Slaughter and May Podcast
Tax News Highlights: November 2022

Zoe Andrews	Welcome to the November 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 CJEU's decision in the *Fiat* State aid case and the Supreme Court's decision in *NHS Lothian*. We will also discuss UK Finance's report on the total tax contribution of the UK banking sector and certain international tax developments, including the recent signature of two separate multilateral competent authority agreements on the automatic exchange of information. This podcast was recorded on the 15th of November 2022 and reflects the law and guidance on that date.
Zoe Andrews	Let's start with the latest case on fiscal State aid – involving Fiat and Luxembourg with an intervention from Ireland. The CJEU overturned the decision of the General Court and annulled the European Commission's decision that a tax ruling granted by the Luxembourg tax authority to a company in the Fiat group which provided treasury and financing services to group companies established in Europe constituted illegal State aid. This will be a considerable blow to the European Commission as the CJEU has reaffirmed the fiscal autonomy of Member States and put an end to the Commission's application of an overarching EU arm's length principle. This is a very significant case – not just for Fiat and Luxembourg, but for the implications for the Commission's appeal to the CJEU in the *Apple* case. Which is why Ireland brought a separate appeal as intervener in the *Fiat* case. So let's look at where the Commission and the General Court went wrong in the *Fiat* case. The tax ruling in question was an advance pricing agreement, based on Luxembourg law and administrative practice, intended to bring about a reasonable approximation of the market price of the financial transactions. Without getting too technical, there are a number of conditions to be fulfilled for a measure to constitute unlawful State aid. The condition at the centre of the *Fiat* case is that the measure must confer a selective advantage on the beneficiary. It is crucial for assessing the existence of an advantage and whether it is selective that the reference system is correctly identified.
Tanja Velling	The Commission is required to carry out a comparison with the tax system normally applicable in the Member State. Where the Commission went wrong (and where the General Court erred in law by endorsing this) is that, when defining the "normal" taxation of an intra-group company, the arm's

	length rule actually applicable under Luxembourg national law was disregarded and instead a hypothetical tax system applying a different arm's length principle was used as the comparator. This principle has been referred to by some commentators as "an overarching EU arm's length principle". The CJEU concluded that there is no autonomous arm's length principle to be applied independently of the national law. The fixing of the methods and criteria for determining an arm's length outcome falls within the discretion of the Member States and that there are significant differences in the detailed application of transfer pricing methods between the Member States. So, although this case is a victory for fiscal autonomy, the CJEU did not rule out the possibility that a tax ruling could constitute unlawful State aid if the conditions were satisfied. But on the facts of this case, because the analytical framework did not include all the relevant norms implementing the arm's length principle under Luxembourg law, the Commission had failed to show the conditions for unlawful State aid had been satisfied.
Zoe Andrews	That's right, but it begs the question whether it is good use of the Commission's time and resources to challenge individual tax rulings in this way and why the Commission has done so. Transfer pricing cases are by their very nature fact dependent and evidence intensive and the transfer pricing of group financial transactions is highly complex. In the absence of tax harmonisation across the EU, the Commission has repeatedly used State aid as a tool for tackling tax competition but as this case shows it is not the right tool for the job. The latest attempt at tax harmonisation is "BEFIT". The Commission is consulting on the framework for this and plans to publish a proposal next year.
Tanja Velling	In other transfer pricing news, the OECD published a new version of its Transfer Pricing Guidelines on the 20th of January 2022 and the UK's transfer pricing rules have now been updated to designate these latest guidelines for the purposes of the definition of "the transfer pricing guidelines" in section 164(4)(a) of TIOPA.
Zoe Andrews	I thought we were going to discuss the cases first?!
Tanja Velling	Yes, of course. You're right. So, *NHS Lothian* is a recent Supreme Court decision on VAT. The laboratories within NHS Lothian's remit primarily worked for the NHS, but they also undertook some paid work for third parties. It was common ground that this paid work constituted a business activity for VAT purposes and that, in principle, NHS Lothian was entitled to recover related input tax. In March 2009, NHS Lothian submitted a claim for such input tax incurred during the period from 1974 to 1997. This was possible due to certain legislative measures which we won't discuss further. The claim quantified

	the input tax by reference to the taxable percentage of work carried out in 2006/2007.
Zoe Andrews	But HMRC rejected the claim and the First-tier Tribunal and the Upper Tribunal agreed with HMRC. The First Division of the Inner House of the Court of Session then overturned the Upper Tribunal's decision, but the Supreme Court now decided the case in favour of HMRC. In order to establish a valid claim for input tax recovery, the taxpayer must establish how much it is entitled to claim, not merely that it must have incurred some recoverable input tax during the course of a business activity. The Supreme Court cited the CJEU's decision in *Vădan* as support for this proposition. The taxpayer was unable to evidence how much input tax it had incurred and the CJEU held that an expert report setting out the amount of input tax that the taxpayer would likely have incurred in the context of the business activity was insufficient to found a claim. Similarly, in this case, it was clear that NHS Lothian had incurred some input tax, but it did not provide sufficient evidence to prove specifically how much or that its method of quantifying such input tax was reasonable. The business income of the laboratories for the relevant years was not recorded in the available accounting information, no sales ledgers or copy tax invoices were provided to HMRC and the aggregate output tax paid to HMRC had not been established.
Tanja Velling	The Supreme Court went on to consider the application of the EU principle of effectiveness in this context. It broadly means that Member States must not render directly effective EU rights, such as the right to recover input tax derived from the Principal VAT Directive here, ineffective through excessive procedural hurdles. But, importantly for this case, it does not require that a claimant is allowed to rely on presumptions or circumstantial evidence in the absence of any more direct evidence where this is not permitted under normal procedural rules. In other words, the principle of effectiveness does not require that either the ordinary rules of evidence or the burden of proof are set aside. And what else is new?
Zoe Andrews	The EU Anti-Tax Avoidance Directive previously imposed restrictions, including a sunset clause, on the regulatory capital exemption from the UK's hybrids rules in Part 6A of TIOPA 2010. Regulations have now been made to remove the expiry of the exemption after the 31st of December 2022 to ensure the continuation of the exemption from counteraction for certain regulatory capital instruments issued by banks to their overseas associates. Draft regulations were subject to consultation earlier this year and no changes were made to those.

	This is good news for banks! But there's not so much good news in the latest UK Finance Report is there?
Tanja Velling	Certainly not from the perspective of the competitiveness of the UK for financial centres. UK Finance's report on the total tax contribution of the UK banking sector (published in October 2022) shows the banking sector is estimated to have generated £38.8bn in taxes in the financial year to the end of March 2022 (up from £37.1bn the previous year). This was in the second year of the Covid-19 pandemic which illustrates the resilience of the sector and its continuing significant contribution to public finances. But the report shows that the UK is currently on a course to become a less competitive financial centre for banks compared to other financial centres because of the sector-specific taxes and the increasing rate of corporation tax. The projected total tax rate for the UK for 2024 is 45.7% but this assumes the bank surcharge goes down to 3% and that there are no further relevant tax rises. We await the Autumn Statement to see if these assumptions remain correct! Other financial centres have much more competitive projected total tax rates – around 27% or 28% in New York and Dublin, and less than 40% for each of Amsterdam and Frankfurt. But what has been going on at the OECD?
Zoe Andrews	Pascal Saint-Amans left the OECD on the 31st of October. Grace Perez-Navarro has been appointed interim director until the 31st of March 2023 when a permanent replacement will take over. Meanwhile, it appears that the work on international tax reform continues apace. Earlier in October, it had been announced that "strong progress" continues to be made towards its implementation. A "Progress Report on the Administration and Tax Certainty Aspects of Amount A of Pillar One" was published for comments by last Friday, the 11th of November. The portion of the report concerning the tax certainty framework for Amount A and tax certainty for issues related to Amount A built on the earlier consultation of May 2022 on these matters. In relation to the latter aspect, further technical work is ongoing, for instance, in respect of the interaction between this new process and the mutual agreement procedure under existing double tax treaties. In contrast, the report is the first time that we have seen the administrative provisions. It is generally envisaged that a covered group would centrally prepare a standardised tax return, which would set out the additional tax liabilities of the group as a result of Amount A. This would be supported by one set of standardised documents. This return and these documents would then be made available to support local tax filings. In describing this

	mechanism, I have been deliberately vague on the question as to which entity would have the additional tax liability and filing obligation. This is because one big open point is the question whether to take a single taxpayer approach where one group entity would be liable for the additional tax across all market jurisdictions or a multiple taxpayer approach where one or more entities in each relevant jurisdiction would be so liable.
Tanja Velling	So, clearly, a lot is left to be resolved, but the Inclusive Framework is still working towards a mid-2023 finalisation of the Multilateral Convention for the implementation of Amount A, to enter into force in 2024. Time for countries to start considering how they might have to adapt their national rules for the introduction of Amount A?
Zoe Andrews	The Public Accounts Committee certainly seems to think so. It has launched an inquiry into the UK's digital services tax – including on the UK's "readiness to replace it with the OECD reforms". In addition to taking evidence on the reasons for the introduction of the UK's DST and associated risk management, it will ask how HMRC and the Treasury intend to use lessons learned during the implementation of the DST in the implementation of the OECD reforms. The Public Accounts Committee calls for anyone who has evidence on these issues to get in touch by 6pm on the 27th of November.
Tanja Velling	The other big issue on international tax reform is progress towards the implementation of the GloBE rules under Pillar 2. Unfortunately, I think we will have to wait at least until the Autumn Statement to find out more about the UK's plans following the change in Government. Meanwhile, however, the OECD has published an interesting report on "Tax Incentives and the Global Minimum Corporate Tax" urging countries to take the introduction of Pillar 2 as an opportunity to reconsider their tax policy design. The global minimum tax will make certain tax incentives inefficient to the extent that they reduce a company's local tax liability to a level that triggers a charge under another jurisdiction's income inclusion rule. Examples of incentives that could prove ineffective are corporate income tax holidays or rate reductions granted in return for inward investment or special intellectual property regimes such as the UK's patent box.
Zoe Andrews	The structure of the substance-based carve-out under the GloBE rules means that incentives narrowly targeted at investment in local employees and tangible assets should be less affected. The same is true for incentives that are qualified refundable tax credits (as they would increase the GloBE income rather than decreasing the covered taxes for the purpose of the effective tax rate calculation). Any incentives granted to businesses that are out of scope – whether that is because they do not meet the revenue threshold or fall within a subject matter exclusion – would be unaffected.

Tanja Velling	So, does this mean that there is a simple solution – such as turning incentives for in-scope businesses into qualified refundable tax credits?
Zoe Andrews	Perhaps in theory. But in practice, a large-scale introduction of qualified refundable tax credits would seem unlikely given that they imply a refund to taxpayers and this has substantial revenue consequences. Indeed, the OECD's report encourages a much broader rethinking of tax policy. Whilst countries' priority would and should be an assessment of the impact of the GloBE rules on existing incentives with reform where they would no longer be cost-effective, the report encourages jurisdictions to "use the opportunity presented by Pillar Two to engage in a deeper reconsideration of the use of tax incentives, beyond those directly affected by the GloBE Rules". Reforms should be targeted to remove redundant and inefficient incentives, reduce distortions and improve signalling for investors. But the OECD goes even further than that and calls on jurisdictions to consider "opportunities for tax reform beyond tax incentives". One example would be to consider the revision of existing anti-avoidance rules. I think this would be a welcome development – especially if the result was the abolition of some of the rules or at least their disapplication for businesses that are within the scope of the GloBE rules.
Tanja Velling	But this still is not the end of international tax developments. On the 9th of November, the 15th Plenary Meeting of the Global Forum on Transparency and Exchange of Information for Tax Purposes took place in Seville, and in its sidelines a signing ceremony for two separate multilateral competent authority agreements took place. The UK is among the signatories for both MCAAs. The first MCAA concerns the automatic exchange of information collected from digital platforms pursuant to the national implementation of the OECD's "Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy". These rules require that digital platform operators collect and verify certain information in respect of their sellers. Platform operators also have to report certain information, including the sellers' income, to the tax authority in their home jurisdiction. Under the MCAA, the tax authority in the operator's home jurisdiction would then exchange this information with the tax authorities in the sellers' jurisdictions. HMRC is currently consulting on draft regulations to implement the OECD's Model Rules. The draft regulations were published on the 18th of October and comments can be submitted until the 13th of December 2022. In the EU, DAC7 included provisions equivalent to the OECD's Model Rules which Member States are required to implement by the end of this year.
Zoe Andrews	The second MCAA concerns the automatic exchange of information collected pursuant to the national implementation of the OECD's "Model

	Mandatory Disclosure Rules on Common Reporting Standard Avoidance Arrangements and Opaque Offshore Structures”. Catchy title. These rules require intermediaries (and in some circumstances taxpayers) to report information on arrangements intended to circumvent the Common Reporting Standard and structures that disguise the beneficial owners of assets held offshore. Hallmark D of DAC6 in the EU is equivalent to the substantive scope of these Model Rules. As anyone involved in preparing for the introduction of DAC6 in the UK will recall, the UK had initially implemented DAC6 in full. At the end of the transition period, this was, however, scaled back to cover only Hallmark D.
Tanja Velling	This scaled-back DAC6 implementation continues to be the way in which the OECD’s Model Rules are implemented in the UK. At the back end of 2021, HMRC did, however, consult on draft rules, more closely aligned with the OECD’s Model Rules, to replace this. The draft rules provided that, in certain circumstances, there would be an exemption from the reporting obligation if the arrangement or structure had already been reported in a “partner jurisdiction”. The consultation document published alongside the draft rules indicated HMRC’s expectation that, in order to be a “partner jurisdiction”, a country would normally have to have signed up to the relevant MCAA, meaning this second MCAA that was signed on the 9th of November. So, it currently looks as if the reporting exemption under the proposed new rules could apply only in respect of the currently relatively small number of signatories. That is, of course, only if the new rules are actually implemented. Perhaps we will find out about their fate as part of the Autumn Statement.
Zoe Andrews	And this takes us neatly onto what’s coming up. Tomorrow’s Autumn Statement is clearly the most important upcoming event in UK tax. It has long been trailed that this will reflect difficult decisions. Quite what these were remains to be seen. Looking across the Channel, the European Commission will launch its Tax Symposium in Brussels on the 28th of November 2022. This is intended as a high-level event to reflect on the right tax mix for the EU over the next 20-30 years. And the 22nd of November is the OECD’s Tax Certainty Day 2022, to be marked with a livestreamed event during which the 2021 MAP Statistics and Awards will be presented.

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