Slaughter and May Podcast
Tax News Highlights: August 2022

Zoe Andrews	Welcome to the August 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 cover the Upper Tribunal's decisions in the unallowable purpose cases of *Euromoney* and *BlackRock* and in a case on statutory interpretation, *Altrad Services*. We will discuss certain employment-tax related developments: the planned OTS review of distance working and an update to the Uncertain Tax Treatments by Large Businesses Manual. We will also comment on an interesting opinion from the GAAR panel, certain draft legislation published on L-day and the Treasury's sovereign immunity consultation. Shall we start with the cases?
Zoe Andrews	Yes, *Euromoney* involved a third party acquisition where the substantial shareholding exemption ("**SSE**") was unavailable to the seller. After the commercial teams had agreed a cash and share deal, the tax director on the seller side got involved, suggesting that the cash element should be replaced with a preference share issue. This was intended to prevent a tax charge on the cash element through the application of reorganisation treatment on the sale, and SSE becoming available in respect of a later redemption or disposal of the preferences shares. HMRC challenged this under the purpose test in section 137 TCGA on the basis that the share-for-share exchange formed part of a scheme or arrangements a main purpose of which was the avoidance of a liability to corporation tax. The parties agreed that the exchange for these purposes was the whole deal – so, both the originally agreed share consideration and the preference share issue that replaced the cash element. And if HMRC had won, this would have been the real kicker for the taxpayer because reorganisation treatment would have been denied for the entire exchange. The inclusion of the preference shares in the deal would have cost Euromoney £7.7 million in tax instead of saving £2.8 million as intended.
Tanja Velling	Fortunately for Euromoney, the Upper Tribunal has now upheld the First-tier Tribunal's decision in its favour. In doing so, the UT rejected HMRC's submission that, in applying the relevant test in section 137, the FTT would first have to identify all possible formulations of a scheme or arrangements of which the exchange could be said to form part and that the test would be failed if one of these candidate schemes had a main tax avoidance purpose. Quite rightly, the UT stated that this was not the test set out in the

	legislation and that there is no reason for inferring it based on parliamentary intention. Whether or not the exchange formed part of a scheme or arrangements and the identification of the purpose of such scheme or arrangements were questions of fact to be determined by the FTT. The UT affirmed the FTT's determination that the relevant arrangements included the whole deal rather than, as HMRC had argued, only the preference share issue. The UT also confirmed that, in determining the purpose of the arrangements, the FTT had been entitled to take into account the size of the tax saving relative to the deal, and the fact that Euromoney had not even considered the potential downside and spent comparatively little time and expense on the preference share issue element of the deal.
Zoe Andrews	So, overall a welcome decision from the taxpayer's perspective – although one point is worth noting in terms of its precedent value. The UT made clear that it expressed no view regarding whether the purpose test in section 137 was an objective or a subjective test (or a combination of the two). The case had proceeded on the assumption of both parties that it was a subjective test. Interestingly, the FTT's decision in *Euromoney* is not included in HMRC's annual statistics on tax avoidance litigation implying that they do not consider it a tax avoidance case. The most recent of such statistics were published on the 18th of July and showed that HMRC won or partially won all cases where judgments were published during the financial year 2021-22.
Tanja Velling	The Upper Tribunal's decision in the *BlackRock* case (which HMRC does consider tax avoidance litigation) was less good news for the taxpayer. The case concerns tax deductions for interest paid by a UK-tax resident entity, LLC 5, on debt finance from its parent which was used to acquire a US business. LLC 5, however, did not acquire the business directly; instead, it acquired preference shares in another US entity which then made the acquisition. That other entity was controlled by LLC 5's parent. LLC 5 was to service the interest payments out of dividend flows on the preference shares; it did not matter that LLC 5 had no control over those dividend flows as LLC 5's parent and lender did.
Zoe Andrews	HMRC challenged the interest deductions on two grounds, transfer pricing and the unallowable purpose test in section 441 of the Corporation Tax Act 2009. The FTT had decided the case in favour of the taxpayer on both grounds. On transfer pricing, the FTT considered that a third party would have lent the same amount to LLC 5 because LLC 5's parent would have given additional covenants to assure a sufficient dividend flow on the preference

	shares to service the debt (thus, placing the third party lender in a position equivalent to itself). The UT overturned this decision on the basis of a new argument raised by HMRC, namely, that the hypothetical arm's length loan cannot take into account third party covenants which did not in fact exist. Clearly, the actual loan did not include covenants from LLC 5's parent (because they were unnecessary) and, as a third party would not have lent without them, the interest deductions had to be disallowed as non-arm's length. This is a somewhat perplexing conclusion, not least because it seems that BlackRock would have succeeded if they had just gone through the artificial exercise of writing these unnecessary covenants into the intra-group loan.
Tanja Velling	This should have been enough to dispose of the appeal, but the UT went on to consider – *obiter* – the unallowable purpose point. It concluded that the FTT did not err in determining that BlackRock had a commercial as well as an unallowable tax avoidance purpose. But the FTT did err in attributing all of the debits to the commercial purpose. In the UT's view, all of the debits should have been attributed to the unallowable purpose. A crucial difference in the approach to apportionment resulted in these diametrically opposed results. The FTT had approached apportionment from the subjective perspective of LLC 5, having regard, in particular, to evidence that the transaction would have gone ahead even if the tax deduction had been withdrawn immediately before it. On the UT's view, such evidence would be far less relevant. It considered that the "correct approach is to determine whether the reason the debits existed was in order to obtain a tax advantage on the basis of an objective consideration of all of the relevant facts and circumstances". Given that, if the tax relief had never existed, the debt financing would never have existed, the interest deductions would have to be disallowed in full. As I said earlier, the case was not actually decided on this basis. So these comments are obiter, but they are likely to inform the arguments, and potentially the decision, in the *Kwik-Fit* appeal which is due to be heard by the UT in September. Let's move on to *Altrad Services*– on the face of it that was a surprising case for the taxpayer to win, wasn't it?
Zoe Andrews	Yes. The *Altrad Services* case involves an artificial series of transactions which the FTT found to be devoid of business purpose and which were effected just to achieve a "magical" uplift in qualifying expenditure for capital allowances purposes. The scheme had been disclosed under DOTAS and HMRC had issued closure notices reducing the taxpayers' entitlement to capital allowances. HMRC was successful before the FTT in arguing that the scheme failed based on the *Ramsay* line of cases but the Upper

	Tribunal allowed the taxpayers' appeal criticising both the way the FTT applied the two-step *Ramsay* approach and the way HMRC formulated the *Ramsay* argument. As a reminder, the two-step approach is to ask whether the facts, viewed realistically, answer the statutory description, interpreted purposively. The success of the scheme depended on a sale of assets being a disposal event under section 61(1)(a) of the Capital Allowances Act 2001 even though the assets were immediately leased back and ownership was regained after a few weeks by exercise of a put option. The UT found that the FTT had viewed the facts realistically but failed to interpret the legislation purposively. Section 61(1)(a) operated by reference to a snapshot in time - whether a person had ceased to own an asset **at any time** - not over a period of time. It did not expressly invite any analysis of why a person had ceased to own an asset nor of whether it was possible, likely or pre-ordained that the person would own the asset again unlike other limbs of s. 61(1) which looked at, for example, whether a loss of plant or machinery was "permanent". The UT concluded that construed purposively, section 61(1)(a) asked whether the taxpayer had lost legal and beneficial ownership of the assets, and on the facts, even when viewed realistically, it had.
Tanja Velling	So you could view this case as an example of HMRC choosing the wrong argument. But what I find interesting is that the Tribunal, although hinting that there was a way that HMRC could have put their *Ramsay* argument which would have resulted in them winning, the Tribunal was not going to do it for them. As Mike Lane describes this case in his blog post it is "something of a masterclass in statutory interpretation, coupled with an invitation to appeal and do better"! And now for some employment-related developments.
Zoe Andrews	The Office of Tax Simplification has published a scoping document indicating that they are planning to conduct a review of hybrid and distance working. The review will include, cross-border working and the allocation of taxing rights and the creation of permanent establishments for corporation tax. We expect that a call for evidence will be published in the near future.
Tanja Velling	Another interesting development was an update to the Uncertain Tax Treatments by Large Businesses Manual to indicate that the result provided by HMRC's Check Employment Status for Tax (CEST) tool can constitute a "known" position for the purposes of the notification requirement. Of course, employers are not required to use this tool, but if they do and then apply a

	tax treatment contrary to the result it gave, a notification may be required, if the other relevant conditions are also met. One of these conditions is the £5 million threshold. In this respect the manual has also been updated to confirm that, where several persons are engaged in the same way and this form of engagement gives rise to an uncertain tax position, the individual tax advantages in respect of each person must be aggregated when applying the threshold test. Taken together, it would seem that, if a company were to engage multiple contractors in similar circumstances, an adverse CEST tool determination in respect of one of them could mean that the £5 million threshold has to be assessed by references to the tax saving across all of the relevant contractors.
Zoe Andrews	Since August 2017, the GAAR panel has issued a good 20 opinions – but don't worry, we will not bore you with the details of any of these. The latest opinion which was published on the 21st of July is, however, worth being aware of because it is the first time that the GAAR panel sided with the taxpayer and found that entering into the arrangements and carrying them out had been a "reasonable course of action in relation to the relevant tax provisions". Why was that? Well, the key point seems to have been that the hole in the legislation that had been exploited was such a "big and obvious matter" that it could not be plugged by the GAAR, but would have had to be addressed by further legislation. It's also worth noting that the GAAR panel considered that the arrangements did not involve any contrived or abnormal steps in the period under review. Quite clearly, the opinion should not be understood as an invitation to go hunting for obvious legislative gaps, but it certainly represents something of a high-water mark of what the GAAR can be used to counteract.
Tanja Velling	Now, let's look at two of the measures which will be included in the next Finance Bill and for which draft legislation was published on L-day. The first measure proposes amendments to the Qualifying Asset Holding Companies regime which was introduced in this year's Finance Act and broadly taxes investors as if they had invested directly in the underlying assets. The amendments concern the ownership condition which a company must meet to qualify for the regime. The ownership condition is, broadly, that the interests of non-Category A investors in the company do not exceed 30%. An anti-fragmentation rule applies when determining this and one of the changes is to extend this anti-fragmentation rule with effect from the 20th of July 2022 (subject to a

	grandfathering provision) to also take into account interests held indirectly through one or more qualifying asset holding companies.
Zoe Andrews	"Qualifying funds" are one type of Category A investor. In order to be "qualifying", a fund must meet the "diversity of ownership condition" and one way of meeting that is, broadly, to be a collective investment scheme that is widely marketed and made widely available. The two other amendments relate to this limb of the test. First, the definition of collective investment scheme is extended to cover bodies corporate which would have qualified as a collective investment scheme if they had not been a body corporate. This change addresses the issue that some non-UK vehicles may have failed to qualify by reason of their foreign corporate form and is treated as always having had effect. The other change provides broadly that, where one of several funds investing in parallel with substantially coordinated management is a widely marketed and available collective investment scheme, the other parallel funds and any aggregator into which they feed are also treated as meeting this condition. No commencement date for this change is specified in the draft legislation.
Tanja Velling	Draft legislation has also been published for the implementation of one part of the Pillar 2 GloBE rules, the Income Inclusion Rule, which will be known in the UK as the "multinational top-up tax". It will apply for accounting periods beginning on or after the 31st December 2023. A consultation response was published alongside the draft legislation, which runs to 116 pages and is as complicated as one might expect for something based on the OECD's Model Rules. We will highlight a few key points. The government's response to concerns raised with the Model Rules was – unsurprisingly – that there is little scope for changing the Model Rules. The UK implementing legislation does not, however, slavishly follow the text of the Model Rules. It is rather drafted in line with their intent and expands on the Model Rules where possible to address concerns raised. In particular, the government has sought to include rules reflecting the outcomes expressed in the OECD's commentary on the Model Rules where these were unclear in the Model Rules themselves. Does the consultation response say anything about GILTI coexistence?
Zoe Andrews	The government expects that US GILTI in its current form would not constitute an Income Inclusion Rule. So, if GILTI is not amended, which looks increasing likely, it is expected that GILTI charges would be attributed to the foreign subsidiaries of a US parent and included in the adjusted covered taxes figure for the purposes of the GloBE rules. How such an

	attribution would work is, however, currently unclear and additional rules would have to be devised. The Income Inclusion Rule is the primary top-up tax mechanism under the GloBE rules, but there is also a back-up rule known as the Undertaxed Profits Rule ("**UTPR**") to apply where no jurisdiction has applied an Income Inclusion Rule. Will the UK introduce a UTPR as well?
Tanja Velling	The consultation response states that the government is preparing to introduce a UTPR in the UK and "will make a final decision on timing, at a later date". I wonder, however, whether the paragraphs surrounding this statement could also be read as an indication that the UK may yet decide not to introduce a UTPR in case a sufficient number of countries implement an Income Inclusion Rule so as to make a UK UTPR unnecessary. What's the position on a UK domestic minimum tax ("**DMT**")?
Zoe Andrews	No decision has yet been made on whether the UK will adopt a DMT. If it were introduced, it would be subject to the GloBE revenue threshold, but may be applied to purely domestic as well as MNE groups. In deciding whether to introduce a DMT, the government will take into account a range of factors including whether there will be a safe harbour from the IIR and UTPR when a jurisdiction has a qualified DMT. The UK government is supportive of such a safe harbour and will ensure that its benefits are considered at OECD level. The consultation response also highlights a number of other points which the government will raise as part of the discussion of the Implementation Framework that is being developed at the OECD level and the publication of which is keenly awaited. These include the risk that businesses in financial distress could become subject to a top up because credits arising from a debt release are not excluded under the Model Rules. So, there is a lot left to consider and work on in the UK and beyond. What's happening in the EU?
Tanja Velling	The proposed GloBE implementing directive continues to be stuck in the Council. After Poland had been won over, Hungary withheld its approval. Reaching agreement, however, continues to be a priority for the Council presidency which was taken over by the Czech Republic at the start of July. In this context, it is interesting to note that the US has terminated its double tax treaty with Hungary with effect from the 1st of January 2024. The relevant US Treasury press release does not give a reason for the termination, but the Hungarian side referred to the termination as linked to Hungary's veto of the GloBE implementing directive.

	But onto our final item – what's happening in respect of sovereign immunity?
Zoe Andrews	The UK Treasury is consulting on reforming the direct tax treatment of sovereign investors. The press release accompanying the launch of the consultation indicated that the reform would "deliver better value for money for UK taxpayers". This will be done by narrowing the sovereign immunity exemption so that sovereign investors pay more tax in the UK. At the same time, the Treasury does not expect the reform "to have a material impact on foreign investment into the UK". I struggle to see how both points could be true and HMRC's own analysis of the capital gains tax statistics for the 2021-22 financial year would seem to furnish a case study to the contrary. HMRC links the 42% increase in tax receipts as compared to the previous year to media speculation around a potential increase in capital gains tax rates as this may have led taxpayers to crystallise gains early. So, HMRC itself seems to think that just talking about tax raises can have a significant behavioural impact. It is not clear to me why one would not expect the tightening of the sovereign immunity exemption to have a similar effect. But let's look at the proposal. The key element is that the sovereign immunity exemption is proposed to be narrowed down to UK source interest. What would that mean for other revenue streams and gains?
Tanja Velling	Sovereign natural persons would be taxed in accordance with the rules for non-resident individuals and sovereign non-natural persons would be taxed in accordance with the rules for non-resident companies. Broadly speaking, that means the following: • Sovereign persons should generally still be able to receive dividends free of UK tax, given that the UK does not generally impose a dividend withholding tax (although there are some exceptions). • Sovereign persons would, however, become subject to tax on UK trading income which is likely to put some pressure on the dividing line between trading and investment activities at the fringes of portfolio investment management. • Sovereign persons would also become subject to tax on income and gains from UK real estate.
Zoe Andrews	Of course, such tax charges would be subject to any available exemptions or reliefs, including under the UK's double tax treaties. But, unlike other countries' treaties, these do not normally exempt sovereigns specifically.

	Finally, it's worth noting that the consultation also seeks views on how sovereign persons should be defined. One question is whether government pension schemes should be included (as they are currently) or should they instead rely on existing alternative exemptions? The consultation sounds as if the Government might favour the latter approach but this may prove problematic. Foreign government pension schemes currently favour sovereign immunity over the pension schemes specific exemptions because the way the funds are structured may pose challenges for meeting the eligibility criteria for these exemptions. And what's coming up?
Tanja Velling	• The OECD's consultation on the Progress Report on Amount A of Pillar One closes on the 19th of August; • the Treasury's sovereign immunity consultation closes on the 12th September; and • consultations on the draft legislation for the next Finance Bill close on the 14th of September.
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.