Corporate tax update

Second quarter 2015

Welcome to the latest edition of our corporate tax update, written by members of RPC's Tax team and published quarterly. In this edition we highlight some of the key tax developments of interest to UK corporates from the second quarter of 2015.

General Election 2015

UK General Election result – corporate tax implications

The Conservative Party's outright victory in the 2015 General Election came as a surprise to many political commentators and tax advisers alike. Whilst in many ways it means there will likely be a continuation of the last Parliament's perceived business-friendly tax policies, there were a few surprises sprung in the summer budget that followed the election result. more›

VAT

Upper Tribunal holds VAT incurred by University on fund management fees to be recoverable

On 9 June 2015, the Upper Tribunal (in *HMRC v University of Cambridge*) held that VAT on fees paid by Cambridge University to the investment managers of its endowment fund was partially recoverable as the managers' fees were part of the University's general overheads. more›

Upper Tribunal confirms VAT overpayment compromise agreement valid and binding

On 1 April 2015, the Upper Tribunal (in *HMRC v Southern Cross Employment Agency Ltd*) held that a compromise agreement entered into between HMRC and the taxpayer in respect of overpaid VAT was valid and binding, despite it subsequently emerging that, as a matter of law, no VAT had been overpaid. more›

Employment taxes

First-tier Tribunal holds payment under compromise agreement to be taxable

On 19 June 2015, the First-tier Tribunal (in *Hill v HMRC*) held that a payment to an employee pursuant to a compromise agreement was taxable as it was made to compensate him for a change to the terms of his employment contract. The decision makes some interesting points around the effect of TUPE transfers on the tax treatment of compromise agreement payments. more›

Any comments or queries

David Gubbay
Partner
david.gubbay@rpc.co.uk
+44 20 3060 6050

Ben Roberts
Senior Associate
ben.roberts@rpc.co.uk
+44 20 3060 6184

Adam Craggs
Partner
adam.craggs@rpc.co.uk
+44 20 3060 6421

Robert Waterson
Senior Associate
robert.waterson@rpc.co.uk
+44 20 3060 6245

International

Further developments in the BEPS project

A number of further publications have been released this quarter as part of the Organisation for Economic Co-Operation and Development's (OECD's) Base Erosion and Profit Shifting (BEPS) project. more›

Supreme Court finds taxpayer entitled to double tax treaty relief on share of Delaware LLC profits

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"Corporate Taxation Action Plan" launched by European Commission

On 17 June 2015, the European Commission launched its action plan for fair and efficient taxation in the EU. Within the package to be consulted upon are plans for a common consolidated corporate tax base (CCCTB) and a number of administrative measures around cross-border cooperation, dispute resolution and greater transparency. more›

HMRC clarifies further "exemptions" from requirement to file FATCA returns

On 13 April 2015, HMRC confirmed that UK financial institutions will not be required to file "nil" returns under the UK's FATCA regulations, if they do not maintain any US financial accounts. However, UK financial institutions that maintain only US accounts below the applicable de minimis threshold ($50,000 or $250,000, for individual and entity accounts, respectively) will still be required to file 'nil' FATCA returns. more›

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The Conservative Party's outright victory in the 2015 General Election came as a surprise to many political commentators and tax advisers alike. Whilst in many ways it means there will likely be a continuation of the last Parliament's perceived business-friendly tax policies, there were a few surprises sprung in the summer budget that followed the election result.

The summer budget was not actually announced until early in July. Whilst it included the announcement of further reductions in the (already relatively low) UK corporation tax rate and a (broadly welcomed) change to the UK tax treatment of dividends received by individuals, there were also measures announced on the tax treatment of investment managers that caused some concern within the industry.

Our blog on the summer budget, can be found here.

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VAT

Upper Tribunal holds VAT incurred by University on fund management fees to be recoverable

On 9 June 2015, the Upper Tribunal (in *HMRC v University of Cambridge*[1]) held that VAT on fees paid by Cambridge University to the investment managers of its endowment fund was partially recoverable as the managers' fees were part of the University's general overheads.

The Cambridge University Endowment Fund (the Fund) invests donations and endowments in a range of equities, bonds and other investments. Income generated by the Fund is used to support all of the University's activities. The Fund's investment activity is outside the scope of VAT.

Professional managers engaged by the University to manage the Fund charged fees subject to VAT at the standard rate. The University sought to recover input tax on the manager fees, under its partial exemption method (the University makes both taxable and non-taxable supplies). HMRC refused the recovery claim on the basis that (in its view) in order for the VAT to be recoverable the investment management fees needed to be incorporated into the costs of all the University's economic activities (which they were not).

The Upper Tribunal dismissed HMRC's appeal from the First-tier decision, applying the tests established by the European Court of Justice (ECJ) in the *Kretztechnik* and *SKF* cases. As the University's investment activity was carried out for the benefit of the University's economic activity in general, the managers' fees were part of the University's overheads and the VAT incurred was recoverable under its partial exemption method.

The decision can be found here.

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Upper Tribunal confirms VAT overpayment compromise agreement valid and binding

On 1 April 2015, the Upper Tribunal (in *HMRC v Southern Cross Employment Agency Ltd*[2]) held that a compromise agreement entered into between HMRC and the taxpayer in respect of overpaid VAT was valid and binding, despite it subsequently emerging that, as a matter of law, no VAT had been overpaid.

The taxpayer, an employment agency, supplied dental nurses to dental practices.

The taxpayer made a claim for repayment of VAT pursuant to section 80 VATA 1994, in respect of its services supplied between 1973 and 1997. HMRC resisted the claim, on the grounds that the taxpayer would be unjustly enriched by receipt of a VAT repayment, before ultimately (after correspondence with the taxpayer's advisers) suggesting a "compromise" position on a "without prejudice basis". After further negotiation, a repayment amounting to 74% of the taxpayer's claim (plus interest) was agreed.

Less than three months after agreeing the compromise, HMRC wrote to the taxpayer stating that no repayment should have been made. HMRC had now received legal advice that the taxpayer's supplies were, in fact, taxable. HMRC raised an assessment for the repaid amount.

1. [2015] UKUT 305 (TCC).
2. [2015] UKUT 0122 (TCC).

The Upper Tribunal, rejecting HMRC's appeal, held that:

- The language of section 80 VATA 1994 did not prevent HMRC from entering into compromise agreements in respect of claims for repayment of overpaid VAT.
- The agreement in this case was not ultra vires. At the time of the agreement there was genuine uncertainty as to the correct VAT treatment of the taxpayer's supplies.
- The agreement was valid and binding.

The decision is welcome as it confirms compromise agreements relating to VAT should be viewed in the same way as those relating to direct taxes. Taxpayers will welcome this decision, as allowing HMRC to renege on compromise agreements could have had wide-ranging implications for the way in which taxpayers and HMRC settle disputed matters (and the certainty taxpayers have that such agreements will be honoured).

The decision can be found here.

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Employment taxes

First-tier Tribunal holds payment under compromise agreement to be taxable

On 19 June 2015, the First-tier Tribunal (in *Hill v HMRC*[3]) held that a payment to an employee pursuant to a compromise agreement was taxable as it was made to compensate him for a change to the terms of his employment contract. The decision makes some interesting points around the effect of TUPE transfers on the tax treatment of compromise agreement payments.

The employee argued before the tribunal that the £30,000 payment should be paid free of tax pursuant to section 401 ITEPA 2003, because the payment was made in return for a combination of his agreeing not to pursue a claim against his employer for (i) failing to consult on a TUPE transfer that had the effect of transferring his employment, and (ii) breach of the terms of his employment contract, which stipulated that he would only be required to work within a 10 mile radius of a specified location.

The tribunal dismissed the employee's appeal, as:

- The payment was taxable as "earnings" under ITEPA, and could not therefore fall within section 401.
- This was supported by the fact that the employee did not raise the issue of his location of work (and the purported breach of his employment contract) until after the TUPE transfer had taken place.
- This was further supported by the fact that the terms of the compromise agreement required the employee to pay back (part of) the payment if he left his employer's employment within a specified amount of time.

Although the decision did not turn on the question, the tribunal's view was that the effect of the TUPE transfer was that there was no termination of the employee's employment (which would have removed one of the possible arguments for section 401 applying).

The decision can be found here.

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3. [2015] UKFTT 0295 (TC).

International

Further developments in the BEPS project

A number of further publications have been released this quarter as part of the Organisation for Economic Co-Operation and Development's (OECD's) Base Erosion and Profit Shifting (BEPS) project. These include:

- The 8 June 2015 publication by the OECD of a package of measures relating to "country-by-country reporting" (relevant to Action 13 of the BEPS project). This package includes model domestic legislation and international agreements to implement country-by-country reporting of the profits earned, and tax paid, by multinational enterprises The documents can be found here.
- The 4 June 2015 publication by the OECD of a discussion paper for draft revisions to transfer pricing guidelines on "hard-to-value" intangibles (relevant to Action 8 of the BEPS project). The paper can be found here.
- The 22 May 2015 publication by the OECD of a revised discussion paper on preventing tax treaty abuse (relevant to Action 6 of the BEPS project). The paper can be found here.
- The 15 May 2015 publication by the OECD of a revised discussion paper on the prevention of artificial avoidance of permanent establishments (relevant to Action 7 of the BEPS project). The paper can be found here.

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Supreme Court finds taxpayer entitled to double tax treaty relief on share of Delaware LLC profits

On 1 July 2015, the Supreme Court (in *Anson v HMRC*[4]) held that a taxpayer was entitled to treaty relief on his share of a Delaware LLC's profits. This casts doubt on HMRC's published position (though each case must be judged on its own facts).

The taxpayer, a UK "non-domiciled" individual, was a member of a Delaware LLC. For US tax purposes, each member (rather than the LLC itself) was subjected to US tax on their share of the LLC's profits (whether distributed or not).

The relevant article of the applicable US/UK double tax treaty stated that: "[US tax] on profits or income from sources within the United States ... shall be allowed as a credit against any United Kingdom tax computed by reference to the same profits or income by reference to which the United States tax is computed."

The taxpayer remitted his gross profit share to the UK, and claimed foreign tax credit in the UK. HMRC denied such foreign tax credit as:

- HMRC regarded the LLC as opaque for UK tax purposes.
- The LLC had therefore, in HMRC's eyes, effectively paid a "dividend" to the taxpayer.
- This meant that the taxpayer had not been taxed in the UK on the same income as that on which the LLC had been taxed in the US.

Earlier decisions in this case had focussed on the fact that the taxpayer did not have a proprietary right in the LLC's underlying assets, and that the taxpayer relied on a contractual right to receive their profit share. However, the Supreme Court held that the critical question

4. [2015] UKSC 44.

is to consider the source of the income, and to determine whether one treaty country is taxing the same income as the other treaty country.

It is clear from the decision that it will be necessary to look at a particular entity's arrangements in any case, and that the decision does not produce a rule that can be applied, in all cases, to all Delaware LLCs or indeed other non-UK, locally-transparent entities.

However, HMRC may now need to revisit its stated guidance on Delaware LLCs (at least), as it currently states: "the Revenue take the view that for UK tax purposes LLCs should be regarded as taxable entities and not as fiscally transparent. Accordingly, the UK taxes a UK member of an LLC by reference to distributions of profits made by the LLC and not by reference to the income of the LLC as it arises ... It follows that relief for underlying tax is not available to an individual UK member of an LLC."

The decision can be found here.

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"Corporate Taxation Action Plan" launched by European Commission

On 17 June 2015, the European Commission launched its action plan for fair and efficient taxation in the EU. Within the package to be consulted upon are plans for a common consolidated corporate tax base (CCCTB) and a number of administrative measures around cross-border cooperation, dispute resolution and greater transparency.

The UK Government has already signalled its opposition to the proposed mandatory CCCTB (which, in broad terms, seeks to tax profits where they are made, much like the UK's own Diverted Profits Tax and elements of the OECDs' Base Erosion and Profit Shifting (BEPS) project).

The action plan can be viewed here.

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At the same time, HMRC also confirmed that holding companies and treasury companies will no longer be classified as "financial institutions" for FATCA purposes.

HMRC's announcement can be viewed here.

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About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 78 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol.

"... the client-centred modern City legal services business."

At RPC we put our clients and our people at the heart of what we do:

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- **Winner – Competition Team of the Year – Legal Business Awards 2014**
- **Winner – Best Corporate Social Responsibility Initiative – British Insurance Awards 2014**
- **Highly commended – Law Firm of the Year at The Legal Business Awards 2013**
- **Highly commended – Law firm of the Year at the Lawyer Awards 2013**
- **Highly commended – Real Estate Team of the Year at the Legal Business Awards 2013**

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15065

Tower Bridge House
St Katharine's Way
London E1W 1AA
T +44 20 3060 6000

Temple Circus
Temple Way
Bristol BS1 6LW
T +44 20 3060 6000

11/F Three Exchange Square
8 Connaught Place
Central Hong Kong
T +852 2216 7000

8 Marina View #34-02A
Asia Square Tower 1
Singapore 018960
T +65 6818 5695