Corporate tax update

Second quarter 2018

Welcome to the latest edition of our Corporate Tax Update, written by members of RPC's tax team and published quarterly. In this second 2018 edition we highlight some of the key tax developments of interest to UK corporates from the second quarter of 2018.

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Court of Appeal denies input tax recovery on supplies mistakenly treated as VAT exempt

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VAT recovery on (failed) share acquisitions – AG opinion

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First-tier Tribunal views outsourced "loan administration" services as standard-rated debt collection

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Compensation for injury to feelings not taxable as termination payment – Court of Appeal decision

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Any comments or queries?

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Termination payments and post-employment notice pay (PENP) – updated HMRC guidance

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Stamp taxes

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On 13 June 2018, the Supreme Court allowed HMRC's appeal in the long-running case regarding the 2007 sale by the MoD of the Chelsea Barracks. more›

International

UK ratification of BEPS Multilateral Instrument

On 29 June 2018, the UK became the ninth jurisdiction to deposit with the OECD its instrument of ratification of the BEPS project's "multilateral instrument" (MLI). This follows the making, on 23 May 2018, of the Double Taxation Relief (Base Erosion and Profit Shifting) Order 2018 which implemented the MLI in the UK. more›

Action required: mandatory disclosure of cross-border tax planning arrangements – effective now

New EU rules providing for mandatory disclosure of certain cross-border tax planning arrangements by intermediaries and taxpayers entered into force on 25 June 2018. more›

Miscellaneous

Court of Appeal upholds Upper Tribunal decision as to "multifactorial" test for determining "source" of interest

On 21 June 2018, the Court of Appeal upheld the Upper Tribunal's decision in the *Ardmore* case. In summary, a multifactorial test is to be used when determining the "source" of interest (relevant for the purposes of the scope of UK withholding tax on interest payments). more›

VAT

Court of Appeal denies input tax recovery on supplies mistakenly treated as VAT exempt

On 29 June 2018, the Court of Appeal[1] held that input tax could not be recovered by the recipient of a supply which, originally, was treated as VAT-exempt.

The appellant was a fully taxable business but, in respect of the supplies in question (for which the appellant was now seeking VAT recovery), all parties (including HMRC) had originally treated the supplies made to it as exempt for VAT purposes. Crucially, the supplier (the Royal Mail) did not at the time issue VAT invoices to the appellant. It took a subsequent ECJ decision to determine that this (VAT-exempt) treatment was, in fact, wrong.

The appellant did not, following this 'correction' of the VAT treatment, make a further payment to the Royal Mail equal to the VAT properly chargeable. Instead, the appellant now wished to treat the payments originally made to the Royal Mail as comprising an element of VAT, and recover an equal amount by way of input tax recovery.

The Court held the lack of a VAT invoice to be fatal to the appellant's claim for input tax recovery. The requirement for a VAT invoice to support input tax recovery claims is mandatory in order to enable HMRC to monitor payment by the supplier of the output tax for which input tax recovery is sought. The appellant in this case was in possession of invoices which evidenced exactly the opposite (that no output tax was paid because the supplies were treated – albeit incorrectly – as exempt).

Given the Court's decision on the VAT invoice point, it remains uncertain whether in cases where (as here) consideration is expressed to be VAT-exclusive, but the supply in question is mistakenly treated as VAT-exempt, the necessary requirement for input tax recovery for VAT to be "due or paid" would have been satisfied.

This case is a lead case with, it is thought, around £1 billion-worth of VAT resting on the outcome. Given the numbers involved, an appeal is likely.

The decision can be viewed here.

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First-tier Tribunal holds option to tax not dis-applied where CGS rules come into play, even though legislation is "circular"

On 15 June 2018, the First-tier Tribunal held[2] that the rules[3] which dis-apply an option to tax in certain cases, were not triggered.

The taxpayer had opted to tax a property, which was then leased to a party "connected" with the taxpayer. Such connected party occupied the land other than for (substantially) wholly "eligible" purposes[4]. The taxpayer subsequently sold the property subject to the lease and – in reliance upon paragraph 12 of Schedule 10 – did not charge VAT.

The Tribunal's view was that the purpose of the option dis-application rules was "less than clear", and also highlighted the circularity of the rules. In particular this circularity arises where

1. In *Zipvit Ltd v HMRC* [2018] EWCA Civ 1515.
2. In *Moulsdale t/a Moulsdale Properties v HMRC* [2018] UKFTT 309 (TC).
3. Paragraph 12 of Schedule 10 to the VATA 1994.
4. Broadly, the making of business supplies which give rise to a right to input tax credit.

the land that is sold is not a CGS item for the seller, but becomes a CGS item for the buyer. In such cases the seller's option to tax would be dis-applied, resulting in the supply becoming VAT-exempt, which in turn means that the item would not be a CGS item for the buyer.

The tribunal found that, at the date of the sale, the taxpayer knew that the supply would not be taxable. As this meant that the taxpayer could not have intended for the property to become a CGS item for the buyer, the option dis-application provision could not have been engaged. The Tribunal also agreed with HMRC that, despite the fact that the relevant part of the legislation was headed "anti-avoidance", the motive of the taxpayer was irrelevant.

The decision can be viewed here.

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VAT recovery on (failed) share acquisitions – AG opinion

On 3 May 2018, the Advocate General (AG) opined that VAT on professional fees incurred on a failed takeover bid was recoverable by the bidder. The case relates to Ryanair's failed 2006 bid to takeover Aer Lingus (AL). Ryanair's intention was to provide VAT-able management services to AL.

In the AG's view, Ryanair could recover the VAT it had incurred as there existed the required "direct and immediate" link between the proposed share acquisition and Ryanair's future taxable supplies. Where, as here, the intention was for the acquisition to extend/modify the taxpayer's existing business this was sufficient for VAT recovery purposes. It did not matter that the bid in fact failed, and therefore no VAT-able supplies of management services were actually made.

If the ECJ follows the AG's opinion it would appear that operating companies can recover VAT on acquisition costs (whether successful or not) without the need (or intention) to provide management services to the acquired subsidiary, provided the acquisition is (or would have been) a strategic one relating to an existing business.

The AG's opinion can be viewed here.

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First-tier Tribunal views outsourced "loan administration" services as standard-rated debt collection

On 20 April 2018, the First-tier Tribunal held[5] that a supply of "loan administration" services to a bank was a standard-rated supply as they amounted to "debt collection".

Although the UK VAT legislation provides that the issue, transfer or receipt of, or any dealing with, money, any security for money or any note or order for the payment of money and the operation of any current, deposit, or savings account are each exempt supplies for VAT purposes, the EU VAT Directive makes it clear that "debt collection" is not part of this exemption.

The services in question, which ran for the lifetime of the loans, perhaps crucially did not cover the making of the initial advance. The services included setting up customers' direct debits, allocating payments to different customers' loan accounts, issuing statements to the lender, and seeking to recover outstanding amounts.

5. In *Target Group Limited v HMRC* [2018] UKFTT 226 (TC).

The Tribunal held on the facts that, applying the VAT exemption narrowly (as required), the dominant supply made by the taxpayer in this case was the supply of debt collection services to the bank.

The decision will be of interest to taxpayers who outsource services that include debt collection.

The case can be viewed here.

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Employment

IR35 – private sector compliance consultation published

On 18 May 2018, HM Treasury published a consultation document exploring proposals to increase 'IR35' compliance in the private sector.

The 'IR35' rules, introduced in 2000, are concerned with so-called 'off-payroll' working. The aim of the rules is to ensure that workers providing services through personal service companies (PSCs) pay the same amount of tax and national insurance contributions (NICs) as employees if (had they been engaged directly ie not via a PSC) they would also have been regarded as employees of the services-recipient.

One of the consultation's proposals is to extend to the private sector the changes introduced in 2017 (applicable to the public sector). These changes, broadly, made the public authority or agency (ie the services-recipient) responsible for determining the IR35 employment status of the worker, as well as being responsible for accounting for and paying tax and NICs to HMRC under PAYE.

The consultation ended on 10 August 2018.

The consultation document can be viewed here.

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Compensation for injury to feelings not taxable as termination payment – Court of Appeal decision

On 20 April 2018, the Court of Appeal held[6] that compensation for injured feelings in connection with a termination of employment fell within the statutory exemption for injury payments.

Although the compensation was, in the Court's view, connected with the termination (and therefore prima facie taxable as a termination payment, albeit with the benefit of a £30,000 tax-free threshold) the question was whether the payment then fell within the full exemption provided by section 406 of ITEPA 2003.

The Court could find no reason not to give "injury" its ordinary meaning (including injury to feelings).

From 6 April 2018, "injury" in section 406 of ITEPA 2003 specifically includes psychiatric injury but expressly excludes injury to feelings. The decision is therefore of largely historic interest.

It does, however, confirm that discrimination-related payments for injured feelings can be paid tax-free if not connected with termination of employment.

The decision can be viewed here.

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6. In *Moorthy v HMRC* [2018] EWCA Civ 847.

Termination payments and post-employment notice pay (PENP) – updated HMRC guidance

On 6 April 2018, HMRC updated its Employment Income Manual to address the changes (taking effect from the same day) to the taxation of termination payments.

Broadly, in cases where a payment in lieu of notice (PILON) (whether contractual or non-contractual) is made on or after 6 April 2018 **and** employment is terminated on or after 6 April 2018, it will be necessary for employers to identify (and tax appropriately) any non-contractual PILON which would not have been taxed under the pre-6 April rules.

The new requirements, again broadly, require employers to calculate "post-employment notice pay" (PENP). This is the amount of "basic pay" the employee will not receive because employment is terminated without proper notice. The employee's PENP is taxed and subject to employee and employer NICs. The remainder of any termination award is only taxable to the extent it exceeds £30,000.

The updated Employment Income Manual can be viewed here.

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Stamp taxes

Feeling Blue? Supreme Court reverses Court of Appeal decision – section 75A gave rise to a notional land transaction with consideration of £1.25bn (more than price paid for the land)

On 13 June 2018, the Supreme Court[7] allowed HMRC's appeal in the long-running case regarding the 2007 sale by the MoD of the Chelsea Barracks.

Our previous commentary on the CoA decision, together with a summary of the facts, can be found here.

The *Project Blue* case is the first to consider in detail the wide-ranging stamp duty land tax (SDLT) anti-avoidance provision (section 75A of Finance Act 2003). Given that the (other) SDLT legislation that is the focus of this decision has long since been amended, it is the Court's views on section 75A that are attracting much of the attention.

The Court agreed with the earlier decisions in this case that section 75A does not require the taxpayer to have a tax avoidance motive. It was also noted that section 75A had been drafted deliberately widely, presumably with the intention of catching a broad range of transactions.

The uncertainty around section 75A, and when HMRC might choose to invoke it, is not particularly lessened by HMRC's statement that it will not apply section 75A if it considers that transactions have been taxed appropriately.

The decision can be viewed here.

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7. In *Project Blue Ltd v HMRC* [2018] UKSC 30.

International

UK ratification of BEPS Multilateral Instrument

On 29 June 2018, the UK became the ninth jurisdiction to deposit with the OECD its instrument of ratification of the BEPS[8] project's "multilateral instrument" (MLI). This follows the making, on 23 May 2018, of the Double Taxation Relief (Base Erosion and Profit Shifting) Order 2018[9] which implemented the MLI in the UK.

The MLI is designed to implement those BEPS measures that impact on existing double tax treaties (BEPS Action 15). Arguably the most ambitious aspect of the entire BEPS project, it is anticipated by the OECD that the MLI will provide for the amendment of approximately 2,000 of the 3,000 tax treaties currently in existence, without the need for each treaty to be individually amended.

The MLI will not actually directly amend the existing tax treaties of participating states, but will sit alongside the relevant treaty modifying it for the purpose of implementing those BEPS measures which impact on existing tax treaties (for example Action 2 (hybrid mismatches), Action 6 (preventing treaty abuse) and Action 7 (preventing PE status avoidance). The MLI includes provisions that a state may opt out of, or choose an alternative option.

The MLI will come into force in the UK on 1 October 2018, but in many cases the changes made by the MLI do not have effect immediately. For withholding tax purposes, the changes take effect from 1 January 2019. For income tax and corporation tax purposes, the changes take effect from April 2019. However, if the counterpart jurisdiction to a relevant treaty has not yet (by those dates) ratified the MLI, then the changes shall take effect for the purposes of such treaty from such later date at which the counterpart jurisdiction deposits with the OECD its instrument of ratification of the MLI.

The OECD press release can be viewed here.

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Action required: mandatory disclosure of cross-border tax planning arrangements – effective now

New EU rules providing for mandatory disclosure of certain cross-border tax planning arrangements by intermediaries and taxpayers entered into force on 25 June 2018.

Although reports to tax authorities will not be required until July/August 2020, the retrospective nature of the new rules means that reportable arrangements implemented after 25 June could be reportable in this first batch of (2020) reports. Preparations for the new regime should therefore begin now.

Our blog on these changes can be viewed here.

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8. Base Erosion and Profit Shifting.
9. SI 2018/630. See here.

Miscellaneous

Court of Appeal upholds Upper Tribunal decision as to "multifactorial" test for determining "source" of interest

On 21 June 2018, the Court of Appeal[10] upheld the Upper Tribunal's decision in the *Ardmore* case. In summary, a multifactorial test is to be used when determining the "source" of interest (relevant for the purposes of the scope of UK withholding tax on interest payments).

The Court confirmed that all facts must be considered and declined to set out any general principles as to which factors may be most determinative of the question of "source". The test was whether a "practical" person would regard the source of interest as being in a particular jurisdiction.

Despite this, and the Court's recognition that the test was "acutely fact-sensitive", on balance the decision has probably done little to advance the general market approach of considering, as a first step, the published HMRC guidance on this question (which states HMRC's view to be that the most important factors are the residence of the debtor and the location of the debtor's assets).

The decision can be viewed here.

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10. In *Ardmore Construction Ltd v HMRC* [2018] EWCA Civ 1438.

About RPC

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