

Insight and analysis for
the business tax community

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BEPS: the OECD's 2014 deliverables

Few surprises, but no let up

Richard Collier & Philip Greenfield • PwC



Tax and Scotland

Examining the further
devolution of tax powers

Bill Dodwell & John Macintosh •
Deloitte



The CJEU on *Skandia*

Branch VAT group planning
cut down

Nick Skerrett & Gary Barnett •
Simmons & Simmons



ANALYSIS

This month's international tax review

Chris Morgan • Partner • KPMG

Where are we now on employment taxes?

Darren Oswick • Partner • Simmons & Simmons


ASK AN EXPERT

JVs, EBTs and disguised remuneration

Keith Gregory • Partner • NGM Tax Law

IN BRIEF

- Withholding tax and transfers of loan receivables
- Obama's antiquated tax inversion reforms

A full-page background image of a surfer in a black wetsuit riding a yellow surfboard inside the barrel of a massive, curling blue wave. The surfer is crouched low, looking towards the camera. The water is a deep, vibrant blue, and the wave's crest is white with foam.

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From the editor



This week's edition covers three hugely significant developments in tax. First, there is the OECD's first set of recommendations on BEPS published last week. As experts at PwC observe: 'What stands out is an overall determination to push through the entirety of the BEPS package on the basis of building and retaining a very broad consensus of states' (page 8). (In related news, the UK government is the first of 44 countries to formally commit to implementing the new country by country reporting template; see page 3.)

Second, there are the promises of further devolution of tax-raising powers for Scotland (see the commentary by Deloitte at page 7).

Third, the CJEU has issued its judgment in *Skandia*. This is a surprising decision which advisers are warning is a fundamental change in the VAT treatment of intra-company transactions. See the article by Simmons & Simmons at page 18. How HMRC will respond is keenly awaited.

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News

Covering the key developments in tax

Business taxes

Relief over Scottish 'no' vote 'may be temporary'

Tax advisers have warned that despite Scotland voting 'no' in its historic referendum for independence last week, 'don't underestimate how much Scottish taxes are going to change regardless of the "no" vote'. PwC head of tax Kevin Nicholson said: 'The Scotland Act will have a big impact on many people and businesses on both sides of the border, which many have underestimated. For instance, different income tax rates could affect where people choose to live or work. People buying property in Scotland will find a progressive land and buildings transaction tax (LBTT), instead of the usual stamp duty.'

The CIOT said politicians must confront the crucial question of how much tax competition they are willing to entertain within the UK. Moira Kelly, chair of the CIOT's Scottish technical sub-committee, said: 'The political convention provides an opportunity for Scotland and the UK to address what can be done with taxation in terms of devolution, and how differential tax rates, thresholds and allowances will affect the operational make-up of the UK economy.'

Ronnie Ludwig (Saffery Champness) said: 'Things will certainly be simpler than if it had been yes, but given the devolution process in motion we are set for a great deal of change in the Scottish tax system. So many of the people that I deal with have lives and businesses which span Hadrian's Wall, and this will certainly not be straightforward. If Scotland's income tax rate [expected in 2016] ends up differing considerably from the rest of the UK, we may see people moving or rearranging their business affairs.'

Meanwhile, Chris Groves (Withers) commented: 'Any relief felt as a result of last week's news may sadly be temporary. The devolution of tax powers to Scotland are likely to lead it down a similar, if less dramatic, path as full independence. Whilst we should be glad that the immense potential upheaval of Scottish independence has been averted, individuals with assets in Scotland would be well advised to keep a close watch on changes to property and tax rules.' (See also page 7.)

Travel and subsistence consultation

HM Treasury is consulting on its *Travel and subsistence review*, which closes for comment at 11:45pm on 23 October 2014. This is the first stage in the government's review of the rules underlying the taxation

People and firms

Bradley Phillips has joined PwC as asset management tax director from Herbert Smith Freehills. He was previously chair of the City of London Law Society Revenue Law Committee.

Corporate tax partner **Stuart Sinclair** has moved to **Akin Gump Strauss Hauer & Feld** as part of the move of the London and Frankfurt offices of Bingham McCutchen, which are joining the firm.

To publicise tax promotions, appointments and firm news, email paul.stainforth@lexisnexis.co.uk.

of travel and subsistence expenses, which it announced at Budget 2014 following the January 2014 report from the OTS entitled *Review of employee benefits and expenses: second report*. See www.bit.ly/1x6gdWw.

EMI independence requirement

The Finance Act 2014, Schedule 37, Paragraph 22 (Commencement) Order, SI 2014/2461, brings into effect from 1 October 2014 the amendments made by FA 2014 Sch 37 para 22(1) to the 'independence requirement' for enterprise management incentive (EMI) schemes. See www.bit.ly/1slrS2A.

Medical treatment exemption

HMRC has published the Income Tax (Recommended Medical Treatment) Regulations, SI 2014/Draft, for comment until 15 October 2014, which sets out the additional conditions that expenditure by employers on recommended medical treatment must meet in order to qualify for the tax exemption at FA 2014 s 12. See www.bit.ly/1uV1ADb.

VAT

Skandia 'may affect VAT groups'

Advisers are warning that the recent CJEU decision in *Skandia America Corp* (C-7/13) (reported at page 5) could have a major impact on VAT groups across the EC.

Skandia concerned a VAT group in Sweden, where one of the group members (the Swedish branch of a US company) was supplied by its US head office with externally purchased IT services. Martin Sharratt (Smith & Williamson) explained: 'The taxpayer argued that the supply took place within the same company and was not therefore within the scope of the tax. However, the Swedish tax authority argued that VAT was due under the reverse charge

provisions, on the grounds that the US head office was not part of the group. The court found that VAT was indeed due, but on a subtly different basis; the court ruled that the VAT group was a separate taxable person from any of its member companies, so that the services could not be regarded as supplied within the same company. It is this aspect of the decision that has implications for the UK and other member states.'

While HMRC is expected to give its reaction to the decision, Richard Woolich (DLA Piper) said: 'The decision is likely to hit financial services companies, whose businesses are exempt and partially exempt, particularly hard, as these kinds of company often use branches to conduct overseas business and use VAT groups to minimise the VAT leakage on recharges. Many businesses with EU branches may therefore need to look again at how they structure and allocate the costs of their cross-border intra-group supplies of services.'

Andrew Bailey (EY), added: '*Skandia* marks a fundamental change in the VAT treatment of certain intra-company transactions. This isn't just a UK issue; the effects will be felt across the EU. The question marks over whether there will be a transitional period before any changes come into effect will no doubt have caught the attention of major financial institutions.'

Writing in this week's journal (page 18), Nick Skerrett and Gary Barnett said the judgment may 'sound the death knell for [similar] branch planning arrangements'.

'At this stage, it is unclear whether the UK will choose, or feel obliged, to change its practice on branch to branch supplies. If it does, then VAT will become chargeable on the acquisition of the services from the overseas head office. Concerns will of course turn to the potential retrospective application of the judgment. Until HMRC makes its position known, UK groups should sit tight, whilst considering what arrangements might need to be put in place if the current arrangements do need to be unwound,' they added. 'An early announcement by HMRC of its reaction to the decision is, accordingly, highly desirable.'

Museums and galleries consultation

HMRC has published the Value Added Tax (Refund of Tax to Museums and Galleries) (Amendment) Order, SI 2014/Draft, for comment by 20 October 2014. The draft legislation proposed a number of changes to bodies and dates concerning refund claims for VAT which is attributable to the provision of free admission to specified museums and galleries. See www.bit.ly/1DsrMsH.

Our pick

UK is the first country to commit to country by country reporting

The government announced that the UK 'is the first country in the world [of 44 countries] to formally commit to implementing the new country by country reporting template', which was unveiled as part of the OECD's first seven recommendations on base erosion and profit shifting (BEPS), which the OECD published last week and presented to the G20 finance ministers' meeting.

UK-based multinationals will have to report to HMRC where they make profits and pay taxes around the world, as Britain 'takes the lead to clamp down on international tax avoidance', financial secretary to the Treasury David Gauke MP said.

The UK initiated the country by country reporting template during its G8 presidency last year, calling on the OECD to develop the template as part of its project to strengthen international standards on BEPS.

The template is designed to help tax authorities gather information on multinational companies' global activities, profits and taxes, enabling them to better assess where risks lie and where their efforts to counter tax avoidance should be focused.

Gauke said: 'We believe country by country reporting will improve transparency and help identify risks for tax avoidance – that's why we're formally committing to it. Reporting high level information using a standardised format across all jurisdictions will ensure consistency, give tax authorities the information they need and minimise the administration burden on business.'

Meanwhile, in a similar show of support from the UK government for tax transparency, chancellor George Osborne tweeted: 'Thanks for the powerful petition to No. 11 on tax transparency by ONE.org. The UK is leading the way in the G20 – I promise to keep up the pressure.'

Speaking from Cairns, OECD tax policy director Pascal Saint-Amans said: 'This demonstrates that we are serious about pursuing the dialogue with developing countries on BEPS and giving them a seat at the table.'

The OECD will report to the G20 leaders in November on its plan to deepen the involvement of developing countries in the OECD/G20 BEPS project and ensure that their concerns are addressed.

Administration & appeals

PCS tax gap estimate is 'over-inflated, flawed and muddled,' says HMRC

The Public and Commercial Services (PCS) Union has released its report into the UK tax gap for 2013/14, which it estimates at £119.4bn in total.

The report, *Tax evasion in 2014 and what can be done about it*, was written by tax campaigner Richard Murphy FCA of Tax Research UK, and 'includes reductions in the estimates of tax avoidance and tax debt, but a significant increase in the estimated tax loss from evasion.'

The previous PCS report, published in 2010, estimated the tax gap at £120bn; while the current estimate 'includes significant new data and a much more comprehensive analysis of tax evasion [and] shows that tax evasion is higher than previously estimated. It concludes that the government should tighten up legislation and reverse the counterproductive cuts in HMRC staffing.'

However HMRC criticised the PCS figure, insisting that it is 'not complacent and will continue to exert maximum downward pressure on the tax gap'. HMRC's own estimate of the tax gap in 2011/12 was £35bn, a figure that has been fairly constant since 2005/06. (HMRC has not yet published estimates for later years.)

A spokesperson told *Tax Journal*: 'The PCS tax gap estimate is over-inflated, flawed and muddled. The IMF has endorsed HMRC's estimate of the gap at £35bn, which is in line with the code of practice for official statistics. Since 2011, we have brought in £60bn from tackling tax-dodging alone. Ninety per cent of all tax liabilities are paid and the vast majority of UK taxpayers, both large and small, pay their dues. HMRC's ability to collect what's due is improving, which even the PCS recognises.'

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International taxes

US Treasury announces steps to counter inversions

The US Department of the Treasury and the Internal Revenue Service (IRS) announced they are taking action to tackle corporate tax inversions. In a statement issued from Washington DC, Treasury secretary Jacob J. Lew said: 'These first, targeted steps make substantial progress in constraining the creative techniques used to avoid US taxes, both in terms of meaningfully reducing the economic benefits of inversions after the fact, and when possible, stopping them altogether. While comprehensive business tax reform that includes specific anti-inversion provisions is the best way to address the recent surge of inversions, we cannot wait to address this problem. The Treasury will continue to review a broad range of authorities for further anti-inversion measures as part of our continued work to close loopholes that allow some taxpayers to avoid paying their fair share.'

According to *The Daily Telegraph* (22 September), the move 'could scupper tens of billions of dollars-worth of deals already in the pipeline'. The share prices of several British firms, including AstraZeneca, Shire and Smith & Nephew, fell following the news. (See also page 6.)

G20 finance ministers welcome 'significant progress' on BEPS and mandates OECD work on developing countries

The finance ministers and central bank governors of the G20 welcomed the

'significant progress achieved towards the completion of our two-year G20/OECD base erosion and profit shifting (BEPS) action plan' at their meeting in Cairns, Australia, on 20–21 September, and vowed to 'commit to finalising all action items in 2015'. In a statement, they said: 'We endorse the finalised global common reporting standard for automatic exchange of tax information on a reciprocal basis which will provide a step-change in our ability to tackle and deter cross-border tax evasion. We will begin exchanging information automatically between each other and with other countries by 2017 or end of 2018, subject to the completion of necessary legislative procedures.'

'We welcome progress so far, and ... will continue to take practical steps to assist developing countries preserve and grow their revenue bases and stand ready to help those that wish to participate in automatic information exchange.' For the full communiqué, see www.bit.ly/1DwaYkq. (For more on BEPS deliverables, see page 8.)

In related news, the G20 has mandated the OECD and its Global Forum on Transparency and Exchange of Information to develop toolkits to support developing countries addressing BEPS and to launch pilot projects to assist them to move towards automatic exchange of information. This mandate comes in response to two reports:

- a new report on the impact of BEPS in low income countries (www.bit.ly/1uGkQSn); and
- a roadmap for developing country participation in the new global standard for the automatic exchange of information between jurisdictions (see www.bit.ly/1rmQF3M).

Cases

Reporting the tax cases that matter

Personal taxes

IHT on gift to charity

In *Routier and anor v HMRC* [2014] EWHC 3010 (18 September), the High Court found that a disposition in a will was subject to IHT, as it was not a gift to charity.

Mrs Coulter died in Jersey in October 2007, leaving the residue of her estate to a trust for the benefit of the Parish of St Ouen to provide homes for the elderly of the parish. The disposition was subject to conditions and provided that, if they were not fulfilled by the parish, a disposition should instead be made to Jersey Hospice Care.

HMRC did not accept that the gift was exempt from IHT. A deed of variation of the trust provided for an absolute gift of £10,000 to Jersey Hospice Care and an absolute gift of the residue to the appellants to use for the purpose of the construction of homes for the elderly of the parish.

Under IHTA 1984 s 23(6), a gift is exempt from IHT if it is held on trust for charitable purposes. It was accepted that the trust was set up for UK law charitable purposes; however, HMRC contended that there was an implied requirement in the provision that the trust be governed by UK law.

Agreeing with HMRC, the High Court found that the trust did not qualify for exemption. Referring to *Dreyfus* [1956] AC 39, the High Court noted that it would be incongruous to require a court to ascertain whether the purposes of a body governed by foreign law were UK law charitable purposes.

Why it matters: Following this case, practitioners should ensure that trusts set up by wills for UK charitable purposes are governed by UK law. If not, the relevant disposition will be subject to IHT.

Indirect taxes

VAT and games of chance

In *HMRC v IFX and others* [2014] UKUT 0398 (16 September), the UT found that 'spot the ball' was not a game of chance.

The UT had to decide whether the game of 'spot the ball' was a game of chance, and therefore exempt from VAT (Sixth Directive art 13(B)(f)). In all versions of the game, a photograph of a football match was taken. The football

was then removed from the photograph (along with much of the rest of the background) and participants had to guess the exact location of the centre of the missing football.

The UT observed that a game is an activity under rules which provide for an outcome 'such that it can be said that a player has won or lost'. In a typical 'game of chance', the rules provide for some event occurring randomly after the start of the game to influence its outcome to a significant degree. The effect produced by the uncertain outcome of the random element is one of the purposes of the game.

The UT found that the activities involved in 'spot the ball' – looking at a picture and posting a coupon marked with an 'X' showing the location of the ball – did not constitute the playing of a game. Furthermore, there were no rules setting out how the game should be played.

Disagreeing with the FTT, the UT therefore concluded that 'spot the ball' was a competition involving an element of chance, but that it was not a game.

Why it matters: The taxation of betting and other games has led to much litigation and this decision referred to a plethora of case law to identify the meaning of the phrase 'playing a game of chance'. The case is therefore a useful reference for anyone wishing to argue that they fall within the exemption.

Yacht used for both business and personal purposes

In *TJ Charters v HMRC* [2014] UKFTT 896 (16 September), the FTT reviewed the way HMRC had apportioned input tax incurred on the acquisition of a yacht used for both business and private purposes.

The appellant had purchased a yacht for the dual purpose of running a chartering business and personal use. The issue was whether the so-called *Lennartz* method of accounting for output tax was appropriate. In *Lennartz* [1995] STC 514, the CJEU had held that a taxable person is entitled to recover input tax incurred on the purchase of goods, however small the proportion of business use of such goods. The yacht had quickly become a 'white elephant'. The chartering market had been badly affected by the recession and, for various reasons, the appellant and his wife had not been able to use it for leisure purposes.

The appellant contended that the

Lennartz method should not apply. He had not intended to apply the method when acquiring the yacht and had intended to pay a commercial rate for the private use of the yacht. The yacht was therefore solely used for business purposes. The taxpayer also took issue with HMRC's allocation to private use of a large proportion of the time when the yacht was idle.

The FTT observed that the taxpayer had intended to reclaim all the input tax incurred on the purchase of the yacht and had therefore allocated the vessel entirely to its business – and had charged VAT on hire accordingly. Later on, he had attempted to claw back some of the tax. The FTT also accepted HMRC's evidence that the yacht had been used for personal purposes 1/12th of the time.

The FTT however disagreed with HMRC's treatment of the idle periods as private use periods, pointing out that the legislation refers to 'private use', not to the 'possibility of private use', because the yacht is not required for business purposes. The FTT noted the resulting distortion; a calculation supposedly based on 1/12 private use had led to an output liability of over 60% of the original input tax recovered.

The FTT also found that some of the assessments had been time-barred. It accepted, however, that time had started running from the point HMRC received the relevant information; this was when the percentage of private use had been communicated to their direct tax colleagues.

Why it matters: The confirmation that an asset used for both business and private purposes should not be deemed to be used for personal purposes when idle could be relevant to many types of businesses.

More than one excise duty point?

In *B&M Retail v HMRC* [2014] UKFTT 902 (16 September), the FTT held that there can only be one excise duty point.

B&M Retail is a leading retailer of alcoholic beverages. It procures stocks of alcohol for retail sale from suppliers; under B&M's terms of business, the suppliers are required to warrant the sale of the alcohol as 'excise duty paid'.

During a visit of B&M's warehouse, HMRC detained goods (later, seizing them) under CEMA 1979 s 139, on the ground that excise duty had not been paid on these goods.

The issue was whether there could be more than one release for consumption

Our pick

Skandia America v Skatteverket

VAT chargeable on cross-border supplies to branches

In *Skandia America v Skatteverket* (C-7/13) (17 September), the CJEU found that supplies of services between a US holding company and its European branch were taxable transactions.

Skandia had appealed against the decision of the Swedish tax authorities to charge VAT on the supply of services by Skandia America (SAC), established in the US, to its branch Skandia Sverige (Sverige), established in Sweden.

SAC sold externally purchased IT services to Sverige, which processed them and sold a final product to companies within the group.

The CJEU first observed that a supply of services is only taxable if a reciprocal legal relationship exists between the supplier and the recipient. Here, this depended on whether Sverige carried on an independent economic activity. The CJEU found that Sverige did not function independently and was not therefore a taxable person.

However, because Sverige belonged to a VAT group, services it received were deemed to be supplied to the group.

On the basis that SAC and Sverige could not be considered as a single taxable person, supplies by SAC to Sverige must be taxable transactions.

Finally, as the services were supplied by SAC, a company established in a third country to Sverige, a company established in a member state, Sverige was liable for the VAT (Sixth Directive art 56).

Why it matters: This decision will have negative implications for financial businesses, such as banks and insurance companies, which make exempt supplies and are therefore unable to recover a large proportion of their input tax. Until now, such businesses have not suffered VAT on cross-border supplies within the same legal entity. The key outstanding issue is how HMRC will implement the decision. (See the article at page 18.)

Information notice in relation to bank statements

In *Karim Mawji v HMRC* [2014] UKFTT 899 (16 September), the FTT found that an information notice was reasonably requested.

HMRC had opened an enquiry into the appellant's self-assessment return and requested UK bank statements. The appellant's advisers had replied that no case had been made for requiring the bank statements. HMRC then explained that they had information suggesting that the appellant had received interest, which had not been declared in his return.

A certificate showing an interest receipt of £19,956 was provided. The appellant apologised for not including the interest in his return, explaining that all the documents had been stolen during a robbery of his apartment in Switzerland.

HMRC then requested statements for the account, on the basis that the interest suggested a large amount held on deposit. Such statements were not provided and HMRC eventually issued an information notice (FA 2008 Sch 36 para 1). Mr Mawji appealed against the notice.

The FTT observed that if the source of the remitted funds was overseas income which had not been taxed in the UK, then the funds became taxable when remitted to the UK. It was therefore important for HMRC to know whether the overseas account from which the funds had been remitted to the UK had earned interest. The FTT also noted that the appellant had given contradictory statements on the provenance of the funds. The FTT added that the bank statements were still in the appellant's power, regardless of the fact that he no longer had them; he could ask his bank to produce them. Furthermore, the six year time limit did not apply, as the notice had been given by an authorised officer (Sch 36 para 20). Finally, the fact that the requested statements would lead to further requests and therefore more 'trouble' for the appellant was not a relevant consideration. The FTT concluded that the information was 'reasonably required' by HMRC.

Why it matters: This is a useful example of the way the FTT will approach an appeal against an information notice. The FTT went to the substantive issues to ascertain the reasons why HMRC needed the information, as well as more procedural issues; the lack of cooperation of the taxpayer.

Cases reported by Cathya Djanogly
(cathya.djanogly@hotmail.com).

(under the Excise Goods (Holding, Movement and Duty Point) Regulations SI 2010/593, reg 6). HMRC contended that the provisions reflected a continuous state of affairs, whereas B&M argued that the provisions referred to a 'snapshot' and therefore a single release for consumption. The FTT observed that the term 'release' suggested a single event and added that the language of the 2010 regulations did not lend itself to a pattern of sequential detention and release.

The FTT concluded that once goods had been released they could not be charged with duty again; and therefore a person could not be liable for duty if, before he held the goods, an identified excise duty point had arisen.

Why it matters: In confirming that there can only be one excise duty point, the FTT's decision is a very useful reference for retailers of alcohol and cigarettes.

Administration & appeals

Jurisdiction of the FTT and legitimate expectation

In *Clare Gore v HMRC* [2014] UKFTT 904 (18 September), the FTT held that it did not have jurisdiction to hear a claim based on legitimate expectation.

Ms Gore ran a business providing a children's indoor playcentre. Her husband

had been told by the VAT helpline that no VAT was due on the entrance fees. She therefore had stopped charging VAT on those.

As a result of an audit, HMRC realised that VAT should have been accounted for and assessed accordingly. Ms Gore appealed, on the ground that she had acted in reliance on advice given by HMRC. The issue was therefore whether the FTT has jurisdiction to consider a taxpayer's claim based on the public law concept of legitimate expectation.

The FTT observed that the appellant's arguments would remove much of the distinction between the jurisdiction of the tax tribunals and that of the administrative court. Clear words would be required for that purpose and they were not included in VATA 1994 s 83(1)(p). The jurisdiction of the tax tribunals is limited to whether the assessment is correct as a matter of law, including whether it is made to best judgment.

Why it matters: The FTT clearly had some sympathy for the appellant. Whilst it suggested that judicial review was the best remedy, it also recommended approaching the adjudicator or the Parliamentary ombudsman. However, the FTT felt bound by case law, and in particular *Abdul Noor* [2013] UKUT 071, to find against the appellant.

In brief

Views on recent developments in tax

Withholding tax and transfers of loan receivables

HMRC's helpful guidance on withholding tax obligations following the transfer of loan receivables flags risks for intermediaries in the chain of payment.

HMRC has issued revised guidance on the person who is responsible for paying withholding tax (WHT) on payments of interest when loan receivables have been transferred (see HMRC's *Savings and investment manual* at SAIM9078). This will occur typically on a securitisation or loan book sale. Often, the seller of the receivables (or its agent) will retain the legal title after disposing of the beneficial interest, while entering into a contractual obligation to hold payments of principal and interest for the new beneficial owner. The underlying borrowers will not necessarily be notified that beneficial ownership of the loans has been transferred.

Where yearly interest is paid to a person whose 'usual place of abode' is outside the UK, there will be a WHT obligation on the payer of the interest, unless HMRC has directed that interest need not be withheld (or can be withheld at a lower rate) because the owner of the interest is entitled to double tax treaty relief. It is the residence status of the beneficial owner of the interest which determines whether tax should be withheld.

HMRC has now confirmed that where payments move through a chain of intermediaries, HMRC will usually expect the last person in the chain (and not the borrower or the legal owner of the interest) to comply with WHT obligations before the payment moves to an overseas beneficial owner, and (provided this occurs) it will presume WHT obligations to have been satisfied by everyone else in the chain.

At first sight, HMRC's guidance looks to be good news, and it will be helpful to certain types of securitisation. However:

- If the last person in the chain does not comply properly, HMRC explicitly reserves the right to go after the borrowers (and, implicitly, any intermediary in the chain) for payment of the WHT. Depending on

the deal, this may affect the risk and contractual position of intermediary payers in the chain and may mean, for example, that an agent in a residential mortgage securitisation will still want to apply for treaty clearance on behalf of all the underlying borrowers.

- HMRC also confirms that if a legal owner of a receivable transfers interest to a beneficial owner, the payment should be regarded as being paid 'through' the legal owner, which is then obliged to withhold tax. Technically, this has always been the law on a strict reading, but some in the market have previously taken the position that it was not necessarily the case. Consequently, some intermediary payers may find themselves without contractual protection in respect of previous deals.

What should you do? On securitisations or loan book sales involving a non-UK resident, intermediaries in the chain of payment need to ensure their position is protected.

Eloise Walker, partner, Pinsent Masons
(eloise.walker@pinsentmasons.com),
Tax update (September 2014).

Obama's tax inversion reforms

The antiquated approach to US tax policy continues.

The Obama administration has announced sweeping reforms to tackle companies engaged in tax inversions (see page 3) – a transaction whereby a foreign corporation acquires a US company, so as to remove overseas business expansion from the reach of the US corporate tax system.

Under the new rules, it will be harder for companies to meet the strict requirements for an inversion deal, while those companies that have an inverted structure will now struggle to access their overseas cash piles without paying US taxes when they move cash between foreign jurisdictions.

With a federal tax rate of 35% and an overall rate that can be close to 40% including state and local taxes, the US has the highest corporate tax rate among the major world economies. On top of this, unlike many other jurisdictions, US corporations are also taxed on their worldwide income.

This scale of taxation is at odds with a number of other jurisdictions across the globe, which are taking steps to make their tax environments more attractive to multinational companies, recognising the investment and employment benefits they bring.

As a result, countries such as Ireland have become popular locations for corporate inversions, where companies benefit from a corporation tax rate of just 12.5% on trading profits and 25% on passive income.

The rationale for inversions is not simply to achieve a reduction in the overall corporate tax rate, but also to escape the burden of the complex US tax rules that add to compliance costs, such as the controlled foreign corporation (CFC) legislation, and to satisfy longer term business objectives in relation to overseas expansion. One recent example was Burger King, which subsequently came under fire for using a tax inversion following its merger with Canadian coffee shop Tim Hortons.

The new rules would forbid non-US subsidiaries of inverted companies from providing a loan to their foreign parent company as a means to circumvent paying US tax. They will also stop new parent companies from buying subsidiaries overseas to free up cash from their balance sheets as a way to evade paying US tax.

The publicity associated with the US government's aversion to inversions could be compounding the issue. We are already seeing evidence that media coverage has sufficiently raised alarms at start-ups, so much so that they are avoiding establishing their parent companies in the US.

The announced changes around inversions only highlight the impending storm which is likely to surround the current lack of wider corporate tax reform in the US. At present, the change to inversion rules is not legislative and only removes some of the advantages of an inversion.

The continued approach which the US is taking on this issue is yet another example of antiquated tax policy which fails to create a pro-business environment. Combined with its approach towards offshore cash, the country is creating an uneven playing field and is losing out to those jurisdictions who recognise the benefits of a forward looking tax policy.

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What's happened?

The Scottish independence referendum has resulted in a victory for the 'Better Together' campaign. Part of its appeal to the Scottish voters involved a 12 point plan articulated by former Prime Minister Gordon Brown for transferring more powers from Westminster to the Scottish Parliament. It includes: 'Further devolution of tax powers, particularly in the sphere of income tax.'

Haven't some taxes already been devolved to Scotland?

Yes. The most significant tax is business rates, which raises about £2bn. Council tax is also a local tax, which raises just under £2bn. In 2015, Scotland takes control of stamp duty land tax (SDLT) and landfill tax, which together raise about £150m. Land and buildings transactions tax will take over from SDLT and is notable for two innovations: it will abandon the longstanding 'slab' basis in favour of a progressive system (with as yet unannounced rates, expected in October); and it will be collected by the Scottish Land Registry (Registers of Scotland) under the supervision of Revenue Scotland. However, whilst Scotland has some freedom in designing the taxes that replace the UK taxes, it may only legislate in the areas allocated to it. Thus, for example, Scotland has made choices in the design of its replacement for SDLT, but it could not introduce a land value tax in its place.

What about income tax?

In April 2016, there will be a Scottish rate of income tax (SRIT). Strictly, this isn't a devolved tax, although the revenue implications are similar. From April 2016, each of the UK rates of income tax will be reduced by 10 pence and replaced by the SRIT. The SRIT does not allow the Scottish government to choose the thresholds or to impose different tax rates at different levels. If the SRIT is set at, say, 9 pence, the rates of tax in Scotland would become 19%, 39% and 44%. The SRIT applies only to income from employment, self-employment and pensions. Investment income remains subject to the general UK rates. Westminster will also continue to set the personal allowance and define the tax base. The tax will continue to be collected by HMRC, which will need to notify employers and annuity payers who are liable to the SRIT. A Scottish taxpayer is an individual who is resident in the UK and then has his or her main residence in Scotland. For the majority, this will be easy to determine; however, those who move between Scotland and other parts of the UK may need to wait until the end of the tax year before their status can be determined.

Are there any further requirements regarding devolution of taxes?

Devolving tax to any individual part of a country runs into the requirements of EU law, in the form of the Azores case (*Portugal v Commission* (C-88/03)). There must be a separate administration, which is clearly met in the case of Scotland, Wales and Northern Ireland. The

individual country must bear the risk of its decisions. Consequently, the Scottish budget must be reduced by the taxes allocated to it. Should the Scottish Parliament choose to reduce tax, it must also reduce spending or at least take on borrowing. Equally, should the Parliament increase taxation, the additional revenues generated will remain with it.

What are the main political parties proposing?

The Scottish Labour party, Conservatives and LibDems all formed commissions to consider taxation. They all recommended that Scotland should be given greater control over the taxes that finance Scottish spending, with the minimum being control over taxes that raise about 40% of devolved spending. The three main taxes in the UK are, of course, income tax, national insurance and VAT.

Each party proposes greater control by Scotland over income tax. The Conservatives and LibDems would allocate control over both rates and thresholds. However, Labour proposes that Westminster should retain control over thresholds, but that Scotland should be granted the ability to increase (but not decrease) the higher rate and additional rate of income tax.

All parties would leave control over the tax base and personal allowance with Westminster and would also leave Westminster to set the tax rates for investment income – as with the current SRIT. The reason for leaving investment income with Westminster is presumably that huge complexity would be introduced for banks and other deposit takers and for HMRC were the basic rate to differ.

It is not possible to have different rates of VAT within a country under EU law, so it is not possible to pass control of VAT to Scotland. Nonetheless, some of the parties favour allocating VAT receipts from Scotland to the Scottish parliament. Discerning exactly what those receipts are would be challenging.

None of the parties favour passing control over corporation tax to Scotland. This surely makes sense within the UK. Allowing different rates would encourage tax-motivated transactions, creating huge complexity and no doubt reducing the size of the overall UK cake. There are better ways to incentivise investments.

National insurance is also perceived as too linked to the welfare system to be capable of being passed to Scotland (or indeed to the other countries within the UK). There seems to be widespread acceptance that the UK needs to keep a single welfare system, which requires the support of national insurance. Perhaps if NIC and tax were ever to be merged, that might change.

Final thoughts?

The apparent speed with which it is desired to reach a conclusion on devolving powers will surely encourage a relatively simple settlement. HMRC systems are an important part of this, together with employer payroll systems. It will be important to give as much notice as possible so that systems are ready. ■

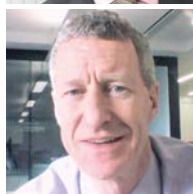
Analysis

OECD's agreed recommendations on 2014 BEPS deliverables

SPEED READ The OECD's agreed recommendations for changing the international tax rules are wide ranging, under its first stage of work in connection with base erosion and profit shifting (BEPS). Seven of the 15 areas of the BEPS action plan are covered by this first stage. Among the recommendations is an acknowledgement that the digital economy is so widespread that its tax treatment cannot be ringfenced. There is a comprehensive set of proposed rules on hybrid mismatches, with more work to follow here in 2015. There are two major proposals to tackle treaty shopping: a limitation of benefits article to provide a relatively objective basis of relating treaty benefits to entities with a nexus in the resident country; and a new subjective main purpose/anti-abuse rule within treaties generally. As regards transfer pricing documentation, a three-tier approach is recommended, comprising a master file, a local file, and a separate country by country (CbC) template. The plan for the harmful tax practices work in BEPS is based on looking first at the tax regimes of OECD members, and then at those of non-OECD members, before revising as required the existing harmful tax framework. A multilateral instrument is proposed so that countries may rapidly implement measures developed in the course of the work on BEPS. While agreed, the proposed measures are not yet finalised, as they may be impacted by the 2015 deliverables. There are clearly implementation details to work on, but it is clear that material change is in progress. Taxpayers will need to take account of the speed of these developments, including in relation to the work which remains in progress, in framing their response.



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Scope of reports

The OECD published, on 16 September, reports on the BEPS action plan items dealing with the following:

- digitisation of the economy;
- hybrid mismatches;
- treaty abuse;
- country by country reporting and transfer pricing documentation;
- transfer pricing and intangibles;
- harmful tax practices; and
- use of a multilateral instrument.

They were adopted by the OECD's Committee on Fiscal Affairs on 25–26 June, after months of work by OECD staff and representatives of the Revenue authorities of OECD and some non-member countries in working parties. Consultations also took place with input from other, particularly developing, countries and various supranational bodies like the European Commission, United Nations and International Monetary Fund, as well as business and civil society organisations.

We're seeing, for the first time, the working parties' thoughts on two areas. These are, firstly, how to address the ability to apply changes to treaties using a multilateral instrument; and, secondly, countering the use by governments of tax practices which are harmful to international trade. Reports on the other areas have previously been circulated in draft form.

Digitisation of the economy

The OECD discussion draft on the digital economy of 24 March 2014 was exceptionally long (81 pages). It sought to provide a large amount of contextual material, which made it fairly complex. In seven chapters and one annex, it considered the impact on the economy of information and communication technology, new business models being used, common features of BEPS in relation to both direct and indirect tax and broader challenges to be addressed.

The March discussion draft did not make recommendations, but instead set out some options which had been considered for addressing the perceived problems with some taxpayers.

While the final version of the report issued on 16 September does not introduce any conclusions that were not trailed in the initial draft, it does bring greater clarity over the issues which have given rise to the need for the digital economy workstream. The report also explains the role of the Digital Economy Task Force (DETF) for the remainder of the BEPS project. A primary conclusion is that the digital economy is so widespread that it does not represent a special part of the economy, but rather the economy itself. Therefore, it is not possible to isolate the digital economy for the purposes of creating separate tax rules.

Nonetheless, it is clear that if the other BEPS workstreams do not address the specific concerns and challenges identified, the DETF has the remit to propose its own solutions. Indeed, in referring to the continual developments of how technological innovation affects business, the DETF implies that its work may need to survive the end of the BEPS process in order to deal with a recurrence of the issues which it identifies. It also notes as yet unidentified issues which may come from: the Internet of Things; virtual currencies; advanced robotics and 3D printing; the sharing economy; access to government data; and reinforced protection of personal data.

The report focuses on the fragmentation of international business models, aided by developments in technology, as being the key tax area to address, and identifies the specific remedies to be considered by the other BEPS workstreams – specifically, controlled

foreign company (CFC) rules; the artificial avoidance of permanent establishment (PE); and transfer pricing measures.

On these specific points:

- The DETF concludes that the general operation of the preparatory or auxiliary exemption in the PE article needs to be reviewed, along with the specific warehouse exception. In addition, there is the suggestion that the reliance on concluding a contract in one territory so as to avoid taxation in another should be reviewed. This is a new development, which potentially impacts the fragmented business models about which the DETF has concerns.
- The DETF highlights the role of intangibles in fragmented business models and the increasing importance of data. It concludes that transfer pricing allocation methodologies need to be reviewed. There is the suggestion that it may not be wholly appropriate to rely upon a model which allocates a routine return to a low risk subsidiary and the balance to a low tax entrepreneur company.
- The DETF highlights the possibility of changing CFC rules to target the types of income that may typically feature in a digital economy business model. The comments made appear to go beyond what was included in the original draft report.
- The DETF addresses the consumption tax questions in the draft report and concludes that the work in this area should focus upon administrative procedures to collect B2C VAT type taxes rather than suggest changes to VAT regimes.

A new suggestion in the report (which picks up on a request in the public consultation) is that Working Party No. 1 of the OECD Committee on Fiscal Affairs should consider the characterisation of various payments arising in the new information and communication technology enabled world (a couple of examples are given in the report, namely cloud computing and 3D printing).

Hybrid mismatches

The OECD's March 2014 papers on hybrids (dealing separately with treaty issues and domestic law issues) were amongst the most complex and lengthy of its proposals to date.

The initial proposals for changes to domestic laws dealt separately with hybrid instruments and transfers; hybrid entity payments; and imported mismatches and reverse hybrids.

The discussion left open a number of important points on which responses were requested. The chief open issue concerned the type of approach, i.e. whether a 'top-down' or 'bottom-up' approach should be adopted. Other questions posed related to the clarity and scope of the rules and the particular treatment that should be applied in the case of regulatory capital.

The discussion paper has been turned into a comprehensive set of proposed rules, with more work to occur in 2015 on imported mismatches, repos, interaction with CFCs, regulatory capital and

collective investment vehicles, and to take account of deliverables from other workstreams.

The domestic law recommendations now made by the OECD generally have relatively minor changes from the March 2014 draft discussed above. The principle of automatic application with no motive or purpose test, and a structure of primary and defensive linked rules with a hierarchy, has been preserved. Some of the main changes and points to note are set out below.

- Hybrid payments are broadly defined and can include royalties or even payments for goods, but do not include deemed payments, for example notional interest deductions.
- The reverse hybrid and imported mismatch rules have been revised somewhat to make them clearer and more consistent with other recommendations.
- A bottom-up approach is taken to scope and in several areas is now restricted to related parties, structural arrangements or controlled groups (including generally treating a person as holding any investments held by an investor that is acting together with that person). Rules against deductible dividends and double deduction situations are proposed to have no scope restriction. Where a related party threshold is used, it has been raised to 25%.

There is no substantive change to the treaty recommendations.

The OECD and G20 will consider the coordination and timing of the implementation of these rules. This may not be until after a commentary and guidance have been produced, foreseen by September 2015.

Businesses will need to take action (in some cases, urgent action) both to comply with new requirements and to consider the ways in which they do business in different countries.

Treaty abuse

The OECD published a discussion draft in March 2014 on the proposals for counteracting the perceived abuse of tax treaties.

The draft was unexpectedly robust in its proposed changes to the Model Treaty. Clarity was called for in relation to the overall intention that treaties are not designed to allow double non-taxation. It also included the OECD's recommendations regarding the design of domestic rules to prevent the granting of treaty benefits and identified tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country.

There were two major proposals:

- a limitation of benefits article (LoB) to provide a relatively objective basis of relating treaty benefits to entities with a nexus in the resident country; and

- a new totally subjective main purpose/anti-abuse rule within treaties generally.

The OECD originally proposed that both specific measures be applied simultaneously to combat treaty shopping.

The OECD action 6 report now recommends that, in accordance with proposed changes to the Model Treaty, states adopt a 'minimum level of protection' to prevent treaty abuse. However, the report recognises the need for further refinements in the objective tests, particularly in view of constitutional or EU law restrictions that prevent some states from adopting the exact wording of the model provisions recommended in the Action 6 report. Rather than a one-size-fits-all solution, the report concludes that any of the following would suffice:

- LoB plus principal purpose test (PPT);
- PPT alone; or
- LoB plus a restricted PPT rule applicable to conduit financing arrangements, or domestic anti-abuse rules or judicial doctrines that would achieve a similar result.

The LoB now includes a 'derivative benefits' provision, allowing certain entities owned by residents of other states to obtain treaty benefits that these residents would have obtained if they had invested directly.

The PPT is identical to the previous March 2014 version, except for the substitution of 'principal' purpose for 'main' purpose regarding obtaining a treaty benefit, unless granting that benefit would be in accordance with the object and purpose of the relevant provisions of the treaty in question.

The report continues to recommend that treaties include in their title and preamble a clear statement that the contracting states, when entering into a treaty, intend to avoid creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty shopping arrangements.

The report also includes recommendations to deal with:

- certain dividend transfer situations (usufruct and similar transactions);
- transactions designed to circumvent the application of the treaty rule that allows source taxation of real estate companies;
- situations where an entity is a resident of two contracting states where a competent authority tie-breaker is recommended but states retain the right to use the effective management tie-breaker; and
- situations where the state of residence exempts the income of PEs situated in third states, and where shares, debt-claims, rights or property are transferred to PEs set up in countries that do not tax such income or offer preferential tax treatment, where it is recommended that to fully access treaty benefits the income must be taxed at a rate that is at least 60% of the rate that would have applied absent the residence country tax exemption.

Apart from the type and form of the appropriate LoB (the recommendation remains largely to adopt the US model) and compatibility with EU law, there are two main concerns:

- There is an argument that this is a disproportionate restriction to accessing treaty benefits, in order to counter abuse that would be better prevented by other measures. This has been mitigated slightly by the inclusion of a derivative benefits clause.
- There are still issues to be finalised regarding the application of income tax treaties to collective investment vehicles (CIVs) and pension funds, which is being addressed independently of the BEPS project, and for which a 'carve out' from these rules is expected, subject to certain thresholds.

The report states that further work is required on the precise contents of the model provisions and related commentary and, in particular, on the LoB rule and the policy considerations relevant to the treaty entitlement of CIVs and non-CIV funds. Accordingly, the Model provisions and related commentary should be considered as drafts subject to improvement, before their final release in September 2015.

Country by country reporting and transfer pricing documentation

With regard to transfer pricing documentation, notwithstanding considerable pushback from business, a three-tier approach comprising a master file, a local file, and a separate country by country (CbC) template has been proposed in the OECD's earlier work on this topic. The CbC information is to be reported to tax authorities at a very high level and for risk assessment only.

In the latest OECD report, there are few substantive changes from the earlier January draft. The report now confirms that the data points that will be required to be reported for each country will be the following:

- revenues (from both related and unrelated party transactions);
- profit before income tax;
- income tax paid (cash basis);
- current year income tax accrual;
- stated capital;
- accumulated earnings;
- number of employees; and
- tangible assets (excluding cash and equivalents).

The clear implication is that the template is designed to highlight those low-tax jurisdictions where a significant amount of income is allocated, without some 'proportionate' presence of employees. This means, in practice, that there will be pressure to assure that profit allocations to a particular jurisdiction are supported by the location in that state of sufficient appropriately qualified employees, who are able to make a 'substantial contribution' to the creation and development of intangibles.

Concerns have already been noted regarding the confidentiality of this data, as well as the potential for adjustments by tax administrations based on a formulary apportionment approach and leading to many more transfer pricing controversies.

The OECD has also noted that some countries (for example, Brazil, China, India and other emerging economies) would like to add further data points

to the template regarding interest, royalty and related party service fees. These data points will not be included in the template in this report, but the compromise is that the OECD has agreed that it will review the implementation of this new reporting. Before 2020, at the latest, it will decide whether there should be reporting of additional or different data. A concern in this context is that there may well be a tendency to expand CbC reporting, particularly in developing countries. The emerging market economies that implement CbC reporting will likely require the reporting of interest, royalty and related party service fees; they will also be likely to require CbC reporting for any company doing business in their jurisdiction, regardless of where the MNE parent is located. The availability of this data to requesting countries will also be considered in the OECD's review of the implementation of CbC reporting.

The proposals on the transfer pricing documentation master file and local file are broadly in line with what has already been announced.

The OECD does not yet have absolute consensus on the arrangements for the sharing of master file and CbC information, although they are seeking to finalise those arrangements by January 2015. This will include confidentiality issues, with indications that information will only be exchanged pursuant to treaty or tax information exchange agreement provisions.

Transfer pricing and intangibles

The OECD has a long running project on intangibles, which now forms part of its BEPS agenda.

With regard to the latest report, parts of the intangibles document will not be finalised now, but will represent only interim guidance. This is because a portion of the content of the intangibles report will clearly be influenced by the work the OECD will be doing over the course of the next year on risk, recharacterisation, hard to value intangibles, and special measures.

The relevant portions are the guidance on:

- ownership of intangibles;
- intangibles whose valuation is uncertain at the time of the transaction;
- use of unspecified methods; and
- profit split methods.

Importantly, the OECD has stated that, with respect to special measures, it will not be constrained by the arm's length principle, and it may be willing to go beyond that for 'hard to value intangibles' (which would essentially be any important intangible). Some of the potential special measures which have been discussed publicly so far include:

- commensurate with income rules (pricing intangibles with hindsight, using actual results);
- treating pure 'cash-box' entities as per se debt investors, rather than equity investors sharing in residual profits;
- mandatory use of contingent payment terms or the application of profit split methods; and
- the application of the Article 7 KERT or 'significant people function' analysis to pure cash boxes or 'thickly capitalised' entities.

The level of support for these various options among OECD/G20 countries is not known. However, given that they reflect a willingness to consider moving beyond the arm's length principle, this may indicate that obtaining a complete consensus will be difficult.

What stands out is an overall determination to push through the entirety of the BEPS package on the basis of building and retaining a very broad consensus of states

Harmful tax practices

Whilst the bulk of the work on BEPS is directed at the position and actions of taxpayers, the work on countering harmful tax practices focuses on the actions of states.

The OECD has recognised that there has been a shift by some states from creating ringfenced tax regimes (which was largely the focus of the OECD's work on harmful tax practices 15 years ago) towards introducing more broadly based corporate tax reductions for particular types of income, such as financial activities or intangibles. This explains the reason for the revamping of the work in this area under the BEPS project. It also indicates why much of the early work on this topic within the BEPS project has focused on patent box regimes.

The plan for the harmful tax practices work in BEPS is based on a three-stage approach: looking first at the tax regimes of OECD members; then at those of non-OECD members; and finally then revising the existing harmful tax framework, as required.

The paper just released by the OECD is concerned with the first phase of this work, focusing on the tax regimes of OECD members.

Three key pieces of work are identified as needing to be done:

- the elaboration of a methodology to define a substantial activity requirement in the context of intangible regimes;
- the improvement of transparency through the introduction of compulsory spontaneous exchange of rulings related to preferential regimes; and
- the provision of a progress report on the review of member and associate country regimes.

It should also be noted that much of the work expressed throughout the BEPS Action Plan is a variation on the same theme, with a focus on aligning taxation with the 'substance' of transactions – and that seems to be defined as determining where people are located, and where the performance of significant people functions takes place.

'Substantial activity' is similarly the touchstone in this report on harmful tax practices. Nonetheless, determining the location of substantial activity is inevitably a subjective determination, making objective criteria difficult.

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Implementing a common template for country by country reporting (Bill Dodwell & Alison Lobb, 22.11.13)

Special report: The OECD's action plan on BEPS (26.7.13)

The report also voices concerns with regimes that apply to mobile activities and that unfairly erode the tax bases of other countries, potentially distorting the location of capital and services. There is some overlap of this work with that in the transfer pricing space relating to intangibles and risk and capital, as well as to similar issues being addressed in the report on the tax challenges of the digital economy. This is not particularly surprising, given that much of the BEPS work is heavily focused on re-examining basic transfer pricing principles, as well as the threshold for jurisdiction to tax embodied in the PE rules.

With respect to the proposals for improving transparency through compulsory spontaneous exchange on rulings related to preferential regimes, this requirement contributes to the third pillar of the BEPS project, which is to ensure transparency while promoting increased certainty and predictability. This reinforces the OECD's point that the transparency of an MNE's tax affairs is an important way to address BEPS. It should also be noted that the word 'compulsory' is understood to introduce an obligation to spontaneously exchange information wherever the relevant conditions are met, meaning that this is a further step in moving more generally from the exchange of information upon request to the automatic exchange of information.

The framework proposed by the OECD requires spontaneous information exchange only on taxpayer-specific rulings related to preferential regimes, i.e. rulings that are specific to an individual taxpayer and on which that taxpayer is entitled to rely. There is currently no such requirement for general rulings, meaning rulings that apply to groups or types of taxpayers or that may be given in relation to a defined set of circumstances or activities.

Use of a multilateral instrument

Since the start of the work on BEPS, the OECD has recognised the need to address the speed of implementation of any measures that it develops to counter BEPS practices. In the absence of any special measures, changes to be effected through bilateral tax treaties would take many years to introduce across the network of double tax treaties, as individual treaties are renegotiated.

To address this situation, the OECD proposes to develop a multilateral instrument, so that countries may rapidly implement the measures developed in the course of the work on BEPS.

The work in this area has raised uncertainties at a technical and practical level. Technically, it has not been clear if the objectives of the OECD can be readily achieved, given the essentially bilateral nature of tax treaties. Practically, there have been uncertainties as to the likely level of participation by states in such a multilateral instrument.

The recently released OECD paper now answers the first of these issues, confirming that a multilateral instrument is both desirable and, from a tax and public international law perspective, technically feasible. The report indicates that in January 2015, OECD and G20 countries will consider a draft

mandate for an international conference for the negotiation of a multilateral convention.

There is also an indication that such an instrument could, in addition to updating bilateral treaties, be used for other things, such as to 'express commitments' to implement certain domestic law measures or to provide the basis for exchange of the country by country template, discussed above.

There is no discussion of the practicalities of such an instrument, but the reference to the fact that 'interested countries' may wish to develop a multilateral instrument perhaps hints at the difficulties of achieving a full consensus in this area.

Further points on implementation

While agreed, the proposed measures are not yet finalised, as they may be impacted by the 2015 deliverables, the OECD states. To the extent that the changes relate to the OECD's Model Tax Convention and transfer pricing guidelines, their implementation is assured and should follow fairly quickly. The speed with which they will then be implemented in existing bilateral tax treaties will be heavily linked with the success of the OECD's proposed 'multilateral instrument', which the OECD now reports can be applied without any obvious technical barriers (though practical issues may be of more concern). The proposed OECD rule changes that involve amendments being made by individual territories to domestic tax rules are likely to be widely but not universally adopted, though consistency and timing is uncertain. Meanwhile, the OECD must carry out the process of redrafting and agreeing materials and governments must decide what policy changes they will make, with tax authorities having to work out how to implement them effectively.

Final thoughts

For those closely following the OECD's work on BEPS, the package of information now released by the OECD will contain relatively few surprises, given what has been known or trailed about the ongoing work on the action plan. Nonetheless, what stands out is an overall determination on the part of the OECD to push through the entirety of the BEPS package on the basis of building and retaining a very broad consensus of states. In that regard, the clear involvement of developing countries across the BEPS programme is significant.

It will be important that continued commitment to the process balances the task of rebuilding public trust in the international tax system with the task of supporting, rather than damaging, the cross-border trade and investment that are key to economic growth.

There are clearly implementation details to work on, as the OECD itself acknowledges. What is very clear is the material change which is in progress. Taxpayers will need to take account of the speed of these developments, including in relation to the work which remains in progress, in framing their response.

The OECD's reports are available from the OECD's website and via www.bit.ly/1uFprFL.



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Analysis

Employment tax consultations: where are we now?

SPEED READ Following various reports by the Office of Tax Simplification, the government published a number of consultations over the summer aimed at the (much needed) simplification of various areas of the employment tax code. The consultations focus on four different aspects of the benefit in kind rules, and on potential changes to the employment-related securities rules. The government has also issued a call for evidence on remuneration practices and instigated a review of the tax rules around travel and expenses. The only discernible thread running through the consultations is that they are all areas which are ripe for simplification.



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In the 2014 Budget, the government announced that, in response to the recommendations of the Office of Tax Simplification (OTS), it would launch a package of four consultations on employee benefits in kind and expenses. These consultations were launched in June 2014 and have been supplemented in July and August 2014 by further related consultations on subsistence and travel and a general call for evidence on remuneration practices.

In addition, the government has launched consultations on possible changes to the tax treatment of employment related securities (ERS): firstly, introducing the concept of a 'marketable security', for the purposes of determining the date when payment of any tax due arises; and, secondly, introducing an apportionment basis for applying NIC to ERS awards to internationally mobile employees.

The only discernible thread running through the consultations is that they all cover areas which are ripe for simplification. In some cases (such as the benefits in kind consultation), the government's proposal should go a long way to achieving this simplification. In other areas (such as the marketable securities consultation), what is being suggested is far from simple; instead, it is an additional complex alternative to a set of rules which the OTS has already identified as being too complex.

Benefits in kind

On 18 June 2014, the government launched consultations on the design and implementation of four measures proposed by the OTS, intended to simplify employee benefits administration issues for both employers and HMRC.

The four areas covered by the consultations are:

1. The abolition of the £8,500 threshold:

The government believes that this threshold adds unnecessary complexity to the tax system. It is consulting on who would be affected and how to mitigate the effects of abolition on certain groups of

employees (essentially, those who earn under £8,500 but receive benefits in kind which take them over the personal allowance threshold, either because of the value of the benefit in kind (e.g. accommodation) or because they have income from sources other than employment).

2. Introducing a statutory exemption for trivial

benefits in kind: In 2011/12, 500,000 P11Ds were completed showing benefits in kind of £100 or less. Leaving aside the cost to employers of preparing such forms, it costs HMRC £6.50 to process each P11D that is filed. The government believes that a clear and simple statutory exemption will make administering such benefits substantially easier for employers (and for HMRC). The government is, therefore, consulting on the design of such an exemption. In particular, the consultation looks at how a trivial benefit in kind may be defined, favouring a 'principles based' approach, subject to an individual maximum monetary limit and also an overriding annual exemption limit. Cash or vouchers would not be covered by the exemption and it would not cover any benefits provided on a pre-arranged, regular or continual basis. It would also not be possible to sacrifice salary in return for such a benefit in kind.

3. Replacing the current system of dispensations for reporting non-taxable expenses with an exemption for expenses paid or reimbursed by employers: The government believes that an exemption would be simpler, more transparent, consistent and easier to use for employers than the current system. This consultation covers the design features of such an exemption, which is intended to apply to all qualifying expenses paid or reimbursed by an employer. However, it is not intended that this measure would change the rules which determine whether or not tax relief is available for any particular expenses.

4. Introducing a system of voluntary payrolling

for benefits in kind: The government believes that payrolling benefits in kind, instead of submitting P11Ds, could offer substantial administrative savings for some employers and wishes to create a system that will enable employers to do so if they wish. The government is consulting on the design and scope of a payrolling model. It is also interested to hear from employers who are already payrolling benefits on an informal basis.

These changes are all to be welcomed. In practice, the biggest of the problems addressed by the consultations is the dispensation system for non-taxable expenses. This is counterintuitive, and significantly favours bigger employers (and their employees) over smaller employers. A system of exemption for payment or reimbursement of qualifying expenses would clearly be more straightforward, fairer and easier to administer for both employers and employees.

Review of travel and subsistence

The OTS also identified a number of issues with the tax treatment of travel and subsistence expenses. The government considers that these problems are

symptomatic of more fundamental issues in the tax rules on travel and subsistence expenses, and so has launched a longer term review of these rules, alongside the consultations on expenses and benefits. This review was launched on 6 August 2014.

The review of the travel and subsistence rules aims to produce a new system that reflects working patterns in the 21st century. In particular, since the rules were initially developed, there have been significant changes to working practices, including growth in the temporary labour market and an increase in homeworking. The government does not intend that any new system would provide tax relief for private travel or ordinary commuting (although presumably the existing generous rules on secondments to temporary workplaces – detached duty relief – will remain). However, the government is open to exploring different principles and methods for determining the circumstances when travel expenses should attract tax relief and will invite views on this in a structured way as part of the review.

The first part of the review, from July to October 2014, will gather evidence and consider a framework for the development of new rules. Stage two will take place from winter 2014 to spring 2015 and will involve the establishment of a working group to produce a new set of principles upon which the rules of a new travel and subsistence tax regime will be based.

Modern remuneration practices

The government has also launched a general call for evidence on modern remuneration practices. In particular, the government is seeking evidence on the following broad areas:

- what different forms of remuneration make up remuneration packages;
- why different forms of remuneration are used;
- how different forms of remuneration are provided; and
- what the future of remuneration looks like.

The information gathered is intended to inform future tax policy making, but is not expected to lead directly to any immediate or specific changes in tax legislation.

Marketable securities

The OTS also suggested that changes should be made to the current tax rules dealing with (non-tax advantaged) ERS. In particular, the OTS was concerned that the current rules can lead to a tax charge arising on such securities before the taxpayer is able to sell those securities. Accordingly, the OTS suggested that employees be given a choice as to when to pay tax on ERS between:

- the time when they are acquired; or
- the time when the ERS becomes a 'marketable security' (i.e. when they can be sold for a cash sum at least substantially equal to their unrestricted market value).

This suggestion involves significant changes to the taxation of ERS and, accordingly, the government has released a consultation document, *OTS review of unapproved share schemes: marketable security*. The document raises a number of wide-ranging questions

concerning this proposal and linked changes to the 'readily convertible asset' rules.

In the view of the author, the proposed changes are a solution to a problem which has already been solved. If employees believe that shares will go up in value, and have the funds available, they will pay income tax at the time that the shares are acquired. Any growth in value that results will be subject to capital gains tax. If employees don't believe that shares will go up in value, or if they are unable to fund the income tax bill on the acquisition of those shares, they can be incentivised via share options (or a cash bonus linked to share performance), both of which result in any value that is delivered to the employee being subject to income tax under PAYE with an associated NIC liability. The marketable securities changes are essentially just offering another way of achieving the latter outcome. Whilst the legal structure and/or accounting treatment of the arrangements may be different, the primary tax outcome would be the same.

Internationally mobile employees and ERS

The UK domestic tax rules applying to internationally mobile employees as regards gains from share and option awards have always been somewhat anomalous when compared to the position in other countries. FA 2014 amended the ERS rules, such that they applied to all ERS income, whether or not the employee was resident in the UK at the time of acquisition of the ERS. It also introduced new rules which establish the period over which ERS income can be regarded as accruing (broadly, the time between acquisition and the later chargeable event), with corresponding apportionment between the time spent on UK and non-UK duties (the former being subject to UK tax, the latter not). These changes stemmed from recommendations by the OTS. However, the changes introduced to date only affect income tax; the NIC position is unaffected. The government is, perhaps rather later than might be optimal, consulting on tying in the NIC rules with the new income tax rules. The consultation document, *Internationally mobile employees and ERS*, seeks views on these proposals. In particular, the government proposes to introduce an apportionment for NIC on ERS based on disregarding the number of days that the employee was not within the UK social security system between grant and vesting of the ERS.

Next steps

- The employee benefit consultations released by the government closed on 9 September 2014. The government intends to respond at the Autumn Statement 2014.
- The consultation on marketable security proposals is open for comments until 10 October 2014. Comments should be sent to shareschemes@hmrc.gsi.gov.uk.
- The consultation on internationally mobile employees and ERS is open until 16 October 2014. Comments should be sent to raj.nayyar@hmrc.gsi.gov.uk.

For details of and links to these and other consultations, see Tax Journal's consultations tracker (www.taxjournal.com under the 'trackers' tab).



For related reading, visit www.taxjournal.com

The future of the £30k termination payment exemption (Peter Doyle, 12.9.14)

Analysis

The international tax briefing for September

SPEED READ The big news this month has been the much anticipated publication by the OECD of the first seven deliverables in the BEPS action plan. In the UK, draft legislation to implement the EU Accounting Directive, which introduces country by country reporting for the extractive industry, has been published. Overseas, in India the promised committee to review fresh cases involving indirect transfer of assets has now been established; in Canada, a very large package of tax legislation has been published, but anti-treaty shopping proposals have been put on hold; and in China, new reporting requirements on outbound investment have begun.



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On 16 September, the OECD published seven papers (three reports and four draft instruments) covering the 2014 actions set down in the base erosion and profit shifting (BEPS) action plan published in July 2013, along with the OECD's recommendations on the next steps to be taken. These much anticipated first seven deliverables cover: the digital economy; hybrid mismatches; countering harmful tax practices; preventing treaty abuse; transfer pricing and intangibles; transfer pricing documentation (including country by country reporting); and developing a multilateral instrument to modify bilateral tax treaties. The OECD now moves onto the 2015 action items, including consideration of: the permanent establishment concept; interest deductibility; controlled foreign company (CFC) regimes; and further detailed work on transfer pricing, in particular in relation to risks, capital and intangibles.

The seven documents published are, generally speaking, fairly balanced in seeking to address the issues of base erosion and profit shifting and to defeat double non-taxation, while also recognising that taxpayers need certainty and that the proposals should not result in double taxation or hinder cross-border trade. Sensibly, the recommendations remain in draft form so that they can be reviewed and amended, if necessary, as part of the 2015 workstreams to ensure the overall package properly addresses the issues.

Action 5 merits a mention. The OECD's focus is on agreeing a framework to define 'substantial activities' in relation to intellectual property (IP) regimes and the report references two approaches, a transfer pricing approach and a nexus approach, with a current focus on the latter. The nexus approach seeks to link the IP regime benefits directly to the claimant company's contribution to the development of the IP. This approach is

inconsistent with many business models, however, and flexibility would be needed if it was adopted. The suggestion in the report that benefits will be restricted to profits flowing from patents, or patent equivalents, will also be a real concern to taxpayers currently making use of the broader IP regimes being operated across Europe and more widely. The OECD has made no decisions on which approach will be adopted and HM Treasury and UK ministers remain committed to the UK patent box.

In relation to the 2014 actions, arguably the easy work is now complete. The challenge is now whether, and to what extent, countries will adopt the recommendations that have been made into local legislation, particularly when the recommendations are, by the OECD's own admission, not formally finalised. Whilst there is support at the G20 level, it is to be hoped that this translates into coordinated and consistent action.

The OECD notes that the actions will require careful implementation by countries and guidance will be necessary to support such action. Whilst it is stated that countries will be able to start implementing certain of the recommendations now, it is unclear how far they will be able to go in the short term, given the interdependency between the 2014 and 2015 actions and the need for the detailed guidance. Whilst it is desirable for there to be quick action, both to provide certainty and to deal with public concern, there is a risk that hasty unilateral action could put a country at a competitive disadvantage or require significant modification once the package is finalised.

EU update

EU Accounting Directive – country by country reporting: On 21 August, the Department for Business, Innovation and Skills (BIS) released updated draft legislation to implement Chapter 10 of the EU Accounting Directive in the UK. The legislation introduces country by country reporting for UK extractive companies and groups of tax and other payments to governments. It follows an initial draft published in March 2014, followed by a period of consultation. The industry working group is drafting guidance to the legislation which will also be published in due course and is expected to be endorsed by BIS.

The Chapter 10 requirements will pose a significant compliance burden on extractive companies and groups, as they require country by country reporting of all cash payments by project and by receiving government.

The draft legislation sets out which UK companies will need to comply with the new rules (very broadly, large companies and public interest entities involved in the exploration, prospection, development and extraction of minerals or oil and gas, or the logging of primary forests). There are, though, a number of complexities around the interpretation of the rules and careful consideration will be needed by groups to determine the impact on their businesses.

The rules will apply for financial years commencing on or after 1 January 2015. The reporting deadline is 11 months after the year end.

Global update

India – committee to review fresh cases involving indirect transfer of assets: Readers will be familiar with the widely reported *Vodafone* case in India (*Vodafone International Holdings BV v Union of India* [2012] 341 ITR 1 (SC)), where the Supreme Court held that the transfer, by a non-resident to another non-resident, of shares of a foreign company holding an Indian subsidiary company does not amount to a transfer of any capital asset situated in India. Accordingly, the gains arising from the transaction in question were not liable to tax in India. The Finance Act 2012 was subsequently amended with retrospective effect, such that the government effectively overturned the Supreme Court's decision, not just for future transactions but potentially for all relevant transactions that have taken place since 1 April 1962.

Unsurprisingly, this has proved to be a very controversial decision. The new government in India appears to be taking a softer line. In his budget speech in July, the finance minister announced that all fresh cases arising out of these retrospective amendments will be scrutinised by a High Level Committee, to be constituted by the Central Board of Direct Taxes (CBDT), before any action is initiated by the tax authorities. On 28 August, the CBDT issued an order which brings this promise into action.

The order states that when the assessing officer believes income is deemed to accrue or arise in India before 1 April 2012, but no action has yet been initiated to recover tax on that income, the approval of the committee must be sought before any action can commence. Effectively, therefore, no fresh cases can be taken until they have been examined by the committee, when the taxpayer will be given an opportunity to have their views heard.

This is definitely a step in the right direction, but we will need to wait and see what approach the committee takes and how effective it is at preventing inappropriate litigation. It will also be interesting to see the government's stand in cases where action has already been initiated by assessing officers and proceedings are currently pending before the court.

Canada – Budget and catch-up draft legislation published: On 29 August, the Canadian government released a 230-page package of draft legislative proposals to implement certain outstanding measures originally announced in the 2014 federal budget (see my article of 28 February 2014). These include international tax measures to:

- expand the existing anti-avoidance rules in the thin capitalisation provisions and to add a back-to-back loan provision;
- amend the existing rules related to captive insurance; and

- limit the availability of the offshore regulated bank exception, based on the status of the Canadian taxpayer and related companies.

The package also includes some other outstanding tax legislation, including:

- tax measures that were first released in August 2013 relating to the foreign affiliate dumping rules and the life insurance policy exemption test announced in the 2012 federal budget; and
- tax measures relating to amending the definition of 'non-qualifying country' in the foreign affiliate rules.

It appears that the government may move quickly to introduce a bill and pass the final legislation, as comments on the draft legislative proposals are only being accepted until 28 September.

In a welcome development, the government also announced that it will await further work by the OECD in relation to the Canadian BEPS initiatives, including treaty abuse, that it had first included in the 2014 federal budget. The Canadian government has not yet commented on the BEPS report published on 16 September.

China – new reporting requirements

on outbound investment: China's State Administration of Taxation recently published *Announcement No. 38*, which requires regular reporting of outbound investments and annual reporting of income earned overseas, with effect from 1 September 2014. The reporting requirements apply to tax resident enterprises, as well as those non-residents that have an establishment or a place of business in China and derive income that is effectively connected with this establishment or place of business.

Announcement No. 38 has not changed any existing definitions (such as resident taxpayer) or rules (such as controlled foreign company, foreign tax credit, etc.) under China's tax legislation.

Instead, its emphasis is on the enforcement of the relevant tax rules. The reporting obligations, broadly speaking, are:

- a periodical foreign investment reporting obligation when tax residents (or affected non-residents) establish or participate in foreign companies or sell shares or voting shares in foreign companies; and
- an annual reporting obligation in relation to foreign-earned income.

If a taxpayer fails to comply with these rules, the tax authorities can order that this must be rectified within a set period of time. If the taxpayer still fails to report the required information within the extended time limit, the authorities then have the discretion to adjust the tax payable amount.

These new reporting requirements introduce a considerable compliance burden for organisations operating in China with outbound investments. Subsidiaries of Chinese owned groups are also likely to see more information requests from head office, as group tax departments put in place processes for complying with the new requirements. ■

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News: OECD releases first BEPS deliverables (18.9.14)

International briefing for February 2014 (Chris Morgan, 28.2.14)

Special report: Tax and China (4.7.13)

Vodafone's Supreme Court victory in India (Gareth Miles & Nikhil Mehta, 1.2.12)

Special report: Tax and India (28.11.13)

VAT focus

Skandia: branch VAT group planning cut down

SPEED READ The CJEU judgment in *Skandia* significantly changes the accepted VAT liability of cross-border recharges between an overseas company and its branch, where that branch is in a VAT group. The CJEU has held that where a supply is made intra-entity, in circumstances where the recipient is part of a VAT group, it is necessary to depart from the well-known principle in *FCE Bank* that intra-entity transactions do not give rise to a supply. The disregard of VAT for transactions between head office and branch has been widely used in VAT planning arrangements that avoid VAT on imported IT services and to avoid inefficiencies in global service centre structures.



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Sometimes the solution to a problem can cause more problems than it solves. UK taxpayers would be forgiven for thinking the CJEU judgment in *Skandia America Corporation USA v Skatteverket* (C-7/13) (reported at page 5) to be one such problematic solution, where the resolution of a Swedish VAT group issue has the potential to cause widespread disruption to global procurement and service company structures across the financial services sector. To make matters worse, the CJEU was solving a problem the UK simply didn't have.

Despite being decried as a fiscal theme park of inverted realities, VAT can produce strikingly sensible judgments. The 2006 decision of the CJEU in *FCE Bank* (C-210/04) [2007] STC 165 is one such example, where it held that transactions that take place within the same legal entity, for example between head office and a branch or between different branches of the same entity, do not give rise to supplies for VAT purposes. The VAT rules define a 'taxable person' as any person who 'independently' carries out an economic activity. In applying this definition, the CJEU had held that a branch could not be said to carry out an economic activity independently of the company of which it forms part, as it bears no independent financial risk and has no independent capital. It is hard to view the *Skandia* judgment in the same light.

The problem being tackled by the CJEU in *Skandia* arose because of the way cross-border arrangements have been used by international VAT exempt groups for sourcing services, such as IT and telecoms services, without the imposition of VAT. In

essence, these arrangements involve the registration of a branch of the overseas company in the EU as part of its local VAT group. The overseas head office will source the relevant services and acquire them abroad (without VAT) and then on-supply them to its EU branch, treating that transaction as outside the scope of VAT in reliance of the *FCE Bank* decision. The services could then be recharged throughout the local VAT group by the branch without any further VAT liability.

The UK tax authorities were not complacent in the face of this planning and enacted the Value Added Tax Act 1994 s 43(2A), which disapplies the operation of VAT grouping where there is an on-supply for consideration of those overseas sourced services to a UK VAT group recipient. This did leave some opportunities to produce VAT savings, provided that the UK branch did not on-charge the services to UK subsidiaries, or where possible only on-supplied VAT exempt services.

The CJEU has now held in *Skandia* that such arrangements are ineffective. Where a supply is made intra-entity and the recipient branch is part of a VAT group, the supply for VAT purposes is no longer intra-entity, but is made to a separate VAT entity in the shape of the VAT group. In those circumstances, the supply must be regarded as a taxable supply made to a separate taxable person (the VAT group) and reverse charge VAT is due.

The impact of this decision, if taken at face value, goes further than s 43(2A) and cuts down all VAT group branch planning. Furthermore, innocent bystanders, such as recharges from global shared service centres, are drawn into the VAT charge. The consequences of this are significant. The decision to structure service provision on a global basis will have been based on the assumption of VAT neutrality and the imposition of an irrecoverable VAT cost significantly changes the economic viability. With increased costs there are, of course, knock-on consequences for regulatory capital requirements.

The decision will come as a major blow to many, who may now need to consider unwinding such arrangements. However, from a UK perspective, until HMRC has communicated how it will approach this issue, any knee-jerk reaction would be premature.

Background

Skandia America Corporation (Skandia), a US company with a Swedish branch, received external IT related services from outside the EU. Skandia's Swedish branch was registered as part of a Swedish VAT group, independently of Skandia itself. Skandia recharged its Swedish branch for the IT services and the branch used these services to make onward supplies of IT services, both inside and outside the VAT group.

Skandia contended that no VAT arose on the intra-entity supply of IT services from Skandia to its Swedish branch, relying on the CJEU decision in *FCE Bank*. In contrast, Sweden argued that VAT

should be (reverse) charged on the supply of IT services from Skandia to its Swedish branch. In particular, Sweden argued that the principle in *FCE Bank* should be disapplied where the relevant branch was registered for VAT separately to the entity of which it forms part.

The UK government intervened in the action before the CJEU and put forward a different argument. The UK contended that the language of article 11 (VAT grouping) of the Principal VAT Directive, which refers to the fact that 'a member state may treat as a single taxable person persons established in the territory of that member state', did not allow a branch to join a VAT group on its own, as a branch was not a 'person'. The UK argued that where Skandia wished to join its branch to an existing Swedish VAT group, the correct analysis was that Skandia itself, established in Sweden through its branch, must become part of the VAT group.

The advocate general agreed with the analysis of the UK government and opined that there was no basis, or need, to restrict the decision in *FCE Bank*.

The CJEU's decision

The CJEU has taken a different approach to that of the advocate general. The CJEU has simply held that where a branch joins a VAT group, then a supply from within that entity to the branch must, for VAT purposes, be treated as no longer supplied to the branch but to the independent VAT group of which it forms part. The nature of the VAT grouping rules requires that supplies are treated as being made to the VAT group rather than to the individual members.

Accordingly, the CJEU stated that since 'the services provided for consideration by a company such as [Skandia] to its branch must be deemed, solely from the point of view of VAT, to have been provided to the VAT group, and as that company and that branch cannot be considered to be a single taxable person, it must be concluded that the supply of such services constitutes a taxable transaction' and that the reverse charge mechanism must be applied to that supply.

It is perhaps not surprising that the CJEU has interpreted EU law in a way which ensures that VAT is charged on supplies of IT services received into the EU. Indeed, it is interesting to note that the CJEU has in fact accepted the most straightforward method of tackling the VAT planning in this case, as put forward by the Swedish tax authorities and the Commission. In so doing, the decision produces a simple and neat solution to the VAT planning in this particular case, but does arguably compromise the integrity of the principle in *FCE Bank* to a degree and will also create uncertainty as to the position in the UK.

The UK position

Unlike Sweden, the UK has always taken the position that a VAT registration of a branch of an overseas entity necessarily also includes registration of the overseas entity itself. However, that has not prevented the same planning from being utilised through the

use of UK branches. Whilst a direct acquisition of overseas IT services for use in the UK may have fallen foul of the place of supply rules (giving rise to reverse charge on the original acquisition of overseas services as in *Zurich Insurance Company v HMRC* [2006] All ER (D) 357, the arrangements typically put in place involved large, global, group-wide services with procurement arrangements sitting offshore). As such, no VAT would arise on the offshore acquisition of the services and no VAT would arise on the supply to the intra-VAT group UK branch.

The decision of the CJEU leaves the future of these arrangements in the UK in a very uncertain state.

The impact of this decision, if taken at face value, goes further than s 43(2A) and cuts down all VAT group branch planning

What now?

The CJEU decision may sound the death knell for branch planning arrangements, such as those used by Skandia in EU jurisdictions, which allow VAT grouping of branches. Affected groups will need to carefully consider whether and, if so, how to unwind such arrangements going forwards.

At this stage, it is unclear whether the UK will choose, or feel obliged, to change its practice on branch to branch supplies. If it does, then VAT will become chargeable on the acquisition of the services from the overseas head office. Concerns will of course turn to the potential retrospective application of the judgment. Until HMRC makes its position known, UK groups should sit tight, whilst considering what arrangements might need to be put in place if the current arrangements do need to be unwound. An early announcement by HMRC of its reaction to the decision is, accordingly, highly desirable.

If the UK does change its approach, it is not necessarily all bad news, since the CJEU judgment also raises the possibility for outbound recharges to an overseas head office to be included as supplies giving a right to input VAT deduction in a taxpayer's VAT accounting.

Further implications

It might also be noted that the statements made by the CJEU – that a supply made to a member of a VAT group is treated as made to that VAT group independently of the member – may prove highly relevant in other scenarios. To give but one example, recent decisions of the First-tier Tribunal have reached competing conclusions as to who should benefit from VAT refunds after a company leaves a VAT group or the principal member of the VAT group changes. The statements of the CJEU may well bear on the outcome of any appeals in those cases (see our article 'VAT repayments following changes in group membership', *Tax Journal*, 29 May 2014).

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Cases: *Skandia America v Skatteverket*
(26.9.14)

VAT repayments following changes in group membership
(Nick Skerrett & Gary Barnett, 29.5.14)

The future of VAT group registration in the EU (Peter Jenkins, 11.2.08)

Where now for VAT and financial services? (Cathy Hargreaves & Martin Kelly, 4.6.07)

Ask an expert

Joint venture: ensuring no disguised remuneration charge

Q My client (the trustee of an EBT) would like to provide loan finance in connection with a joint venture development company (JVCo), which is 33% owned by the main beneficiary (A) of the EBT, in order to fund the conversion of a UK property into residential flats. The proposal is for the property to be purchased by a newly formed company (SPV) which would be a wholly owned subsidiary of JVCo. The potential investment was introduced to the trustee by A. The SPV would be financed by the EBT amongst others. My client is concerned to avoid triggering a charge to income tax under the disguised remuneration rules in ITEPA 2003 Part 7A.



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A If the SPV is a wholly owned subsidiary of JVCo, then any loan made to it would be caught by ITEPA 2003 s 554C(1)(a) (payment to a relevant person), as a payment would be made to a person (the SPV) linked to A, because A is a participator in a close company (JVCo) and the SPV is a subsidiary of JVCo. The exclusion in ITEPA 2003 s 554R (acquisitions out of sums or assets) would not help, as the asset (the UK property) would be acquired out of funds provided to the SPV, which is a person linked with A for the reason mentioned above.

I would suggest that the SPV should be established not as a wholly owned subsidiary of JVCo, but as a stand-alone company which is formed by the trustee as a shareholder together with the other two members of JVCo (excluding A). The critical issue here is whether the SPV set up on this basis would now be linked to A. (I assume the other members of the SPV would not otherwise be related to A or in partnership with A.)

Turning to ITEPA 2003 s 554Z1 (interpretation: persons linked to A), the SPV would be a close company as it would be under the control of five or fewer persons. A would not be a participator in the SPV and would only be linked with the SPV if a person connected with A is also a participator in the SPV. The trustee would only be connected with A if A were the settlor of the EBT or some other trust involved with this transaction, which we assume would not be the case here. The tests for connected

persons in relation to s 544Z1 are found in ITA 2007 s 993. Section 993(7) provides that, in relation to a company, any two or more persons acting together to secure or exercise control of the company are connected with each other, so that A would be connected with the other members of JVCo in relation to JVCo. The key point is whether this connection between A and his fellow shareholders in JVCo would relate only to JVCo, or could extend more widely to the SPV because those shareholders are also members of the SPV.

In my view, connection under s 993 is limited by the context. Sub-section (7) asks the question 'in relation to a company' who controls the company. The combination of the indefinite and definite articles makes it plain that the statutory test is directed at a particular company. This means that, in relation to JVCo, A and the other members are connected to each other, but that they are not connected in relation to the SPV because A is not a member of the SPV. Section 993 prescribes when connection is to apply in each subsection (for example, when referring to spouse or civil partner in sub-sections (2) and (3), it is clear that that this only applies to a person acting as a trustee and not in any other capacity). It should be borne in mind that the term 'control' is widely defined in CTA 2010 ss 450 and 451, so it is important that A should not be able to secure control of the SPV by some other means, viewing the facts realistically.

Connection is also of significance for the purposes of s 554C(3) to the meaning of a 'relevant person', which is defined in s 554C(2) to mean A, a person chosen by A, or within a class of persons chosen by A, and which would also include a person (P) if P is taking steps on A's behalf or at his direction or request. The trustee should not make the investment in the SPV on A's behalf or at A's request or direction. Accordingly, the trustee should only subscribe for shares in the SPV after taking independent advice from a third party.

'Ask an expert' provides expert answers to your tax queries. **If you would like a second opinion on a tax issue, please contact the editor** at paul.stainforth@lexisnexis.co.uk and we will endeavour to commission an answer for you. All questions will be anonymised.

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Aside from your immediate colleagues, whom in tax do you most admire?

Undoubtedly, Patrick Soares of Field Court Tax Chambers, who first inspired me over 25 years ago with his wide ranging and yet in-depth knowledge of taxation. He has never let me down.

As an ex-inspector of taxes and then a tax practitioner for some 35 years, what are the most significant changes you have noted within HMRC?

As the older highly trained and experienced inspectors have retired, it is all too clear that their successors have not benefited from the same in-depth and rigorous training. As a result, all too often technical issues have to be referred up to specialists who are so overworked that, whilst practitioners are given four to six weeks to reply to HMRC letters, they often take as many months or more to provide their own substantive replies. There has also been a shift in approach and focus within HMRC, moving away from fairly applying the law towards maximising the tax take and concentrating on evasion and more recently on avoidance.

Has there been a turning point in your professional life?

Yes. My son Ben unexpectedly joining the practice in 2000 and subsequently qualifying as a chartered tax adviser and becoming the practice managing partner.

Apart from its sheer size, is there any one thing about the UK tax legislation that troubles you?

Yes indeed – the fact that every time the government wishes to introduce a relieving provision, such as the recent business investment relief for non-doms, HMRC and the Treasury seem to



Zig Wilamowski
Senior tax partner,
Hamels Consultants

go out of their way to complicate it to such an extent as to render it practically useless.

If you could make one change to UK tax law or practice, what would it be?

The change in practice I would like to see is for HMRC to be able to give rulings like the Netherlands and Maltese tax authorities. This would be particularly helpful in providing certainty for taxpayers and encouraging inward investment from overseas.

The change in law would be to replace the present complex treatment of foreign dividends and the substantial shareholdings exemption with a simple European style participation exemption. This, together with our low corporate tax rates and no dividend withholding taxes, would greatly encourage more overseas holding (HQ) companies to relocate to the UK.

Looking back on your career to date, what key lessons have you learned?

Never rest on your laurels, do your best to keep up to speed technically and always put your clients first.

Tell us a secret.

I am fortunate to have a walled garden and as a consequence have been gardening organically for over 25 years. I find it mentally very relaxing; in fact, I firmly believe that in times of exceptional stress, it has helped me to keep my sanity. I once sat down and counted that my garden produces around 17 varieties of fruit and 15 varieties of vegetables.

September

26 Regulations: The Value Added Tax (Imported Goods) Relief (Amendment) Order, SI 2014/2364, and The Gaming Duty (Amendment) Regs, SI 2014/1930, come into force.

30 Consultations: Comments due on *Maximising economic recovery: consultation on a cluster area allowance*.

EU VAT refunds: Deadline for submitting claims against other EU authorities for EU VAT costs during 2013 calendar year.

October

1 Regulations: The Gaming Duty (Amendment) Regs, SI 2014/1930; The Corporation Tax (Instalment Payments) (Amendment) Regs, SI 2014/2409; The Tonnage Tax (Training Requirement) (Amendment) Regs, SI 2014/2394; The Value Added Tax (Amendment) (No 3) Regs, SI 2014/2430; The National Minimum Wage (Amendment) (No 2) Regs, SI 2014/2485; The Finance Act 2014, Schedule 37, Paragraph 22 (Commencement) Order, SI 2014/2461; and The Presumption of Death Act 2013 (Commencement and Transitional and Saving Provision) Order, SI 2014/1810, come into force.

2 UT hearing: *Spring Salmon & Seafood Ltd v HMRC* [2013] UKFTT 320 (TC): Company's appeal against decision on HMRC investigation into loss relief claim.

3 Regulations: The Income Tax (Earnings and Pensions) Act 2003 (Section 684(3A)) Order, SI 2014/2438, comes into force.

Draft regulations: Comments due on the following draft tax-free childcare regulations: the Childcare Payments (Eligibility) Regs, SI 2015/Draft; and the Childcare Payments Regs, SI 2015/Draft.

Consultations: Comments due on *Review of the oil and gas fiscal regime: a call for evidence*.

5 HMRC deadline: Deadline to notify HMRC of chargeability for income tax/capital gains tax for 2013/14 if not registered for self-assessment.

For a 'what's ahead' which looks further ahead, see taxjournal.com (under the 'trackers' tab).

Coming soon in Tax Journal:

- Challenging accelerated payment notices.
- Is the VAT mini-one stop shop worth bothering with?

THE ONES TO WATCH IN TAX ...

Take part in *Tax Journal's* '40 under 40' for 2015

Previous winners include:

Nicola Shaw QC, Gray's Inn Tax Chambers
'If I am going to counsel, I first think of Nicola as she would be my preferred choice for many areas of indirect tax – both in terms of technical knowledge but more so for attitude, commercial application and the overall client experience.'



Paul Davison, Partner, Freshfields Bruckhaus Deringer
'Paul is great at instilling confidence in us. You know that when you ask Paul a question, you will get the right answer – well considered and technically justifiable. Consistently outstanding.'



Kate Alexander, Partner, EY
'She was outstanding to work with, and went above and beyond the call of duty, both from a technical standpoint and overall organisation. Top level technical ability, commercial instincts and client relationship skills.'



Tom Jarvis, Director, Deloitte
'He went above and beyond to assist us, came up with creative and practical solutions to problems and worked extremely well with a multi-disciplinary, multi-jurisdictional team, even at absurd hours of the morning.'



Darren Oswick, Partner, Simmons & Simmons
'An all-round nice guy with a very open and professional approach. Darren is a credit to the legal profession. A very reliable and commercially minded adviser, who is always prompt and committed to customer service.'



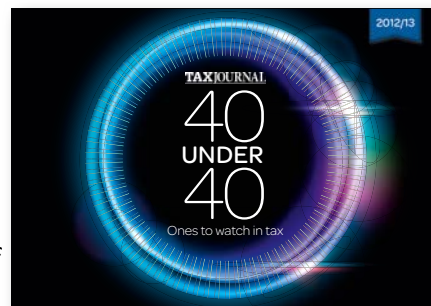
William Arrenberg, Partner, Herbert Smith Freehills
'Will has limitless energy and commitment, coupled with fantastic technical knowledge and a commercial mind. His ability to simplify complex tax matters is a valuable skill and one that ensures he remains a key adviser.'



Tax Journal is delighted to announce the launch of '40 under 40' for 2015.

What is '40 under 40'?

'40 under 40' for 2015 is *Tax Journal's* third guide to 40 leading tax professionals in the UK. What makes '40 under 40' different is the research methodology underpinning our selection – unlike some other awards and rankings, *Tax Journal* engages an independent research team whose findings form the basis of its selection.



Who can apply?

We are now accepting applications from tax and VAT professionals based in the UK (including those working in practice, in-house, at the Tax Bar and at HMRC and HMT). All applicants must be based in the UK and under the age of 40 on 1st January 2015. Previous winners/applicants can reapply, provided other conditions are met. Organisations making multiple entries should coordinate them.

Applications must be received between
15th September and 31st October 2014.

For rules and procedures, see

www.lexisurl.com/tax40

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