the making of the loan and the assignment of the rights to the payments were two separate transactions; • that the unpaid element of the loan resulted in losses outside the ring-fence which could not be set off against the ring-fence income; • that, even if the losses had qualified as an expense of the ring-fence trade, the expense was capital in nature and excluded from deduction under section 53 of the Corporation Tax Act 2009; and • finally, that RBC had no permanent establishment in the UK to which any trading loss which otherwise qualified for deduction could be attributed. The loan was made in Canada and any loss in respect of the loan fell to be dealt with in Canada. This case serves as a reminder for banks or other creditors to take care when enforcing a security over a loan as proceeds from assets received in lieu of repayment may have different tax consequences than cash repayments. Consideration should be given to the nature of any payments received and, where appropriate, which jurisdiction has taxing rights.
Zoe Andrews	During the May 2021 podcast, we spoke about a High Court case which forms part of the cum/ex saga and which took us back to the constitutional law course of our university days. It concerned the application of Dicey Rule 3 which provides that “English courts have no jurisdiction to entertain an action…for the enforcement, either directly or indirectly, of a penal, revenue or other public law of a foreign State”. The case related to thousands of Danish withholding tax refund claims over a three year period totalling around £1.5 billion which the Danish tax authority, SKAT, claimed had been paid on the basis of misrepresentations by the foreign payees that they were shareholders of Danish companies.

	In relation to all but one defendant, SKAT's claim was that the misrepresentations were fraudulent and SKAT brought a number of private law claims, including for damages for deceit, fraudulent misrepresentation and unlawful means conspiracy. The High Court had identified the central issue in the case as the Kingdom of Denmark's sovereign right to tax Danish company dividends and concluded that SKAT's claims fell foul of Dicey Rule 3.
Tanja Velling	SKAT has now succeeded in its appeal on this point, as the Court of Appeal took a different view of the real issue in this case. Dicey Rule 3 did not render SKAT's claim inadmissible because it was not a claim for tax, but for "moneys which had been abstracted from SKAT's general funds by fraud". SKAT was not seeking to enforce any sovereign powers, but seeking a remedy as a victim of fraud.
Zoe Andrews	The Court of Appeal also commented on SKAT's alternative argument that, even if Dicey Rule 3 had rendered SKAT's claim inadmissible, it should be disapplied for public policy reasons. The Court of Appeal expressed agreement that Dicey Rule 3 was not absolute and that there is a public policy exemption. As regards the question whether the exemption would have applied in this case, Sir Julian Flaux's leading judgment expressed the following view: "Whilst not deciding the point, I can see much force in [the] submission that the exception should apply here in a case of a major international fraud".
Tanja Velling	*Cider of Sweden* is a First-tier Tribunal decision addressing the question of when third parties may be granted access to documents relating to proceedings before the FTT. Through newspaper coverage, Ernst & Young had learned of a High Court case between HMRC and Cider of Sweden and applied for, and obtained, disclosure of related documents under Rule 5.4C(1) of the Civil Procedure Rules. From these documents, EY learned of an associated appeal before the FTT and applied to the FTT for disclosure of similar related documents.
Zoe Andrews	The FTT concluded that it had an inherent jurisdiction to allow third party access to such documents, but no obligation to grant it. Weighing the principle of open justice against the parties' interest in keeping the documents confidential, the FTT concluded that EY's application should be denied. The FTT had particular regard to the current stage of the proceedings – the hearing had not even been listed yet – and indicated that its decision may well have been different if the application had been made at a later stage. Consequently, the overarching lesson from this case would seem to be that the timing of a third party's application for disclosure will likely be key.

Tanja Velling	Before we look at what's coming up, I wanted to briefly mention the recent FTT decision in *Scottish Power* in relation to the deductibility of payments made under a settlement agreement with OFGEM following regulatory breaches. It comes after an earlier decision in *BES Commercial Electricity* by a differently constituted FTT. *BES* had been decided after the hearing in *Scottish Power*, but the FTT in *Scottish Power* received further written submissions on *BES*. In both cases, the settlement agreements required compensation payments to customers and both FTTs considered that the question of deductibility should be approached via the "public policy restriction" stemming from Lord Hoffmann's speech in *McKnight v Sheppard*. Whilst the reasoning of the FTTs in *Scottish Power* and *BES* differed, the result was similar. By reason of being in the nature of a penalty, the compensation payments were non-deductible in their entirety in *BES* and largely non-deductible in *Scottish Power*. The difference was around £0.5 million payments that were deductible in *Scottish Power* as being compensatory in nature. This was made up of amounts paid directly to customers affected by a mis-selling issue, "calculated by reference to the extra cost a customer to whom electricity had been mis-sold would have incurred as a result of changing supplier".
Zoe Andrews	In this way, *Scottish Power* might be interpreted as a refinement of *BES*, pointing to the circumstances in which compensation payments following a regulatory failing could exceptionally be deductible. This interpretation would not, however, account for the differences in the underlying reasoning, in particular as to the nature of the settlement agreement and whether the relevant payments were made wholly and exclusively for the purposes of the company's trade. It would be good to have an Upper Tribunal decision to clarify the point. But the Upper Tribunal's register of cases is not showing either to have been appealed yet. What have we got coming up over the next month or so?
Tanja Velling	• HMRC's change of policy on termination fees and similar payments set out in Business Brief 2 of 2022 will take effect from the 1st of April – one can only hope that this is not a joke. • The UK's consultation on the implementation of the Pillar 2 GloBE rules closes on the 4th of April. • The 29th of April is the closing date for comments on the OECD's consultation concerning a new tax transparency framework in respect of crypto-assets, as well as proposed amendments to the Common Reporting Standard.

Zoe Andrews	And that leaves me to thank you for listening. If you have any questions, please contact Tanja 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.