SLAUGHTER AND MAY/

CLIENT BRIEFING

March 2021

# TAX AND THE CITY REVIEW

**Budget 2021 announces an increase in the rate of corporation tax to 25% from April 2023, but promises a review of bank taxation in the autumn to ensure that the combined rate of tax on banks' profits does not increase substantially from its current level and remains competitive with the UK's major competitors in the US and the EU. The OECD publishes the International Compliance Assurance Programme handbook for tax administrations and MNE groups which contains information on the process reflecting the experience and feedback of tax administrations and MNE groups that participated in the two pilots. The Court of Appeal in *Eastern Power Networks and others* warns against the use of the closure notice procedure by taxpayers to pick and choose which information they provide and then ask the tribunal to decide the applicability of one element in the hope that a "quick win" will bring the rest of the enquiry to a halt.**

## Budget - implications for financial services

Tax professionals are well used to listening to the Chancellor's speech and then sifting through the piles of ancillary documents published alongside the Budget to find any announcements relevant to their area of practice which did not even get a mention in the speech itself. But this year, things were done differently. The Budget announcements were mostly confined to those measures to be legislated in Finance Bill 2021 and we have to wait for what has become known as 'Tax Day' on 23 March for policy announcements of changes to be legislated for in later Finance Bills including consultations on capital gains and environmental levies. According to Jesse Norman, the goal of making these announcements separately to the Budget, but still all on a single day, is to give a range of important but less high profile measures greater visibility among, and opportunity for scrutiny by, parliamentary colleagues, tax professionals and other stakeholders.

### *Corporation tax rate increase and review of bank taxation*

The rate of corporation tax will increase from 1 April 2023 to 25% for the largest companies. Companies with profits of under £50,000 will stay on a 19% rate (a new small profits rate) and the rate will be tapered for profits between £50,000 and £250,000 so only the companies with profits in excess of £250,000 will pay the full 25% rate. There will be a review of the 8% bank surcharge because this would be excessive when added to the 25% rate. The Red Book states that in the autumn, the government will set out how it intends to ensure that the combined rate of tax on banks' profits does not increase substantially from its current level, that rates of taxation here are competitive with the UK's major competitors in the US and the EU, and that the UK tax system is supportive of competition in the UK banking sector. Changes will be legislated in Finance Bill 2021-22.

Of course the increase in the headline rate of corporation tax means that, to continue to be punitive, the rate of diverted profits tax (DPT) has to be increased to 31% from 1 April 2023 to maintain the 6% differential. The rate of DPT charged on profits which would have been subject to the bank surcharge, however, will remain unchanged at 33%, reflecting the intention to maintain bank's corporate taxation at the current level.

### *Financial institutions notices*

As previously announced, Finance Bill 2021 will introduce legislation to bring in a new financial institution notice (FIN) allowing HMRC to obtain information and documents from a financial institution for the purpose of checking the tax position of a taxpayer and for collecting a tax debt. We have to wait for the Finance Bill to be published on 11 March to see if any changes have been made since the draft legislation, but in any event, FINs will be an additional compliance burden for financial institutions.

*Bank specific tax rules: changes to definitions to be made by regulations*

The various bank-specific tax rules (bank levy, bank surcharge, Code of Practice on Taxation, the bank loss restriction and the restriction on tax relief for banks' compensation) contain terms currently defined in the FCA Handbook. These definitions will be replaced with the introduction of the Investment Firm Prudential Regime ("IFPR") from 1 January 2022. The Finance Bill 2021 will update powers in the bank-specific tax rules to enable amendments to be made to those rules by statutory instrument.

There will be a consultation on the regulations later this year and it will be important to see whether the new definitions could potentially bring entities within the bank-specific rules that are not within them under the current definitions, although it is understood this is not the policy intention. The updated powers will have limited retrospective power that will ensure that no bank within the population at 31 December 2021 will cease to be within the scope on 1 January 2022, if amendments have not taken effect from that date.

*Temporary extended loss carry back for business*

Current rules allow the carry back of unlimited trading losses for one year. It was announced that for accounting periods ending between 1 April 2020 and 31 March 2022, the period of carry back for trading losses will be extended to three years, with losses required to be set against profits of most recent years first before carry back to earlier years. There will be no change to the current one-year unrestricted carry back, but for the extended relief, there is a £2m a year cap. This £2m cap is subject to a group-level limit. According to the guidance note published at the Budget, the cap should be apportioned to group companies which have losses for carry back in excess of £200,000, but the detail on the group limit has not yet been published so we need to look at what is included in the Finance Bill on this. No changes to group relief rules are proposed so any losses carried back cannot displace existing group relief claims. The time limit for group relief claims remains two years from the end of the relevant accounting period.

According to the costings in the Red Book, the loss carry back is net tax positive over the forecast cycle, presumably on the assumption that it will encourage use of the losses at the 19% rate, rather than the 25% rate if carried forward.

*Review of tax administration for large businesses*

The government recognises the role that tax administration plays in supporting the UK's competitiveness and promoting investment. Accordingly, there will be a review of large businesses' experiences of UK tax administration, including how much early certainty is provided and the degree to which HMRC manages the efficient resolution of disputes in accordance with the law, and promotes a collaborative and constructive approach to compliance with the law. Over the coming months, discussions will commence with businesses, advisers and stakeholders on the perceived challenges in this area, with a view to considering what improvements can be made as HMRC continues to progress its 10-year Tax Administration Strategy and wider Tax Administration Framework Review

**International Compliance Assurance Programme (ICAP): OECD handbook**

The ICAP is a voluntary programme for multilateral cooperative risk assessment and assurance providing increased and earlier tax certainty for MNE groups and giving tax authorities assurance that any tax risks have been identified. The first ICAP pilot was launched in 2018 with 8 participating tax administrations (including the UK). A second pilot followed in 2019 with 19 participating tax administrations. In February, the OECD published the ICAP handbook for tax administrations and MNE groups which contains information on the process for ICAP reflecting the experience and feedback of tax administrations and MNE groups that participated in the two pilots. The handbook includes a detailed description of each stage of the ICAP process, the documentation and information an MNE group participating in ICAP will provide, the level of comfort they may achieve as a result of participation in the programme, and a comparison of ICAP with other possible routes to greater tax certainty (such as advance pricing agreements).

The focus of the pilots was initially on transfer pricing and permanent establishment (PE) risk but the programme now includes any other material international issues agreed between the MNE group and participating tax administrations such as hybrid mismatch arrangements, withholding taxes and the application of relevant international treaties. The PE risks within scope are both the risk of a PE not being recognised for tax by the jurisdiction in which it is located and the risk that profits have not been allocated correctly to the PE.

The ICAP process enables participating MNE groups to meet the relevant tax administrations to talk through their country by country reports (CBCR) and other documentation and provide clarity to aid understanding of their cross-border activities. This should help tax administrations to reach an early decision about the level of transfer pricing risk, permanent establishment risk and other specific international tax risks, if any,

presented by the data contained in the CBCR and which the relevant tax authorities agree to include.

The timeline for ICAP will depend upon a number of factors, but typically an MNE group's ICAP risk assessment will be completed and outcome letters issued within 24-28 weeks following delivery of the main documentation package, at the start of the risk assessment and issue resolution stage. It is hoped that the process will reduce the amount of disputes that have to go into mutual agreement procedures (MAP) and it will certainly be a quicker process than MAP.

### *Eastern Power Networks and others*: closure notices and consortium relief

In *Eastern Power Networks and others v HMRC* [2021] EWCA Civ 283, the Court of Appeal upheld the decision of the Upper Tribunal (UT) and dismissed the taxpayers' appeal. The taxpayers had claimed consortium relief following a restructuring but HMRC had raised enquiries because of a mismatch between the economic interests of the parties in the consortium company and the amount of consortium relief claimed. Over a three year period, information had been requested from the taxpayers in order for HMRC to determine whether the conditions for consortium relief were satisfied following the restructuring, or if the purpose of the restructuring was to exploit the consortium relief rules so as to maximise the relief available. If the latter, HMRC contended that anti-avoidance provisions applied in order to reduce or negate the claim.

Although the taxpayers had provided a lot of information and documents over the course of the enquiry, they had not complied with, and had appealed against, various information notices on the grounds that the information and documents were not reasonably required by an officer for the purpose of checking the tax positions of the relevant companies and, in the case of some of the notices, that they were unduly onerous to comply with.

The First-tier Tribunal (FTT) directed HMRC to issue a closure notice, having decided the relevant substantive point in respect of the existence of disqualifying arrangements in the taxpayers' favour. The Upper Tribunal then set aside the FTT's direction. The Court of Appeal upheld the UT's decision, concluding that there was an arrangement which satisfied both section CTA 2010 146B(2)(b) and section 146B(3)(a). This means HMRC must continue their enquiries to determine whether that arrangement forms part of a scheme which has the purpose specified in section 146B(3)(b).

The Court of Appeal issued a stern warning to the FTT that where a statutory provision sets out a number of cumulative conditions to be satisfied, some of which require information to determine if they are satisfied, taxpayers should not be encouraged to pick and choose which information they provide and then ask the tribunal to decide the applicability of one element in the hope that a "quick win" will bring the rest of the enquiry to a halt. As Lady Justice Rose put it: "*That is a recipe for inefficient, stop/start enquiries and risks wasting a great deal of judicial time*." This was certainly true in this case, where all that has been achieved is a stalling of the enquiry for four years while the case was argued in the FTT, the UT and the Court of Appeal!

**What to look out for:**

- **Publication of Finance Bill 2021 on 11 March.**
- **23 March, 'Tax Day', for publication of consultations/calls for evidence and announcements/updates about measures which are not for implementation in Finance Bill 2021. This will include an interim report on the review of business rates, with a final report not expected until the Autumn.**
- **The consultation on VAT value shifting closes on 30 March.**
- **The OTS survey and call for evidence on use of third-party data closes on 9 April.**

***This article was first published in the 12 March 2021 edition of Tax Journal.***

# CONTACT

Mike Lane
PARTNER
T: +44 (0)20 7090 5358
E: mike.lane@slaughterandmay.com

Zoe Andrews
PSL COUNSEL & HEAD OF TAX KNOWLEDGE
T: +44 (0)20 7090 5017
E: zoe.andrews@slaughterandmay.com



Published to provide general information and not as legal advice. © Slaughter and May, 2021.
For further information, please speak to your usual Slaughter and May contact.