Report
Views from 100 tax experts on HMRC

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Our pick of the top 10 cases of 2015

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Michael Thompson, head of tax at Vinson & Elkins

TAX JOURNAL

Insight and analysis for the business tax community

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End of year review

Reflections on the tax world in 2015

HMRC and the changing compliance landscape

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Lessons in corporate tax

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The private client perspective

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Etienne Wong | Barrister | Tax Chambers, 15 Old Square

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Tim Law | Owner | Engaged Consulting

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Ask an expert: The advantages of growth shares

From the editor

2015 saw some profound changes to the tax world. Perhaps the most significant headline news took place at an international level, such that 'the OECD and EU should no longer be regarded as wallflowers at the party' (page 10). Closer to home, the ever-changing private client world sees proposed reform of the non-dom rules, and the new charge for non-residents on disposals of UK property (page 12). The continued rise in the number of VAT cases made 2015 'a good year for the VAT aficionado' (page 14). Meanwhile, HMRC is expected to do more with less. The drive for increased digital reporting (page 2) will undoubtedly help – and it will no doubt radically change the role of the high street tax adviser in the process. But perhaps what is really needed 'is an open consultation between government, HMRC, taxpayers and agents on what we, as a country, want HMRC to do and how it does this' (page 16).

Finally, I would like to thank all of this year's authors for their expert contributions. Thanks also to my editorial board for their support. And thank you for reading – I hope you've found this year's editions helpful. All that is left is to wish you a Merry Christmas and a happy and prosperous New Year.

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Our pick

Making tax digital: HMRC sets out plan to 'transform tax system by 2020'

HMRC has published its timeline for the introduction of digital tax accounts by April 2016 for individuals and a quarterly payment regime for all but the largest businesses by 2020. *Making tax digital* sets out HMRC's digital tax roadmap, which outlines that by 2020, HMRC plans to have have moved to a fully digital tax system.

The advantages are said to include the eradication of bureaucratic form-filling, such that taxpayers should never have to tell HMRC information it already knows. 'Unnecessary time delays will be eliminated', with the tax system operating much more closely to 'real time', keeping everyone up to date and removing the risk of missed deadlines, unnecessary penalties, debts arising and errors in the system being carried forward from one year to the next. And taxpayers will have access to digital accounts, with the information HMRC needs automatically uploaded, 'bringing an end to the tax return.'

By mid-December, HMRC says, more than a million customers completing their self-assessment will be directed to their online personal tax account (PTA) which will: provide a clear and joined-up view of the tax they pay and benefits they are entitled to; enable customers to update their tax details as they occur in real time (removing the need to resubmit information); and make it easier and more efficient to contact HMRC officials through services like web chat and virtual assistant.

HMRC will be running a series of consultation events in January and February 2016 on the implications for payment and reporting as well as its plans to make greater use of real-time data from employers and third parties as part of the 'making tax digital' move towards a more frequent payment regime across most taxes by 2020.

Speaking at HMRC's stakeholder conference in London, the Financial Secretary to the Treasury, David Gauke said: 'This government is determined to revolutionise how we deliver public services and the tax system is no exception. By 2020, HMRC will be a world-leading tax administration that is efficient, effective and easier for customers to use, enabled by £1.3bn of extra investment announced in November's Autumn Statement.'

For further details, including a discussion paper and illustrative case studies, see www.bit.ly/221jGUa.

Business taxes

Patent box proposals

HMRC has published a policy paper on the patent box following the release of draft FB 2016, along with draft clauses to make changes to the design of the UK patent box to comply with a new international framework for preferential tax regimes for intellectual property (IP) set out by the OECD's work on BEPS. The proposed changes will have effect for new entrants to the patent box regime on or after 1 July 2016, and also for some IP assets (e.g. patents) acquired on or after 2 January 2016.

IP not covered by the new patent box rules will continue to receive the benefit of the existing patent box for a period of five years, which is until 30 June 2021, except that some IP acquired on or after 2 January 2016 may only receive the benefit of the existing patent box until 31 December 2016. See www.bit.ly/1RnfSc8.

Accountancy firm RSM expressed concerns that latest proposals for changes to the patent box regime will have adverse implications for smaller, innovative businesses in the UK. Senior tax partner George Bull said: 'Effectively penalising businesses wanting to use related sub-contractors for legitimate commercial reasons will restrict their development activities and also create a more onerous administration system, meaning that UK companies – and in particular high-tech businesses and developers – will suffer additional costs just so that the patent box regime can meet the OECD's proposals.'

Bank levy consultation

HMRC is consulting until 4 March 2016 on proposals to change the scope of the bank levy from a global balance sheet basis to a UK balance sheet basis from 1 January 2021. For the condoc, *Re-scoping of the bank levy*, see www.bit.ly/1ZaFYjT.

Bank surcharge/DPT from 1 January

Finance (No.2) Act 2015 introduced a surcharge of 8% on the taxable profits of banking companies arising on or after 1 January 2016. Per HMRC's updated guidance on the diverted profits tax (DPT), there have been consequential amendments to the DPT legislation to apply DPT at a rate of 33% in cases where taxable diverted profits would have been subject to the surcharge. See www.bit.ly/12Qn0GK.

Draft FB 2016 regulations

The following are being consulted on:

- Until 8 January 2016: amending legislation identifying the lump sum payments made to individuals under the pension flexibility rules which an employer is required to report to HMRC under PAYE RTI, see www.bit.ly/1Nn019F;
- until 22 January 2016: a draft order to simplify the construction industry scheme (CIS) compliance test as one of three tests that subcontractors must satisfy to be registered to receive payments gross under CIS, see www.bit.ly/1TOducd;
- until 3 February 2016: NICs disregard for trivial benefits in kind (for low-value non-cash vouchers provided by an employer) from 6 April 2016, see www.bit.ly/1UvU24M;
- until 3 February 2016: tax exemption for low-value trivial benefits in kind provided by an employer to a former employee through an employer-financed retirement benefits scheme (EFRBS), see www.bit.ly/1UvU24M; and
- until 5 February 2016: introduction of mandatory online filing of CIS contractors returns from April 2016 (subject to certain exceptions) and for contractors to use approved electronic methods to verify a subcontractor's tax status with HMRC from April 2017, see bit.ly/1O6Moin.

Employer-provided accommodation: call for evidence

HMRC is consulting until 3 February 2016 on the provision of accommodation to employees, seeking information including the reason for, and type of, accommodation provided and which jobs still require such provision. This consultation supports the OTS review of employee benefits and expenses. See www.bit.ly/1ZaN3ku.

Personal taxes

Self-employed NICs

The government is consulting until 24 February 2016 on proposals for abolition of class 2 NICs and introduction of a new contributory benefit test for class 4 NICs. See www.bit.ly/1m5a1Lw.

No change in Scottish rate of income tax

The Scottish government announced on Wednesday 16 December that the Scottish rate of income tax (SRIT), which comes in from 6 April 2016, will initially be set at 10p in the pound, meaning no change in the rate. HMRC has already begun writing to potential Scottish taxpayers to confirm the accuracy of records for the taxpayers who live in Scotland and who will pay the new SRIT. Scottish taxpayers will also receive a new tax code beginning with the letter 'S'.

People and firms

Chancellor George Osborne has appointed **Angela Knight**, a former lobbyist for the banking and energy sectors, to help simplify the tax code as chair of the **Office of Tax Simplification**. She was awarded a CBE for services to the financial industry in 2007 and served as a Conservative MP from 1992 to 1997.

Elsa Littlewood joins **RSM UK** as a private client tax partner in the firm's Swindon office. She joins from Monahans, where she led its rural business and landed estates group in Swindon; and prior to that worked at Deloitte and in industry.

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

Stamp taxes

SDRT 'deep in the money' consultation

HMRC is consulting until 3 February 2016 on draft legislation for Finance Bill 2016 which seeks to counter avoidance arising on the transfer of shares using 'deep in the money' options (DITMOs) by charging the 1.5% higher rate of stamp duty or SDRT on the higher of the market value or the option strike price at the relevant date. See www.bit.ly/1O7sELz.

VAT

Partial exemption changes following *Crédit Lyonnais*

The Value Added Tax (Amendment) Regulations, SI 2015/1978, implement VAT changes following the CJEU decision in *Crédit Lyonnais*. From 1 January 2016, UK businesses using the standard partial exemption method will no longer be able to recover input tax in respect of supplies made by foreign branches. Recovery may be allowed for special methods based on sectors, provided the method reflects the use made of goods and services and the type of activity undertaken in each sector. *Revenue & Customs Brief 22/2015* provides related guidance.

Further VAT grouping rule changes following *Skandia*

HMRC has received additional information about the Netherlands and Spain, neither of which are now expected to apply 'establishment only' VAT grouping that would trigger the UK VAT changes. Where the position in any member state is uncertain, businesses should apply the changes as set out in *R&C Brief 18/2015* from the date 'establishment only' VAT grouping is introduced in that country, if this is after 1 January 2016. See *Revenue & Customs Brief 23/2015*.

Energy-saving materials reduced rate consultation

HMRC is consulting until 3 February 2016 on draft legislation for Finance Bill 2016 which amends the application of the UK's 5% reduced VAT rate on the installation of certain energy saving materials, to comply with a recent European Court decision. The government intends the changes to come into effect from 1 August 2016. See www.bit.ly/1IGpiwr.

International taxes

State aid investigation

The EC has requested more information from Ireland in its ongoing investigation into whether Irish tax rulings granted to Apple were illegal state aid.

US concerns over EU state aid investigations and inversions

The US House Ways and Means Subcommittee on Tax Policy, alongside the Senate Finance Committee, held hearings on 1 December on international tax covering: the implications for US tax policy and US-based companies of the outcome of the OECD's BEPS work, EC state aid investigations and ways to successfully deter the growing trend of tax inversions. Robert Stack, US Treasury deputy assistant secretary for international tax affairs, told the hearings that imposing tax retroactively in EU state aid cases would be unfair and that the US Treasury had not yet decided whether taxes recovered by EU member states from multinationals as a result of the investigations would be considered as foreign tax credits for US tax purposes.

Automatic exchange of information

On Tuesday, the EC adopted new rules to make it easier for EU member states' tax authorities to exchange financial information so that they can ensure full tax transparency and cooperation. The detailed rules mean that the practical arrangements are now in place for the entry into application of the amended Directive on Administrative Cooperation from 1 January 2016. From that date, information will be exchanged between member states' tax administrations on all relevant financial income including interest, dividends and other similar types of income. Information on account balances, sale proceeds from financial assets and income from certain insurance products is also part of the scope.

Separately, the EU confirmed it has signed an agreement with San Marino for the automatic exchange of tax information with effect from 2017. Switzerland and Liechtenstein have also recently signed similar agreements, while Andorra and Monaco are expected to follow.

Administration & appeals

New HMRC taskforce targets sex industry

A new UK-wide HMRC taskforce has been launched to target adult club owners and adult entertainers who have not paid their taxes. HMRC said that the rise of the internet has caused a drastic increase in online escort agencies and HMRC estimated in 2010 that the adult entertainment industry could be worth up to £5bn. The taskforce targets the traders and entertainers – some of whom earn thousands of pounds a day – working in the industry who continue to operate in the 'hidden economy' and not register with HMRC for VAT, income tax and PAYE.

CIOT welcomes offshore tax evasion offence threshold change

The CIOT has welcomed the government's decision to restrict the use of a new 'strict liability' offshore tax evasion criminal offence to situations where the amount of tax underpaid is £25,000 or more.

Jon Preshaw, chairman of the CIOT's Management of Taxes Sub-Committee, said: 'We continue to have concerns over this new offence, which risks criminalising careless mistakes. However the announcement that there will be a threshold of "not less than £25,000 of tax lost per tax year" reassures us that ... the new offence will only be used in the most serious of cases. This increase in the proposed threshold ... should ensure that in most circumstances ordinary taxpayers making unwitting mistakes are not caught.'

Direct recovery of debts regulations

The Enforcement by Deduction from Accounts (Imposition of Charges by Deposit-takers) Regulations, SI 2016/Draft, are open for consultation until 8 January 2016. They set out when banks and building societies may pass on an administrative charge to debtors for processing a HMRC direct recovery of debt 'hold' notice.

Also, the Enforcement by Deduction from Accounts (Prescribed Information) Regulations, SI 2015/1986, come into force on 25 January 2016 following HMRC consultation. They specify the information deposit-takers will have to provide on receipt of either an information notice or hold notice, to enable HMRC to determine whether direct recovery of a tax debt from a taxpayer's bank account is appropriate, under the new powers in F(No. 2)A 2015 Sch 8.

Draft Finance Bill 2016

For a review of draft Finance Bill 2016 provisions, visit www.taxjournal.com. Details will be published in the print journal in the new year.

Case of the year

Pendragon on VAT abuse

In ***Pendragon and others v HMRC*** [2015] UKSC 37 (10 June), the Supreme Court, reversing the decision of the Court of Appeal, found that a scheme to avoid VAT on the resale of demonstrator cars was abusive.

The object of the scheme was to ensure that companies in a car distributor group were able to recover input tax incurred on the price of new cars acquired as demonstrator cars, while avoiding the payment of output tax on the sale of these cars to consumers. The issue was whether it was abusive under the *Halifax* principle.

The KPMG scheme involved the sale by the distributors of newly acquired cars to captive leasing companies (CLCs); the leasing of the cars by the CLCs to the distributor's dealerships; the assignments of the leasing agreements and titles to the cars to a Jersey bank (SGJ); the sale by SGJ of its hire business as a transfer of a going concern (TOGC) to a company of the distributor group (Captive Co 5); and, finally, the sale of the cars by Captive Co 5 to customers.

The success of the scheme relied primarily on the VAT (Cars) Order, SI 1992/3122, article 8, which provides that dealers in second-hand goods are allowed to charge VAT not on the whole consideration for the sale of the goods, but on their profit margin only.

The Supreme Court thus observed that the effect of the KPMG scheme was to enable the Pendragon Group to sell demonstrator cars second hand under the margin scheme, in circumstances where VAT had not only been previously charged but fully recovered, so 'that no net charge to VAT was ever suffered, except on the small or non-existent profits realised on the resale'. The Supreme Court concluded that a system designed to prevent double taxation on the consideration for goods had been exploited so as to prevent any taxation on the consideration at all. The first limb of the *Halifax* test was therefore satisfied; the scheme was contrary to the purpose of the legislation.

As for the second limb, the Supreme Court found that the transaction had the essential aim of obtaining a tax advantage. Two steps had been inserted which had had no commercial rationale other than the achievement of a tax advantage. The first one was the leasing of the cars by the CLCs to ensure that one of the gateways of article 8 applied: the assignment of rights under a hire purchase or conditional sale agreement. The second one was the acquisition of the business by Captive Co 5, so that the acquisition of the cars was brought within the gateway for assets acquired as part of a business transferred as a going concern.

As the scheme was an abuse of law, it fell to be redefined as a sale and leaseback transaction, followed by a sale to customers to which article 8 did not apply.

Why it matters: The court highlighted two difficulties of the *Halifax* principle. The first arose from the assumption that the principle will not apply to 'normal commercial transactions', as 'the VAT Directives must be assumed to have been designed to accommodate them'. This had led the Court of Appeal to find that the arrangements were not abusive. The second difficulty resulted from concurrent purposes. The question was then whether the commercial objective was enough to explain the particular features of the arrangements.

***Tax Journal*'s coverage: 'HMRC is likely to take great comfort from *Pendragon* and to attack existing and future VAT planning structures. The continued efficacy of offshore structures, as in *Newey* [2015] UKUT 0300, must be in doubt … One may also expect a degree of mission creep in the willingness of the Upper Tribunal to take an intrusive approach to factual evaluation by the FTT' (Michael Conlon QC and Rebecca Murray, *Tax Journal*, 26 June 2015).**

Why it's our case of the year: This case has it all – it went all the way to the Supreme Court; it may be about VAT but it is also an example of HMRC's 80% success rate before the courts and tribunals in avoidance cases; and it contains some rather ground-breaking comments about the jurisdiction of the Upper Tribunal.

Tax Journal's pick of the top ten tax cases of 2015, listed in chronological order.

European Commission v UK

In ***European Commission v UK*** (C-172/13) (3 February), the CJEU found that the UK legislation on cross-border group relief complies with EU law principles.

The European Commission was applying for a declaration by the CJEU that CTA 2010 s 119(4) makes it virtually impossible in practice to obtain cross-border group relief, so that the UK has failed to fulfil its obligations under TFEU articles 31 and 49.

Cross-border group relief is only available if the 'no possibilities test' is satisfied; that is, if the losses are not relievable in the country where the loss-making subsidiary is established. Under CTA 2010 s 119(4), the determination as to whether losses may be taken into account in the future must be made 'as at the time immediately after the end' of the accounting period in which the losses were sustained. According to the Commission, cross-border relief can therefore only be available if either carry forward of losses is not possible under the legislation of the country of residence of the subsidiary; or if the subsidiary is liquidated at that time.

However, the CJEU observed that the first situation mentioned by the Commission was irrelevant for the purpose of assessing the proportionality of s 119(4). In such a situation, the member state in which the parent company is resident may not allow cross-border group relief without thereby infringing article 49 (*K* (C-322/11)). As for the second situation, the CJEU considered that s 119(4) does not require the subsidiary to be put into liquidation before the end of the accounting period in which the losses were sustained. The provision only imposes a requirement to make an 'assessment' at that time. The Commission also submitted that the UK was in breach of TFEU articles 49 and 31 in that its legislation precludes cross-border group relief for losses sustained before 1 April 2006. The CJEU found, however, that the Commission had not established the existence of situations in which cross-border group relief for losses sustained before 1 April 2006 was not granted. The CJEU therefore rejected both complaints.

Why it matters: 'This judgment does limit claims for time expired losses. It will also at least delay settlement of claims for terminal losses where it only became evident at a later stage that the losses were terminal. But that part of the judgment is arguably narrow and may not do what HMRC will hope' (Rupert Shiers, *Tax Journal*, 12 February 2015).

Eclipse 35

In ***Eclipse Film Partners No. 35 v HMRC*** [2015] EWCA Civ 95 (17 February), the Court of Appeal found that Eclipse 35 had not been trading.

Eclipse 35, a partnership, and its members had entered into a complex series of transactions for the acquisition, distribution and marketing of film rights.

The members had borrowed money to contribute to the capital of the partnership.

They could only claim tax relief in respect of the interest if the loan was used wholly for the purpose of a trade carried on by Eclipse 35 (ITTOIA 2005 s 863 and ICTA 1988 ss 353, 362).

The FTT had found that Eclipse 35 had not played 'a meaningful part in the marketing and distribution of the films'; it had therefore not carried on a trade. The FTT's decision had been upheld by the UT.

The Court of Appeal noted that the transactions had two aspects. One aspect was that a payment by Eclipse 35 of £503m would be repaid with interest over a 20 year term and would produce a profit unrelated to the success of the exploitation of film rights. That aspect had the character of an investment. The second aspect was the possibility for Eclipse 35 to obtain a share of 'contingent receipts'. The court accepted the FTT's finding that the possibility of receiving such receipts was too remote for this aspect to be significant.

Finally, the court rejected the contention that the activity of entering into a licence and sub-licence inherently constituted the carrying on of a trade.

Why it matters: **Like the tax tribunals, the Court of Appeal accepted that the transactions were not 'shams'. However, this finding did not prevent the court from holding that 'on a realistic view of the facts' (applying the *Ramsay* doctrine), Eclipse 35 had acquired an investment rather than carried on a trade.**

'The court has confirmed that in assessing whether an activity amounts to a trade, it is necessary to consider the totality of what is done. The court has indicated that the concept of trade has a variety of meanings or shades of meaning' (Chris Bates and Judy Harrison, *Tax Journal*, 11 March 2015).

Samarkand

In ***Samarkand Film Partnership No. 3, Proteus Film Partnership and three partners v HMRC*** [2015] UKUT 211 (29 April 2015), the UT found that the partners were not entitled to loss relief and that they had not had a legitimate expectation that the relief would be available.

The issue was whether two partnerships, which had acquired and leased films under sale and leaseback arrangements, were entitled to loss relief in respect of losses which arose on the acquisition of the films. If so, their partners could claim sideways relief under ICTA 1988 ss 380 and 381 to set the losses against their taxable income from other sources.

The purchase of an asset which a person intends to exploit over a period of time is normally treated as capital expenditure. However, ITTOIA 2005 s 134 provides that in the case of a film, the expenditure should be regarded as revenue in nature. Furthermore, ss 138 and 140 allow loss relief to be claimed in advance of the normal rules. Relief is not available, though, if the expenses are not incurred wholly and exclusively for the purposes of a trade or if the losses are not connected with or arising out of a trade.

The UT found that the FTT had been entitled to conclude that the partnerships had not been carrying on a trade, so that no loss relief was available to the partners. This was so, even though a transaction of that type could have constituted a trade. In particular, it accepted the FTT's factual finding that the commercial nature of the agreements was 'the payment of a lump sum in return for a series of fixed payments over 15 years'.

No further arguments were required following the release of the Court of Appeal's decision in *Eclipse Film Partners* [2015] EWCA Civ 95 (see above), which recommended a 'realistic approach to the transaction'. Even if the partnerships had been conducting a trade, they would not have been doing so on a commercial basis, as the transactions were intended to produce a loss in net present value terms. This analysis was not affected by the fact that the individual partners were accruing 'extra benefits' as a result of the tax reliefs. Those reliefs were obtained by 'deliberately causing the partnership to trade in an uncommercial manner'.

The two judges disagreed as to whether, in any event, one of the partnerships had incurred the expenditure for the acquisition of a film (as opposed to that of an income stream). The president exercised its casting vote on this issue, finding that the partnership had incurred the expenditure for the purchase of a film. This was because it had acted bona fide in the belief that it was acquiring valuable rights.

The taxpayers also claimed judicial review on the ground that HMRC's denial of relief was at odds with its own published guidance in HMRC's *Business Income Manual* (*BIM*). The UT pointed out that unlike IR20, which was aimed to give taxpayers guidance on residence, the *BIM* was intended for the use of HMRC staff – although it was made available to the public. The UT observed that the *BIM* stressed in several places that the relief was aimed at tax deferral only.

Furthermore, the *BIM* included clear statements that transactions involving tax avoidance would be closely scrutinised and that the guidance may not be applied to them. The argument that this statement suggested that HMRC reserved the right to treat similar transactions differently was robustly rejected. 'Taxpayers may not like that statement but they could not say that they derived a legitimate expectation that was at odds with it.' Finally, the UT found that HMRC had reasonably thought that tax avoidance was at play. Several features indicated that the aim of the transactions was not tax deferment but tax avoidance.

Why it matters: **The appeal failed on both the 'trading issue' and the legitimate expectation issue. On the trading issue, the UT simply reiterated the points made by the FTT on the basis of its factual findings. On the legitimate expectation issue, the taxpayers could not rely on HMRC's description of a plain vanilla transaction (claiming that their arrangements were similar) and ignore the general statement about tax avoidance. They could not 'take out the plums they liked and ignore the duff they did not'.**

'The decision serves as a reminder to taxpayers of the extent to which they can rely on HMRC's manuals ... No matter how clear or unqualified a statement in HMRC's manuals might appear to be, it will be open for HMRC to depart from that guidance if it considers that tax avoidance is or may be involved, leaving the taxpayer in question with an uphill struggle to prove that it has a substantive legitimate expectation that should be protected' (Jeanette Zaman & Owen Williams, *Tax Journal*, 22 May 2015).

Littlewoods Ltd

In ***Littlewoods Ltd and others v HMRC*** [2015] EWCA Civ 515 (21 May), the Court of Appeal found that Littlewoods was entitled to compound interest on VAT wrongly paid.

Littlewoods had paid VAT which was not due. HMRC had repaid the principal amount together with simple interest. Littlewoods claimed that it was also entitled to compound interest. There were four issues. First, were Littlewoods' restitution claims excluded by VATA 1994 ss 78 and 80 as a matter of English law and without reference to EU Law? The CA found that the net effect of the provisions was that the only cause of action available to the taxpayer for the repayment of the principal sums was that afforded by s 80(1) and so restitutionary claims for repayment of VAT were barred by s 80(7). Furthermore, s 78(1) excluded common law claims for interest.

Second, did the exclusion of the claim by VATA 1994 violate the principle of effectiveness by depriving Littlewoods of an adequate indemnity for the loss occasioned through the undue payment of VAT? The court noted that 'adequate indemnity' was not a rigid 'straitjacket' which required compound interest in every case. However, s 78 did deprive Littlewoods of an adequate indemnity.

Third, ss 78 and 80 could not be construed so as to conform with EU law as the exclusion of common law claims for interest was a cardinal feature of the legislation. The provisions must therefore be disapplied. Furthermore, the court did not have the power to disapply the domestic bar to the enforcement of Littlewoods' rights on a selective basis. The choice of remedy therefore belonged to Littlewoods who chose to make a mistake-based restitution claim as this was not time-barred whereas a Woolwich claim would have been time-barred.

Finally, on quantum, the court found that HMRC should not be treated as if it were an involuntary recipient of overpayments of tax. Consequently, 'objective use value' applied to the valuation of the time value of the overpayments made to HMRC and compound interest was payable. Finally, interest should continue to run after the date of the repayment of the principal amounts of overpaid VAT on such amounts of accrued interest as remained outstanding.

Why it matters: This is the latest instalment of a judicial saga which includes two high court decisions and a preliminary ruling by the CJEU. The tax at stake is colossal; £1.2bn in compound interest. 'In rejecting HMRC's ingenious arguments, the court confirmed that even a substantial payment of statutory interest may not always provide a substantive safeguard for a claimant's EU law rights. Such rights must be asserted not by way of VATA 1994 but by a claim for restitution at common law. But, the battle continues…' (Michael Conlon QC, *Tax Journal*, 5 June 2015). Following the decision, the government introduced a new 45% rate of corporation tax on restitution interest payments (CTA 2010 ss 375YA–375YW inserted by F(No. 2)A 2015 s 38).

Anson

In ***Anson v HMRC*** [2015] UKSC 44 (1 July), the Supreme Court found that a member of a US limited liability company (LLC) was eligible for double tax relief in the UK on his share of the profits.

Mr Anson was resident but not domiciled in the UK for UK tax purposes. He was liable to UK income tax on foreign income remitted to the UK. He was a member of an LLC, which was classified as a partnership for US tax purposes. He was therefore liable to US federal and state taxes on his share of the profits. Mr Anson remitted the balance to the UK, and was therefore liable to UK income tax on the amounts remitted, subject to double tax relief. HMRC considered that Mr Anson was not entitled to double tax relief, on the basis that the income which had been taxed in the US was not his income but that of the LLC. Mr Anson contended that, even assuming that US tax was charged on the profits of the LLC and that he was liable to UK tax only on distributions made out of those profits, the US and UK tax were nevertheless charged on 'the same profits or income', within the meaning of the UK/US double tax treaty. He also argued that, as a matter of UK tax law, he was liable to tax in the UK on his share of the profits of the trade carried on by the LLC, which was the same income as had been taxed in the US.

The Supreme Court rejected the first ground, noting that the context of the treaty and its history did not suggest such a wide approach to the concept of income. However, in relation to the second ground, it found that Mr Anson was entitled to the share of the profits allocated to him, rather than receiving a transfer of profits 'previously vested in the LLC'. His 'income arising' in the US was therefore his share of the profits, which was the income liable to tax both under US law and under UK law – to the extent that it was remitted to the UK. His liability to UK tax was therefore computed by reference to the same income as was taxed in the US and he qualified for double tax relief.

Why it matters: The classification of foreign entities and of the profits they generate continues to raise difficult questions. In this case, the FTT had found that the members of the LLC had an interest in the profits as they arose; therefore, the Supreme Court found that double tax relief was due. Following this decision, HMRC published *Brief 2015/15*, which confirms that HMRC will continue to treat US LLC's as companies. This is on the basis that the decision was fact specific so that it does not need to be applied generally. The brief also explains that individuals relying on the decision in order to claim double tax relief will be considered on a case by case basis.

Larentia + Minerva

In ***Beteiligungsgesellschaft Larentia + Minerva mbH & Co. KG v Finanzamt Nordenham*** (C-108/14) and ***Finanzamt Hamburg-Mitte v Marenave Schiffahrts AG*** (C-109/14) (16 July), the CJEU found that holding companies can deduct input tax to the extent that they are involved in the management of their subsidiaries.

Larentia + Minerva had acquired 98% of the shares in two subsidiaries – constituted in the form of limited partnerships – which it provided with administrative and business services. Marenave had increased its capital and acquired shares in four 'limited shipping partnerships', and was involved in their management. The issue was the extent to which deductions were allowed, in relation to input tax incurred on acquisition and issue costs.

The CJEU observed that the holding of shares is not an economic activity, unless the holding is accompanied by direct or indirect involvement in the management of the company. Furthermore, for VAT to be deductible, the input transactions must have a direct and immediate link with the output transactions giving rise to a right of deduction.

The CJEU concluded that the expenditure connected with the acquisition of shareholdings in subsidiaries incurred by a holding company which involved itself in their management – and which, on that basis, carried out an economic activity – must be regarded as attributed to that company's economic activity; and therefore that VAT incurred on that expenditure was deductible. The deduction of VAT would only be limited if the costs were attributed in part to other subsidiaries, in the management of which the holding companies were not involved. Finally, the CJEU found that the Sixth Directive article 4 precludes national legislation which reserves the right to form a VAT group solely to 'entities with legal personality and linked to the controlling company of that group in a relationship of subordination'; except where those two requirements are appropriate and necessary to prevent abusive practices or to combat tax evasion or tax avoidance.

Why it matters: This decision confirms that VAT incurred by holding companies involved in the management of their subsidiaries is deductible. 'The decision is another dramatic shift in the recovery of VAT on costs incurred in the acquisition of subsidiaries' (Michael Conlon QC and Rebecca Murray, *Tax Journal*, 6 August 2015). See also page 14.

Rowe

In ***Nigel Rowe and others v HMRC*** [2015] EWHC 2293 (31 July), the High Court found that partner payment notices (PPNs) had been validly issued by HMRC.

The 154 claimants had all participated in Ingenious Media schemes, which HMRC alleges, were designed to generate tax losses. The claimants' substantive appeals are being litigated in the FTT and HMRC has issued PPNs (under FA 2014 ss 219–229). The taxpayers contended that the PPNs were unlawful and of no effect for the following reasons: (1) The statutory scheme was unfair, as the claimants had not been afforded the opportunity to make representations as to why the sums demanded under the notices were not due and owing. (2) The notices were ultra vires because Condition B (s 219) was not satisfied. The amounts claimed were shares of losses and did not result directly from an increase or reduction of an item in the partnership return. (3) The notices had been given in breach of the claimants' legitimate expectations that they would not have to pay any tax in dispute until after the FTT had decided all relevant issues. (4) The decision to give notices was irrational, as HMRC had not properly exercised its discretion. (5) The issue of the notices had been in breach of the European Convention for the Protection of Human Rights (ECHR) article 1 of the First Protocol (right to protection of property)

(A1P1) and article 6 (right to a fair trial).

The High Court found that the statutory scheme was not unfair, since the situation created by the PPN was only temporary. Furthermore, recipients of PPNs were afforded the opportunity to make representations; however, such representations could not extend to the merits of the substantive appeal as contended by the appellants.

The court also found that the PPN scheme operated regardless of the mechanics of the tax advantage. The offset loss claimed by the taxpayers therefore fell within the scope of the legislation.

Additionally, no legitimate expectation was established, in the absence of a well recognised practice by HMRC of making 'carry back' repayments. In any event, the new provisions expressly removed pre-existing rights.

The ground that HMRC's decision had been irrational also failed, on the basis that 'there is nothing wrong with a general rule that when the statutory criteria are met, the discretion will be exercised by issuing the notice, save in exceptional circumstances'. Furthermore, the requirement to pay tax which had been avoided for ten years through the implementation of a scheme did not amount to 'significant human suffering'. Finally, the taxpayers' claim under their substantive appeal was not a property right for the purpose of ECHR; and art 6 did not apply when the state determined a person's liability to pay tax.

Why it matters: **The taxpayers essentially challenged the legality of the advance payment statutory scheme. They were robustly rejected by a High Court, which reiterated the notion that taxpayers who engage in tax planning should make provision for the eventuality that the tax may become payable. '*Rowe* is an important watershed. It provides an opportunity to consider whether the grounds of appeal should be refined. Should further information be requested from HMRC? Should claimants provide further evidence of their individual circumstances? ... Will the new regime encourage HMRC to delay matters once the moneys are sitting in its bank account?' (Michael Conlon QC and Julian Hickey, *Tax Journal,* 4 September 2015). The taxpayers have since been given leave to appeal and the case will be heard by the Court of Appeal by 12 December 2016.**

Lloyds Bank Leasing (No. 1) v HMRC

In ***Lloyds Bank Leasing (No. 1) v HMRC*** [2015] UKFTT 401 (14 August), the FTT found that the obtaining of capital allowances had been one of the main objects of a transaction, so that tax relief was not available.

Lloyds Bank Leasing (LBL), a finance leasing company, had incurred nearly £200m in expenditure on the purchase of two ships. The issue was whether the main object, or one of the main objects, of the relevant transaction – which had included the letting of the ships – had been to obtain writing-down allowances. If this was the case, capital allowances should be denied under CAA 2001 s 123(4).

The FTT noted that the draftsman had not intended to confine the application of s 123(4) to those who enter into artificial or contrived arrangements, or to transactions with no other purpose than the securing of an allowance. It added that the subjective purpose of the 'shaper' of the transaction must be examined.

The FTT explained that in the paradigm case (a case which unambiguously falls under the common definition of the term), s 123(1) was intended to apply to a ship purchased outright by an established UK shipping company and leased to an overseas customer. The purpose of s 123(4) was to exclude from the benefit of the allowance those transactions which did not fall within the paradigm. The FTT found that the evidence could only lead to the conclusion that the agreements were structured as they were not only for commercial reasons, but also in order that the requirements of s 123(1) should be met; therefore, the securing of the allowances was a main object of the transactions.

Why it matters: **Here is a tax case in which it was agreed that the transactions had a 'paramount' commercial purpose, and yet the FTT (at its second attempt) held that a main object of 'at least some of the transactions' was to obtain capital allowances, and so those allowances would be denied. 'The discussion on what constitutes a "main object"', and the approach of the FTT to the evidence, is likely to be useful in other disputes. However, a large proportion of current disputes relate not to capital allowances but to loan relationships [where there is a separate test]. This case may, therefore, not take HMRC quite as far as it would like in challenging transactions where a special purpose company has been inserted into a financing transaction' (Heather Self, *Tax Journal*, 11 September 2015).**

Murray Group Holdings

In ***Murray Group Holdings and others v HMRC*** [2015] CSIH 77 (4 November), the Court of Session found that monies paid via trusts were taxable as earnings.

The Murray Group had implemented a scheme designed to avoid PAYE and NICs on payments of benefits to two categories of employees: executives; and footballers. Under the scheme, a group company would make a cash payment to a principal trust, which would resettle the amount to a sub-trust for the income and capital to be applied according to the wishes of the employee. The monies would then be lent by the sub-trust to the employee. The issue was whether the monies were earnings for the purpose of ITEPA 2003 s 62.

As a preliminary issue, the Court of Session had to decide (inter alia) whether it had judicial knowledge of English law. It found that it did, as any other interpretation would be 'highly artificial'. Furthermore, this would not lead to any practical difficulties as the relevant concepts of trust, contract and loan are 'broadly similar' under Scottish and English law, and the parties would present 'careful and informed submissions on English law'.

The court noted that 'the critical feature of an emolument and of earnings as so defined is that it represents the product of the employee's work – his personal exertion in the course of his employment'. This remained so even if the income was paid to a third party. It was also irrelevant that the redirection of the income took place through the medium of trusts. Both the FTT and the UT had overlooked this principle. 'The redirection of earnings occurred at the point where the employer paid a sum to the trustee of the principal trust, and what happened to the monies thereafter had no bearing on the liability that arose in consequence of the redirection.' It was also immaterial that the employee had no contractual entitlement to the sums paid to the trustees of the principal trust, as gratuities are subject to income tax.

Furthermore, following *Arrowtown Assets* [2003] HKCFA 46, it was 'imperative to determine the true nature of the transaction viewed realistically'.

Why it matters: **This latest instalment in the Rangers EBT case may not be the final one, as the Murray Group may appeal to the Supreme Court. In any event, such arrangements may now be caught by FA 2011 Sch 2. However, 'HMRC is likely to use it to vigorously pursue companies which did not take up the EBT settlement opportunity' (Karen Cooper and Mairi Granville-George, *Tax Journal,* 20 November). 'The court applied a redirection of earnings principle to treat payments made by the employer to EBTs as taxable earnings. The decision does not introduce a new principle but is instead a classic application of a 1904 case. Furthermore, the disguised remuneration rules may not apply to an EBT resulting from the redirection principle. Under that principle, the employee is the settlor, not the employer. HMRC is unlikely to agree, however, so some caution is required about future developments' (Nigel Doran, *Tax Journal*, 4 December 2015).**

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

Analysis

HMRC and the changing tax compliance landscape of 2015

Speed read

The House of Lords review, particularly around statutory instruments, may curtail the challenge role of peers, while the new HMRC charter committee also seems to cut back on challenges for HMRC. At the same time, new powers for HMRC are evolving at a great rate, including the worrying strict liability where no intent is required, stronger penalties and new data powers as the CRS is about to come on stream. Will a move towards quarterly reporting really meet the hunger for more data, better compliance and digitalisation? Or will it merely result in earlier tax payments?

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The end of the year inevitably brings out a blend of nostalgia and hope in all of us. The tax world is not immune from this seasonal rite and provides the opportunity to replay some recent developments, rehearse what might be coming and generally be more thoughtful about tax.

There have been some cracking combinations of headlines about HMRC this last year, from the press release accompanying its annual report, 'Another good year for HMRC', through to the *Financial Times*'s comment on the Public Accounts Committee report, 'HMRC under fire for attitude to taxpayers'. One might have thought these were talking about different organisations, rather than about the same one seen from each end of the telescope.

However, I am not here to take cheap shots at HMRC. Which of you, readers, would like to lead HMRC through the rest of the decade to attain its tough targets? These include aims to increase tax collected, reduce costs and slim headcount, while maintaining relations with the unions, cutting tax evasion – even when activity takes place outside our jurisdiction – and moving into the 21st century in terms of digitalisation. And achieving all this while also juggling the longest tax code in the world and keeping a media with a thirst for tax stories on its side.

Henry VIII and all that

One very recent development triggered a 'they cannot be serious' comment. An article in the *FT* announced that Lord Strathclyde, who is currently reviewing the role of peers, is expected to propose that the Lords should lose its veto over delegated or 'secondary' legislation. This was no doubt triggered by the recent tax credit debate – a debacle for the government.

There has been a long held concern in the tax profession about the sections inserted into primary legislation that enable HM Treasury to issue statutory instruments (SI). Some of these sections permit the issue of new powers with wide impact. Known as 'Henry VIII clauses', on account of their unfettered power, these are dotted throughout the legislation, particularly among the powers introduced under the 2005–2012 review.

While the House of Lords rarely uses its veto, and its position with 'money matters' is weak, abolishing the Lords' veto may mean that it loses the nuclear weapon from its armoury. Consequently, its usually measured view (often along the lines of the House of Lords Secondary Legislation Scrutiny Committee choosing to 'draw the special attention of the House to…') may carry less weight, increasing the potential for a government to advance poorly thought through or unclear measures with less Parliamentary scrutiny, let alone public consultation.

In practice, having that extra layer of scrutiny permits ministerial assurances to be sought on how an SI will be implemented. In addition, effectively abolishing it could encourage a future HMRC to ask for, and a government to accede to, more measures being legislated by SI rather than by primary legislation. Surely less scrutiny cannot be good in the long term.

King John and the charter

No doubt like many other tax practitioners, I read the job specification for the 'independent members' on HMRC's refreshed charter panel. As someone with many years' experience in tax policy, who has worked in a variety of practices and run a business, I wondered, for a moment, if I might have something to offer, alongside my current role, to help HMRC. How wrong could I be?

> Challenge is never comfortable, but surely constructive challenge is necessary to attain improvement

The spec was clearly not aimed at many of us with much past and current experience of the tax world. Challenge is never comfortable, but surely constructive challenge is necessary to attain improvement. Will HMRC think again about who it invites into its tent to help make a difference?

Queen of Hearts

Those who can remember doing their CIOT exams a decade or more ago may recall how little time was spent on tax administration. Oh, how times have changed. The plethora of HMRC powers adds significant extra weight in our *Yellow* and *Orange tax handbooks*.

Writing this on 'L-day', I have the luxury of being able to look back and forward at recent and planned changes. Though having only had a glance through the detail of the draft clauses, this forces a big picture view of the latest developments.

Direct recovery of debt is now in force. Rejected in 2007 as impracticable, it has come into force in the second 2015 Finance Act with barely a whimper. Let us hope that its use is strictly limited to the 'can pay, won't pay' that HMRC says it wants to use it against.

Talking of strict, the Autumn Statement confirmed that several other powers consulted on over the summer are to be introduced in Finance Bill 2016, many of which appear in the new draft clauses. Firstly, there is the Queen of Hearts power – not quite an 'off with their heads!' measure, but certainly a strict liability criminal offence for the 'most serious cases' of failing to declare offshore income and gains, for which there will be no need for HMRC to prove intent. It's good to see that HMRC has listened, to the extent of raising the threshold to £25,000.

Secondly, there will be new higher civil penalties for deliberate offshore tax evaders, including a new penalty linked to the value of the asset on which tax was evaded and more public naming of tax evaders.

Thirdly, civil penalties are to come in for those who enable offshore tax evasion, including public naming of those who have enabled the evasion. A significant and welcome provision in the draft clause is that not only must the enabler have carried out a deliberate action which assisted the evasion, but he must have known when his actions were carried out that they enabled, or were likely to enable, the other person to carry out offshore tax evasion.

These measures, together with GAAR and other penalties, naming and further criminal offences, will make the UK a very tough place for anyone attempting to evade tax. This should level the playing field in favour of the compliant, yet even those who always try to be compliant feel uncomfortable when working within such a regulated framework. This is especially relevant to areas such as tax planning and whether it strays into GAAR territory. The amount of compliance training within organisations will need to increase, meaning we will still all be paying for this.

Crown Prince

Offshore disclosure is also stepping up a gear. The existing offshore disclosure facilities for Liechtenstein and the three Crown Dependencies are to close on 31 December 2015. The former was an experiment for both Liechtenstein and HMRC and has to some extent been very successful in bringing in otherwise undisclosed tax to HMRC. It has also put Liechtenstein firmly on the map. There are, however, only a few days left for any taxpayers wishing to make use of these facilities to register – or face a formidable alternative.

HMRC plans to consult on a new statutory requirement for taxpayers to disclose and correct any offshore compliance issues within a defined window. For those who do not, there will be tougher sanctions, including a fixed penalty of 30% of the tax owed for all relevant years and no immunity from criminal investigation.

Big data: context is king

HMRC also has an insatiable hunger for gathering data and is continuing to invest in software. Its Connect system now continues to evolve, matching up data that could not have been linked in the years of manual interrogation. This development is continuing apace – and needs to do so, given the volume of data on its way to HMRC with the common reporting system (CRS) coming on stream over the next couple of years and new data gathering powers in the draft clauses. Yet it seems quite inequitable that HMRC has devoted resources to seek yet more powers, while still not producing guidance well in advance of the start of the CRS in 2016.

Having information about an individual's overseas assets, which were previously unknown to HMRC, permits it to approach overseas authorities to seek further information. The CRS may be just the tip of the iceberg and the key to what lies underneath, representing a sea change in how compliance work will evolve.

Next in line

And what else is coming down the track? Given HMRC's need to reduce its headcount and also the tax gap, it is not surprising that it has been looking at how taxpayers interact with it. HMRC says it already handles over one billion online transactions per year and stores more information than the British Library. It plans to encourage more online submissions and payments, further automation and less need for human interaction with taxpayers. So how will this pan out?

> It will be vital to have better interaction between HMRC systems and agents

The Autumn Statement referred to the apparent leap in logic from more digitalisation and greater simplicity (both fine in themselves) to more, i.e. quarterly, returns to HMRC from all but the very largest businesses.

Given many people's propensity to run their lives through smart phones and apps, it is only natural that HMRC wants to make the most of this and encourage businesses to record everything digitally and send it to HMRC in that format. Keeping good records can aid compliance – we all have anecdotal evidence of that.

However, the move to quarterly profit returns has yet to be fully explained. The idea seems to be a leap of faith and having all this in place within a very short space of time would require a huge commitment from HMRC, tax agents, the software industry, the tax technology people within many firms and, last but not least, almost all businesses. Feeling the effects will be organisations ranging from the smallest self-employed business through to large partnerships and corporates, which already wrestle with international accounting standards, cross-border transactions, transfer pricing reporting and other complications.

We do need to embrace the new digital tax world, but equally it needs to have an achievable roadmap. The problems that are still occurring with RTI indicate that HMRC must not rush this if it is to take the business community with it.

Before the new digital reporting can take off, it will be vital to have better interaction between HMRC systems and agents, who are getting increasingly frustrated at not being able to do things their clients can do. We may have the software at our end and HMRC at theirs, but the systems need to join up and speak to each other, designed with all users in mind.

Final thoughts

Is it time for HMRC to be more transparent about its problems and what it is trying to do and why? Is it time for taxpayers and tax agents to be more transparent? Is it time for the tax profession to be the critical friend – helping HMRC as well as challenging it? Is it time to celebrate the New Year? ■

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- AS 2015: HMRC's misplaced faith in digital compliance (Paul Aplin, 26.11.15)
- Priorities and challenges for HMRC in 2015 (Lin Homer, 8.1.15)
- News: Damning PAC report finds HMRC 'still failing UK taxpayers' (5.11.15)
- Summer Finance Bill: Direct recovery of debts (Tina Riches, 30.7.15)

Analysis

Lessons from the corporate tax trends of 2015

Speed read

The journey currently being undertaken by corporate tax globally has picked up speed. Companies and their advisers need to adopt new rules of engagement as they plan for corporate tax in 2016. They must focus even more on the effective rate as base broadening continues. They need to be vigilant for new taxes hitting companies. The OECD and the EU must be regarded as increasingly important stakeholders, and behavioural issues will fall under a greater spotlight than ever before. All in all, we may be reaching a fork in the road for corporate tax planning.

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The journey currently being undertaken by corporate tax globally has picked up speed in 2015. That journey is gradually transforming the role played by corporate tax (by which I mean tax on corporate profits) in the overall revenue raising programmes of governments worldwide, as well as the ways in which corporate tax is effectively raised. When a lot of change is going on simultaneously, it becomes harder to keep track of where things are heading. However, I do think it is possible to see some trends developing.

What are those trends, and what do they mean for corporates and their advisers as they take stock, and then look forward? What follows is a purely personal view.

Rule 1: Look past the headline rate

The global trend for some time now has been for rates of corporation tax to reduce, while the base has been broadened. To state the obvious, the latter helps to pay for the former.

It might have been expected that by now the so-called race to the bottom had been largely run, but even over the least year or so we have seen further CT rate reductions announced or implemented by countries such as Australia, Japan, Denmark, Portugal, Spain and, of course, the UK. This has not, however, been accompanied by any forecast decrease in the revenue take – usually the opposite.

That is because the base has continued to be broadened, and this shows few signs of slowing down. US-based multinationals have long appreciated the difference between the headline rate (punitive) and the effective rate (surprisingly low). All corporates, and their advisers, need to factor into their planning the global base broadening agenda.

Take the UK as an example. By 2020, over a ten-year period the CT rate will have fallen by a startling amount – from 28% to 18%. In some respects, the regime has become even more competitive, particularly with the ‘territorial’ approach to dividend exemption and the recast CFC rules. Overall, though, the trend has been and is to broaden the base. This is achieved through a mass of avoidance measures, the withdrawal or restriction of incentives (capital allowances, the patent box, goodwill relief) and, most starkly, by a restriction of base erosion via deductible interest. The UK is still a generous regime in comparative terms for the deductibility of corporate interest. That is changing, though – think of bank loss carry-forward, the hybrid proposals and the current corporate debt consultation.

> The UK is still a generous regime in comparative terms for the deductibility of corporate interest. But that is changing…

Of course, it has always been the effective rate which matters. However, as headline rates continue to reduce, at the same time as much conventional BEPS planning runs out of track, it is becoming ever more important to look critically at the projected base and the effective rate which follows.

Rule 2: Don’t just focus on corporate tax

For those of us who have been working in the tax world for a long time, it can be hard to adjust to the declining relative significance of corporate tax. To take only one example, the debate and action in relation to BEPS has tended to reinforce the impression that corporate tax is hugely important – perhaps the most important tax around. So, avoiding it, minimising it or paying the ‘fair share’ of it is a huge deal, and should sensibly be the primary focus of companies, their advisers and other stakeholders such as tax authorities or the OECD.

For a number of reasons, that view is too simplistic.

First, in most countries, corporate tax raises a relatively low proportion of total revenue. In the UK, for instance, the forecast published in March 2015 by the Office for Budget Responsibility predicted that for 2014/15 corporation tax would raise around 7% of total tax receipts. This means that it is of relatively limited significance as a source of raising revenue, or as a concern in relation to any ‘gap’. Perhaps governments should focus more (as some clearly have) on indirect and employment taxes than the political football of corporation tax. It also means that when companies emphasise their ‘total tax contribution’ to an economy, and not just the corporation tax they pay, they actually have a point.

Secondly, and partly as a corollary of this, companies need increasingly to plan for, or react to, tax changes other than corporate tax. In the UK, the staged reductions in the rate of corporation tax, coupled with the ‘tax lock’ on the rates of income tax, VAT and NIC, leaves the chancellor with three ways of raising more tax. He can broaden a tax base, he can increase a ‘non-locked’ tax or he can invent a new tax. Base broadening of corporation tax is rule 1. As to new taxes which directly affect companies, planning will now need to take account of the diverted profits tax, and the apprenticeship levy announced in the Autumn Statement. Doubtless more will follow.

Rule 3: Don't ignore the wallflowers

For many years, companies and their advisers have spent their time at the stakeholders' cocktail party cornering the tax authorities and nodding politely over their shoulders at the supranational bodies. They need to adjust, as bodies such as the OECD and the EU should no longer be regarded as wallflowers at the party.

When the OECD launched the BEPS initiative, many were sceptical. If stand-alone consultations – such as those on intangibles or business restructuring – had largely failed to produce concrete action, how could such an ambitious and comprehensive programme ever hope to succeed?

The outcome serves as a reminder that timing is everything. The BEPS initiative was launched at a time when the negative publicity in relation to multinational tax planning was being harnessed by various governments to gain political backing for revenue raising change. The OECD's programme of proposals is undoubtedly having some success on a multilateral basis, particularly in relation to reporting and transparency issues, but its greater success has been in acting as a catalyst and engine for change. In some cases, the change has been in tax authority behaviour; there is evidence that some jurisdictions have in effect begun to implement the OECD proposals in areas such as transfer pricing as if they had already become law. In other cases, countries have jumped the gun with unilateral actions in relation to BEPS, contrary to the OECD approach. Step forward the diverted profits tax. Less controversially, the UK's commitment to introducing hybrid debt and hybrid instrument rules is a good example of the importance of timing. As the UK wants to broaden the CT base, while still having fewer aggregate restrictions on cross-border debt planning than, say, France or Germany, the hybrid proposals are timely. Overall, there is no doubt that the OECD's importance in corporate tax development has increased, and may continue to do so.

> Bodies such as the OECD and the EU should no longer be regarded as wallflowers at the party

The trend of CJEU decisions seems to have shifted away from favouring the taxpayer. The EU, however, has assumed prominence in the corporate tax world recently for different reasons. The state aid investigations are a reminder that great care is needed in obtaining rulings for cross-border planning. Regardless of the eventual outcome of those investigations, no company would take lightly the publicity implications of such an exercise.

Rule 4: Good global cop, bad global cop

One of the underlying tenets of the OECD BEPS initiative is that behaviour which erodes the global tax base is bad, regardless of any lack of clarity as to which country's tax is being eroded. The creeping success of the OECD initiative marks a greater willingness by some countries to introduce rules which effectively endorse this approach.

The hybrid proposals illustrate the shift. In the UK, the current anti-arbitrage rules largely turn on loss of UK tax. So, if a cross-border debt structure produces the same result purely in UK tax terms as the likely alternative structure, the hybrid structure may well be effective. In endorsing the OECD hybrid proposals, however, the UK has moved away from this approach, towards the 'global policeman' role suggested by the OECD. That role may simultaneously protect the UK corporate tax base, where it denies a UK deduction, but it is nevertheless an important shift in approach. Other countries may well follow suit, and Australia is already consulting.

In parallel with this shift, however, expect countries to continue to play bad cop, by taking any measures possible (and which are EU compliant) to boost the competitiveness of their own corporate tax system.

Rule 5: Behave yourself

A further identifiable trend which corporates need to take account of is the introduction of rules (both hard and soft) explicitly designed to influence behaviour in relation to corporate tax. Such rules may arrive via a Trojan horse, such as the recent HMRC consultation titled *Improving large business tax compliance*.

In one sense, these rules create a pincer effect when combined with adverse publicity for corporate tax planning – whether through a governmental hearing or simply through the media. The pincer movement means that corporates will need to develop a tougher skin if they wish to continue with planning which is arguably at the artificial or aggressive end of the avoidance spectrum. In the UK, for instance, the Autumn Statement presages a requirement for companies to publish their (UK) tax strategies. We already have sector specific codes of conduct, and 'special measures' are likely for what are judged to be high risk businesses.

Within the tax legislation proper, it is also worth pointing out that the diverted profits tax is a particularly stark example of a tax intended to influence corporate behaviour. Its intention is less to raise DPT revenues than to discourage the adoption of structures caught by DPT.

Rules 6: Listen to Yogi

As the late, great Yogi Berra once said: 'When you come to a fork in the road, take it.'

Perhaps the biggest question now for corporates and their advisers is whether collectively these new rules of engagement lead to a fork in the road. As multinationals change track and restructure, as they beef up substance and activities wherever they can, do they continue to strive for structures which rely on conventional planning strategies? Or do they step back and take a quite different approach, perhaps intended to produce greater stability while demonstrating different behaviours? Once the UK rate is 18%, for instance, should intangibles be moved here, with the addition of greater substance?

Maybe we're reaching a fork … and it's time to take it. ■

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- Q&A with Financial Secretary David Gauke (3.11.15)
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- 30 questions on BEPS (Jill Gatehouse & Susanna Brain, 29.10.15)
- Hybrids: the UK and OECD proposals (Tom Scott, 29.10.15)
- Q&A: The condoc on improving large business compliance (Tim Law, 30.7.15)

Analysis

Reflections on the 2015 private client tax landscape

Speed read

Key developments in the ever changing private client tax landscape during the course of 2015 include major changes to the ways in which non-domiciled and non-resident individuals are taxed, the planned introduction of a new inheritance tax nil rate band for homeowners, a three-pronged attack on buy to let landlords and ongoing anti-avoidance measures.

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Proposed changes for non-doms

Perhaps the most important development has been the announcement by the government of significant changes to the ways in which non-domiciled individuals will be taxed from April 2017. Once those individuals have been tax resident in the UK for 15 of the previous 20 tax years, they will be deemed domiciled in the UK for all UK tax purposes.

The implications for those affected are hard hitting. At present, the remittance basis allows them to shelter from UK tax their non-UK income and gains, provided that they do not bring such income or gains to the UK. The remittance basis is viewed by many as being very generous and a major attraction for non-domiciled individuals moving to the UK. From April 2017, affected individuals will no longer be able to benefit from the remittance basis.

Such individuals will be deemed domiciled in the UK for UK IHT purposes. This means that all of their worldwide assets will be subject to IHT on their death, to the extent that their value exceeds the available IHT nil rate band and no exemptions or reliefs apply. This represents a minor change to the existing deemed domicile rule for IHT purposes, simply reducing the period from 17 down to 15 of the previous 20 years.

An additional blow to non-domiciled individuals will be a change to the IHT treatment of UK residential property owned indirectly by them or their trusts through an offshore company. Currently, this can allow the value of the property to escape the IHT net; however, from April 2017, the offshore company will be looked through and the individual or trust will be treated as owning the property directly for IHT purposes.

Points to watch

The proposed changes to the taxation of non-UK domiciled individuals are significant but not entirely unexpected. For some time, there has been a palpable political appetite for clamping down on long term residents who seek to maintain their foreign domicile status and thereby benefit from a generous system of taxation. Had the Labour Party won the general election earlier in the year, there was a possibility that the remittance basis of taxation might have been abolished altogether. In that light, many non-doms will feel the proposed 15 out of 20 years test is tolerable. The government can now claim it has removed one of the perceived injustices of the system, while maintaining the UK's attractiveness as a destination for wealthy foreigners. It presumably expects very few long term resident non-doms to leave the UK as they approach 15 years of residence. Similarly, the government probably hopes that those who do leave – the very wealthiest internationally mobile non-doms – will return after six years when they can reset their deemed domicile clock.

The proposed IHT charge on UK residential property held indirectly through offshore companies is likely to have a far wider impact, since it will apply to properties of any value, including those let out commercially. Whether it has an effect on the market remains to be seen. It is likely, though, that non-doms will seek to shelter from the new IHT exposure; for example, by buying in their children's name to defer the charge, taking out a mortgage on purchase to reduce the net taxable value, or taking out life insurance to fund the tax liability.

New CGT for non-UK resident individuals

Finance Act 2015 provided further evidence of the government's aim to clamp down on generous and beneficial tax treatment enjoyed by individuals with limited connection to the UK. 6 April 2015 saw the introduction of a new CGT charge on non-resident individuals, personal representatives, partners, trustees, foundations and certain companies on the disposal of a UK residential property (FA 2015 s 37 and Sch 7). Affected parties will be liable for CGT on the amount by which the property has increased in value between 6 April 2015 and the date of disposal (FA 2015 Sch 7 para 39).

FA 2015 also included provisions which limited the circumstances in which non-resident individuals can elect for a UK residential property to be their main residence for CGT purposes and thereby benefit from main residence relief on disposal (FA 2015 s 39 and Sch 9). In essence, a non-resident individual has to spend at least 90 nights in the property during the tax year for which the individual wishes to claim main residence relief. This restriction is very much in line with the spirit of the new CGT charge mentioned above.

Points to watch

The new CGT charge was seen by many as a measure to tackle the perceived unfairness of allowing non-residents to dispose of UK assets without suffering any CGT liability. Of course, the change has not prevented non-residents from disposing of UK assets other than residential property without exposing themselves to a CGT liability. In the current political and economic climate, the possibility of the new CGT charge being extended to other UK assets cannot be ruled out.

It should not go unnoticed that there are elements of generosity within the new rules regarding the main residence relief election, particularly the fact that time spent by an individual's spouse in the property in question counts towards the 90 nights which the individual must spend in the property.

Inheritance tax developments

This year has seen several key IHT developments. Arguably, the most significant was the introduction in Finance (No. 2) Act 2015 of the IHT residence nil rate band for deaths in or after April 2017 (ss 8D-M inserted into IHTA 1984 by F(No. 2) 2015 s 9). Broadly, the estate of an individual who dies from that date onwards owning a residential property will benefit from an additional IHT nil rate band if the property in question passes to the individual's descendants on death. The availability of this additional IHT nil rate band will be restricted for estates with a net value of more than £2m. The details of how the restriction will operate in practice are being consulted on and will be included in FA 2016.

F(No. 2)A 2015 also introduced provisions in IHTA 1984 s 66(4) and s 68(5) which simplify the way in which IHT is charged on ten-year anniversaries of relevant property trusts and on distributions from such trusts. Additionally, it introduced anti-avoidance provisions (IHTA 1984 s 62A and 62C) which mean there is no longer any IHT benefit to be obtained by an individual setting up a series of lifetime pilot trusts on consecutive days, each with a nominal sum, with the intention of larger sums being added in the future (such as through the will of the individual on his or her death). Any individuals who have entered into pilot trust planning in conjunction with will planning must therefore review that planning.

In the March Budget this year, it was announced that the government and HMRC would review the use of deeds of variation. HMRC hosted a meeting in September to discuss with practitioners and other stakeholders the reasons for deeds of variation being used, and whether they were being abused in order to obtain tax advantages. The meeting was followed by an open consultation. The outcome of the review has been that the government has decided not to make any changes to the legislation which confers certain tax advantages on deeds of variation.

Points to watch

The introduction of the IHT residence nil rate band is a welcome move by the government and is evidence of its commitment to ensuring that married couples and civil partners can pass assets up to £1m on to their families on death without an IHT charge. Nonetheless, the mechanics announced so far have been widely criticised for being overly complicated draft wording for the tapering restrictions for those whose estates are worth just over £2m was published on 9 December and appears to be no less complicated.

It is to be hoped the government will listen to genuine concerns about over complication and changes in tax legislation generally. Certainly, the climb down on deeds of variation is welcome, as is an acknowledgement that individuals who have entered into pilot trust planning in conjunction with will planning ought to have a grace period (until 6 April 2017) during which they can review and change their wills accordingly.

Attack on buy to let landlords

There have been several moves this year by the government to make it less attractive from a UK tax perspective for individuals to buy and operate buy to let residential properties. The moves include a phased restriction from 2017 on the amount of mortgage interest relief which higher rate taxpayer landlords can claim against their taxable rental income, as well as the abolition of the current generous '10% wear and tear allowance' for rented properties which are fully furnished, to be replaced by tax relief for actual expenditure incurred on acquiring replacement furniture and other specified items.

The most recent move involves a new SDLT rate which will apply to purchasers of buy-to-let residential properties (and second homes). This was announced in the Autumn Statement and will involve a SDLT rate which is 3% higher than would otherwise apply if the property being purchased were not a buy-to-let (or a second home). There will be a consultation on the details before the new SDLT rate comes into effect in April next year.

Points to watch

It is clear that the government is committed to increasing levels of home ownership nationwide. It is therefore no surprise that it wants to tax more harshly those who purchase buy-to-let properties and who, albeit unwittingly, perpetuate a culture of renting rather than ownership. Presumably the hope is that some landlords will sell up, resulting in more stock and lower prices for prospective owner-occupiers. The risk is that rents will rise further for those who cannot or do not want to buy.

Some of the changes do not apply to corporate owners. Why the government wishes to penalise individual landlords compared to corporate and institutional owners of residential investment property is unclear. One suggestion is that it wants to deter those who release cash from their pension following the recent pension reforms from investing in buy-to-let properties and thus adding to demand and fuelling further price rises.

Anti-avoidance

There have been continuing signs this year that anti-avoidance is still high on the government's agenda. HMRC's four consultations on tackling offshore tax evasion closed on 16 October 2015 and it will be interesting to see their responses. The government's proposal to make offshore tax evasion a criminal offence even if no criminal intent can be found is controversial and has provoked strong objections. The fact that the draft wording of the Finance Bill 2016 published last week waters down the government's proposal is therefore seen by many as a step in the right direction. It is now proposed that a taxpayer can only be prosecuted for offshore tax evasion if the tax loss is at least £25,000 per year. Whilst this seems to be a welcome move, many will argue that it does not go far enough.

Finally, it is important to remember that the Liechtenstein disclosure facility (LDF) will close on 31 December 2015. Taxpayers who have undisclosed income or gains and who want to regularise their UK tax affairs under the LDF therefore only have a very short timeframe within which to do so.

Points to watch

There remain clear indications that it is the government's aim to stamp out tax avoidance. Practitioners need to be constantly alive to the general anti-abuse rule, the disclosure of tax avoidance schemes regime and other anti-avoidance rules. ■

For related reading visit www.taxjournal.com

- Q&A: Consultation on the reforms to non-domiciliaries (Arabella Murphy & Claire Roberts, 8.10.15)
- FA 2015: The new CGT regime for non-residents (Andrew Goldstone & Katherine Forster, 23.4.15)
- Review of Finance (No. 2) Act 2015 (Claire Hooper, 18.11.15)
- AS 2015: The private client perspective (Lynne Rowland, 26.11.15)
- APNs: can taxpayers avoid the immediate obligation to pay? (Steve Bousher, 10.6.15)

VAT focus

The 2015 VAT review

Speed read

Key developments in VAT during the last 12 months include: the fallout from *Skandia*, which includes the UK confirming it would, from 1 January 2016, apply a 'two-tiered' approach, differentiating between member states with Swedish-style VAT grouping rules and everyone else; a surprising departure from HMRC guidance in assessing whether a transaction is a TOGC; a rejection of HMRC's restrictive view on VAT recovery by holding companies; the introduction of a new 45% rate of corporation tax on restitution interest, following the taxpayer's continuing victories in *Littlewoods Retail*; and further developments in VAT on debt collection, with a CJEU referral in *National Exhibition Centre*.

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2015 was a good year for the VAT aficionado (not that one can recall too many bad years), but rather than enumerate everything interesting that happened – for fear of producing a list that would rival Santa's – I have decided to focus on five topics that I believe will still be water cooler worthy come the New Year, if not beyond.

VAT groups

Skandia America Corp (C-7/13) pushed the subject of grouping back to the top of the VAT agenda. Although the ruling of the CJEU was handed down in 2014 (and not 2015), much of the debate to determine the extent of its blast radius took place this year.

The CJEU held that services provided by a non-EU company to its Swedish branch – i.e. services provided within the same legal entity – rather than being a 'nothing', gave rise to a supply by virtue of the fact that the branch was in a VAT group (and was thus a different taxable person from its headquarters). The controversy was whether this ruling was restricted to member states which, like Sweden, only allowed in-country establishments to be included in VAT groups; or whether it extended to member states which, like the UK, included entire entities (even their establishments outside the territory).

The VAT Committee and the VAT Expert Group both published working papers on the subject this year (*Working paper 845* and *VEG No. 47* respectively), analysing the arguments from both sides. Despite all the discussions, however, there is no consensus, and we are still some way off from a uniform approach across the EU.

From 1 January 2016, the UK will apply a 'two-tiered' approach, differentiating between member states with Swedish-style VAT grouping rules and everyone else (see *Revenue & Customs Briefs 2/2015* and *18/2015*). It remains to be seen whether this would bring with it its own complications.

Before we leave this topic, I should mention that not all the questions around VAT grouping derive from *Skandia America Corp*. The ruling of the CJEU in *Larentia + Minerva* (C-108/14 & C-109/14) raises the possibility of including partnerships in VAT groups. A door long thought sealed has now been opened, and it will be interesting to see where it leads.

TOGCs

Another area where long held preconceptions were revisited to surprising effect is the transfer of a business as a going concern (TOGC).

Far too often (on real estate transactions in particular), the question of whether a transaction is a TOGC (and thus a non-supply) has been answered not by reference to the law, or the rulings of the CJEU, but by reference to HMRC's guidance (as set out in *VAT Notice 700/9*). Over the years, HMRC's prescriptive examples of what is or is not a TOGC have taken on an authority that, in many cases, was simply unwarranted. Yet few would challenge the *status quo*.

Then, three years ago, came the decision of the UT in *Robinson Family* [2012] UKFTT 360. This led to HMRC revising its policy on whether the grant of a lease (as opposed to the sale of the superior interest), and the surrender of a lease, could be TOGCs (see *Briefs 30/12* and *27/14*).

This year, the UT held in *Intelligent Managed Services* [2015] UKUT 341 that the transferee of a business would be carrying on the same kind of business as previously carried on by the transferor – so that the transfer would be a TOGC – even where the supplies made by the transferee in the course of this business would be disregarded by virtue of it being in the same VAT group as its customer.

This cuts across yet another of the prescriptive examples set out in *VAT Notice 700/9*.

The focus on substance, ascertained from all the facts, is a welcome change from dogmatic adherence to prescriptive 'guidance'. This may be the beginning of a sea change in how one assesses whether a transaction is a TOGC. Who has not wondered whether a series of immediately consecutive transfers could ever be a (non-supply) TOGC?

The impact of recent UT decisions on HMRC's policy on TOGCs was gentle compared to the blows dealt in this year alone to its policy on VAT recovery by holding companies

VAT recovery by holding companies

The impact of recent UT decisions on HMRC's policy on TOGCs was gentle compared to the blows dealt in this year alone to its policy on VAT recovery by holding companies.

HMRC insists that in order for input tax to be recoverable, the cost of the input transaction must be a component of the price of the taxable output transaction. It also took the view that even a holding company that only made taxable supplies to its subsidiaries should suffer some input tax disallowance where it received dividends (on the basis that such receipt was a non-economic activity).

Both of these positions came up for consideration by a court this year, and both were rejected: the first by the Court of Appeal in *Volkswagen Financial Services* (*VWFS*) [2015] EWCA Civ 832; the second by the CJEU in *Larentia + Minerva*.

This was welcome news to taxpayers who have argued for years that HMRC's stance was simply wrong. While it is tempting to think that HMRC would use this opportunity to draw a line and transition to a more sensible position, it is (I understand) in fact seeking leave to appeal the decision of the Court of Appeal.

There is also the question of HMRC's policy on holding companies that are in VAT groups. In such a case, it requires not only that the cost of the input transaction is a cost component of the services supplied by the holding company to the subsidiary (within the VAT group), but also that the supplies from the holding company are used by the subsidiary to make its own (taxable) supplies to third parties outside the VAT group. This has not come before a court yet, but like the 'component of price' and the 'dividend' arguments mentioned above, it is considered by many taxpayers to be wrong.

Irrespective, therefore, of whether HMRC is granted leave to appeal *VWFS*, the story is nowhere near over.

Restitution

The story is definitely not over on where restitution sits in the world of VAT.

The biggest VAT story this year is probably the decision of the Court of Appeal in *Littlewoods Retail* [2015] EWCA Civ 515. In short, the taxpayer prevailed, and it was held that the interest due from HMRC should be calculated on a compound (rather than simple) basis. It is generally understood that this would result in an award in excess of £1bn.

In what many believe to be a desperate move, the government (in a late amendment to the Finance Bill) introduced (with retrospective effect) a special 45% rate of corporation tax that would apply only to interest payable pursuant to a restitution claim and only where it is calculated on a compound basis. The new tax is to be collected at source, so HMRC does not even have to pay the full amount and then wait for the tax return to be filed to receive 45% of it back.

There is doubt as to whether the provisions are lawful under European law, and a challenge is not unexpected. Therefore, just as one controversy (compound or simple) appears to be nearing a conclusion, another rears its head.

Littlewoods was not the only case this year where the Court of Appeal had to consider the interaction between restitution and taxation. The other case was *Investment Trust Companies* (*ITC*) [2015] STC 1280.

The issues in *ITC* are complex. In a nutshell, the question was whether the recipient (rather than the supplier) of a supply (i.e. the tax bearer, rather than the taxpayer) was entitled to claim repayment from HMRC of VAT that had been paid to them, which subsequently transpired not to be due. The Court of Appeal held that the tax bearer was so entitled, but only in relation to the net amount of tax actually paid to HMRC by the taxpayer (i.e. the amount of output tax less the amount of deductible input tax). Perhaps surprisingly, it also held that the tax bearer would have a claim even where the taxpayer himself was time-barred.

In the past, it would have been rare to refer to the law of restitution when dealing with VAT. The leading cases on the subject (at least insofar as it relates to tax) were all direct tax cases (see, for example, *Woolwich* [1992] STC 657, *Sempra* [2007] STC 1559 and *Deutsche Morgan Grenfell* [2007] STC 1, among others). After this year, I would not be surprised if the focus on the interaction between restitution and taxation shifts to the sphere of VAT.

Debt collection

Article 135(1)(d) of the Principal VAT Directive exempts transactions concerning payments, transfers or debts, but it specifically excludes debt collection from the exemption.

What constitutes taxable debt collection was considered in *AXA* (C-175/09), but the wide reading the CJEU gave to 'debt' and 'debt collection' (which blurred – if not entirely eliminated – the line between an agent who actively chased delinquent or bad debts, and one who passively received payments, on behalf of another) led to a number of controversies, a particular uncertainty being whether services only amount to taxable debt collection when supplied to the creditor (but not when supplied to the debtor).

Although the question was thought settled (see *Bookit* [2014] UKFTT 856, for example), the controversy never went away.

Finally, this year, a referral was made to the CJEU in *National Exhibition Centre* (C-130/15). In essence, it asks the CJEU to explain what exactly it meant in *AXA* – i.e. what constitutes a 'debt', what amounts to 'debt collection' and whether the VAT treatment of the service depends on its nature or the status of its recipient.

Will the CJEU provide sufficient clarity for taxpayer and HMRC alike to operate the exemption (and exclusion) with certainty? We shall see.

(The referral also contains questions echoing the referral made in 2014 in *Bookit* (C-607/14) – in particular, whether the mere transmission of information that would cause a transfer to be made has the effect of transferring funds, so that it amounts to a transaction concerning payments or transfers.)

What else?

As with all 'top five' lists, the above is highly personal. Readers are likely to have lists of their own, which may be vastly different. I can see some including *Kumon, Newey* and *Pendragon*, or *Astral Construction*, or possibly e-books, or pensions. *Earl Redway* may make some lists, or a military housing agency in an Eastern European country. Or perhaps *Sveda*, or one of the *Colaingrove* cases. Or *Mapfre*. Or the fact that HMRC felt it necessary to remind businesses that the sale of carrier bags was taxable (and the VAT on 5p was 0.83p).

Whatever VAT developments caught your imagination in 2015, enjoy the holidays and here's to 2016 being just as exciting. ■

For related reading visit www.taxjournal.com

- *Skandia*: HMRC's interpretation (Gary Campbell & Daniel Johnson, 26.2.15)
- Cases: *Skandia America v Skatteverket* (24.9.14)
- AG opinion on *Larentia + Minerva*: VAT recovery for holding companies (Etienne Wong, 10.6.15)
- *Larentia*: the aims and broad logic of the Directive (Michael Conlon QC & Rebecca Murray, 6.8.15)
- VAT groups: an 'Intelligent' solution to TOGC issues? (Peter Mason, 6.8.15)
- Cases: *Intelligent Managed Services v HMRC* (14.7.15)
- TOGCs: connected parties and anti-avoidance (Rowena Clifton & Sean McGinness, 9.9.15)
- Cases: *Volkswagen Financial Services v HMRC* (4.8.15)
- *VWFS* and partial exemption (Etienne Wong, 24.9.15)
- The new 45% corporation tax rate on restitution interest (Paul Farmer & Jivaan Bennett, 3.11.15)
- *Littlewoods Retail*: compound interest claim upheld (Michael Conlon QC, 1.6.15)
- Cases: *Littlewoods Ltd and others v HMRC* (27.5.15)
- Cases: *Investment Trust Companies v HMRC* (18.2.15)
- *Investment Trust Companies*, unjust enrichment and the 'dead period' (Michael Conlon QC, 5.3.15)
- Cases: *HMRC v National Exhibition Centre* (18.2.15)
- *National Exhibition Centre*: referred questions published (Karen Killington & Steve Powell, 3.6.15)

Report

Views from 100 tax professionals on HMRC

Speed read

A poll of 100 tax professionals reveals that 92% believed that HMRC does not have sufficient resource to ensure that all due tax is paid, with 88% saying an independent review of HMRC would be helpful.

100 tax professionals took part in a *Tax Journal* poll designed to gauge the view of the profession on the HMRC resource.

They gave their views on two questions:

- Do you believe that HMRC has sufficient resource to ensure that all due tax is paid? and
- There have been some calls for an independent review of HMRC. Do you believe that this would be helpful?

Results

Ninety-two of the 100 tax professionals said that HMRC is under-resourced, and 88 thought the independent review would be helpful.

The 100 tax professionals were from accountancy firms (68), tax boutiques (8), law firms (3) and chambers (1), as well as those working in-house (11), at HMRC (6) and at other organisations (3).

It comes after some calls from within the profession for an independent review of HMRC; and just after the government's recent announcement in the 2015 Autumn Statement to reuse the £800m savings to deliver an additional £7.2bn from tackling tax evasion and non-compliance over the next five years; and HMRC's announcement of its office closure programme, which will see its 170 UK offices consolidated into 13 regional centres, with plans to retain 90% of its 58,000 strong workforce.

> 'Perhaps what is required is an open consultation between government, HMRC, taxpayers and their agents on what we, as a country, want HMRC to do and how it does this' *Tina Riches*

While most survey respondents appeared to agree that HMRC needed an independent review, some qualified their answers. 'Instead of wasting money on an independent review, they would be better investing that money in more HMRC services,' said one. Another said: 'I answered "yes" to an independent review of HMRC, but in reality I think that the tax profession already has all the information available to say what changes should be made. Money could be saved by just asking the tax and accounting profession how HMRC can be improved and inefficiencies reduced.'

Many commented on the lack of knowledge of many of the staff they dealt with. Customer service was another frequent gripe.

Keith Gordon, barrister at Temple Tax Chambers, said the institution was 'tainted' by its attitude. 'Whilst I would not point the blame at individual officers, the mindset of the institution is in the wrong place. HMRC should aim to collect "the right amount of tax", but its stated objectives now include "maximising revenues",' he said. 'This mismatch is at the core of much of what HMRC does, what it says and how ministers are advised. More worryingly, it affects how HMRC treats taxpayers – effectively denying them their statutory or common law rights, where to do so will help to maximise revenues. HMRC's frequent attempts to sidestep agents are part of this, whereas fairness requires independent tax advisers to stand up to HMRC more than ever on behalf of their clients.'

Reaction to the survey

'The results do not surprise me in the least', said Paul Aplin, partner at A C Mole & Sons and chairman of the ICAEW Tax Faculty Technical Committee. 'Few outside Whitehall believe that HMRC has the resource it needs to do the job. Service standards remain a cause for concern and while I welcome the recent announcement of significant new investment in digital technology, that is not a complete solution. Greater investment is needed in training and in front line service delivery. I am also not surprised to see the huge majority backing a constructive, independent review of HMRC to assess its success against the aspirations set out in the O'Donnell review which created it, to consider its governance, powers, modus operandi and resources and to look at its aspirations for the next ten years.'

Jonathan Riley, head of tax at Grant Thornton, has previously called for a full independent review of HMRC. Only this, he said, 'can really move the dial forward in terms of its performance and reputation'. He added: 'HMRC has to deal with so many aspects of law, not just tax – my guess is that compliance with the apprenticeship levy will fall to HMRC. And now it has to juggle with the next stages of *Building our future* – HMRC's strategy to digitise, as well as digitisation in itself. Add the current customer service performance and it is hard to see how much longer HMRC can keep "in the game".'

However, Tina Riches, national tax partner at Smith & Williamson, pointed out HMRC's success in tax collection compared to some other countries. 'The level of debt is low and envied by many commercial entities, while the tax gap level is comparable on an international basis.'

'I do however think the key problem is not just the volume of resources but having the right resources in the right areas,' Riches said. 'There has been a sea change in what HMRC does, and what it is expected to do going forward, which means it needs a different profile of staff. Years of shedding staff means there seems to be an experience gap between good new recruits and those approaching retirement, some of which portrays itself in a need to better understand what taxpayers and tax agents do, and do today rather than ten years ago, and the impact of proposed changes.

'So, in the same way that there has been a long consultation on tax agents, perhaps what is required is an open consultation between government, HMRC, taxpayers and their agents on what we, as a country, want HMRC to do and how it does this.' ■

Reported by Santhie Goundar & Paul Stainforth. For the full report, see taxjournal.com.

Report

Views from large businesses on tax strategy

Speed read

A recent survey assessed views of large businesses on tax strategies. Nearly two-thirds of respondents said tax was discussed more often at Board meetings than five years ago. 72% now have a Board approved strategy in place. In terms of tax priorities for the business, reputational issues were of most concern, with managing the tax charge or effective tax rate a close second. There were mixed views on HMRC's proposed new code of practice, and businesses seem somewhat lukewarm in their response to increased scrutiny on their tax affairs.

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Tax Journal partnered with Engaged Consulting to assess views of large businesses on tax strategies. Senior respondents from 47 large businesses – all of whom were in-house tax directors or heads of tax – took part. The findings are set out overleaf. My comments on the highlights are below.

Tax strategy

It is reassuring to see that over 70% of the businesses responding have a Board approved tax strategy (see Q1), although only about half of those publish even selected content from that strategy (Q7). My suspicion is that many of these businesses will have developed their tax strategy five to ten years ago, at a time when it was an internal governance document. Publication would require a revision of the document, possibly to split it into some external facing principles and an internal governance element.

60% of all those responding say they don't currently publish anything on their tax strategy (Q7). Looking forward just 12 months, the percentage of those who will still not be publishing falls to 13%, with most having moved into the 'undecided' category. Perhaps this reflects an acceptance that the then ongoing HMRC consultation on large businesses compliance is likely to make some disclosure mandatory. What is clear is that about 50% of those responding are going to be considering tax strategy disclosures in the next 12 months (Q8).

Since the survey, draft provisions for Finance Bill 2016 have been published. These introduce a new requirement for large UK businesses (with a group turnover of more than £200m and/or group balance sheet total of more than £2bn) to publish tax strategies as they relate to or affect UK taxation.

Stakeholders and the Board

Businesses were asked to rank what tax issues matter most to the Board. Reputational issues were of greatest concern, with managing the tax charge or effective tax rate a close second (Q4). In terms of the impact on tax planning, over a third of respondents say that scrutiny on business taxes has decreased their appetite for tax risk (Q10). Tax campaigners will take heart from this. Campaigners will be disappointed that almost all respondents put NGOs at the very bottom of their list of tax stakeholders (Q11). The top tax stakeholders of HMRC/HMT, shareholders and the Board is as you might expect. In the current environment I wonder whether the low placing for the OECD and EU is more about the appetite to engage on policy, than about who actually has an influence on tax.

Of those respondents who do have a Board approved tax strategy, all but two respondents share this information with HMRC (Q12), despite nearly half of those who share it saying this has no impact on their risk rating (Q13). In general, HMRC has made it clear that it takes a positive view of businesses that share their tax strategy, so perhaps these businesses already enjoy a low risk rating. Virtually every respondent felt that tax questions at AGMs will continue, and if anything increase going forward (Q17). I think this is right. With increasing transparency and the growth of well-resourced NGOs ready to use this new information to challenge businesses, Boards will need to be ready to respond to questions on tax. Examples of questions asked at AGM included 'where do you see the tax rate going in light of new acquisitions?'; and 'explain the movement in the effective tax rate.' Anticipated inquiries include whether the group pays a 'fair' amount of tax in each location it operates. Some extractives companies have already seen questions resulting from the country-by-country numbers.

The new code of practice

Views were mixed on HMRC's voluntary 'code of practice' proposals. 43% of respondents 'broadly welcomed' this, although increased management workload was a concern (Q14). 'We welcome the concept that [corporate] groups should have a code which applies to tax and follows the broad principles outlined', responded one, '[but] do not support the concept of either a unilateral code/commitment to HMRC or, more broadly, the idea that a company should have multiple codes (i.e. one for each country) rather than one global code.'

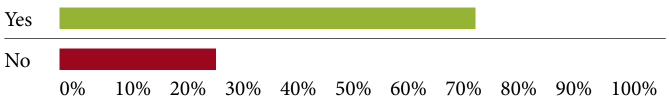
However, just over half of all respondents were either 'slightly or very concerned' by the proposed code of practice. 'The fact that HMRC is not consulting on the core point of whether a tax strategy should be published, and has instead publicly stated it will be legislated for, is a matter of personal concern', answered one. Another called it a one-way street for HMRC: 'Openness and proactivity is not something that is "rewarded" … This is not sustainable and things [will] start going back to courts being jammed with litigation they can't handle.' Others expressed concerns about subjective elements and wording.

Looking ahead

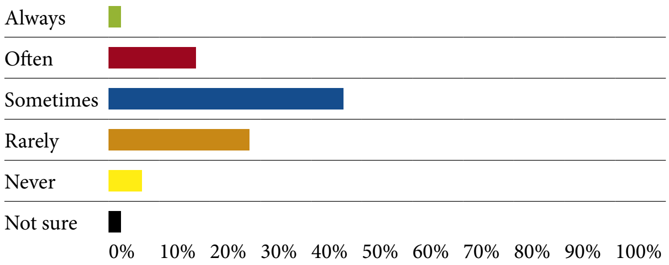
Most respondents felt that OECD style CBCR and publication of a tax strategy were the most likely transparency innovations applying to their business in the next five years (Q19), which comes as little surprise. It is also unsurprising to me that nearly three-quarters of respondents (74%) felt that CBCR data will end up being public (Q20). Public scandals may mean businesses remain reticent about this increased scrutiny on their tax affairs: just over half of all respondents (53%) said they 'somewhat welcomed' this, and 30% were 'somewhat concerned' (Q21). However, it seems clear that businesses are responding to this by looking to refresh their tax governance and transparency, and preparing at the very least for new mandatory disclosures. I suspect they also need to prepare for questions ahead. ■

Tax strategy and the Board

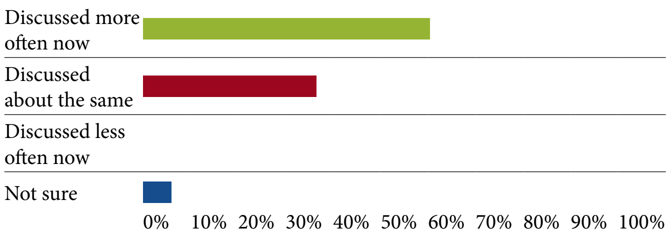
Q1 Do you have a Board approved tax strategy?



Q2 How often is tax specifically an item on the agenda at Board meetings?

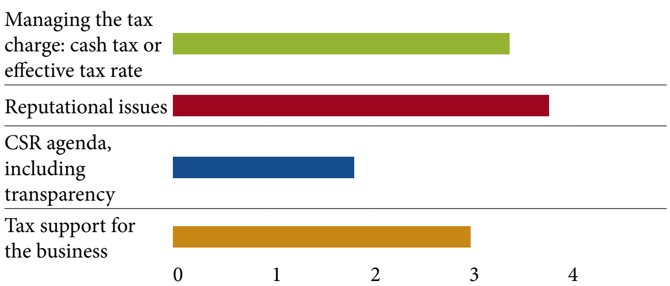


Q3 Is tax discussed more often at Board meetings now than was the case five years ago?

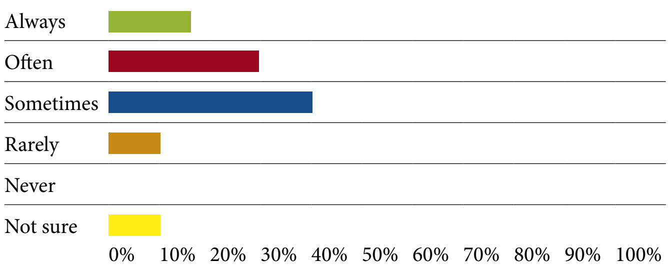


Q4 On tax, what matters most to the Board?

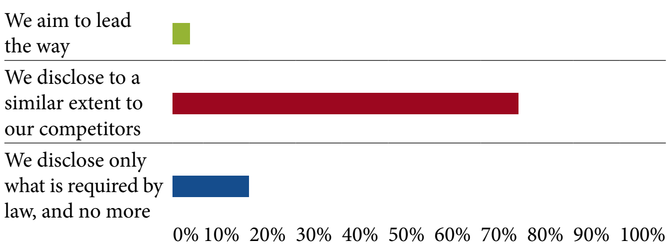
(The following are ranked in order of importance)



Q5 How often is tax specifically an item on the agenda at Audit Committee meetings?

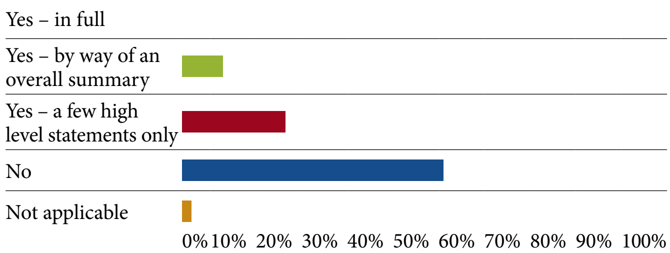


Q6 What is your overall approach to tax transparency?

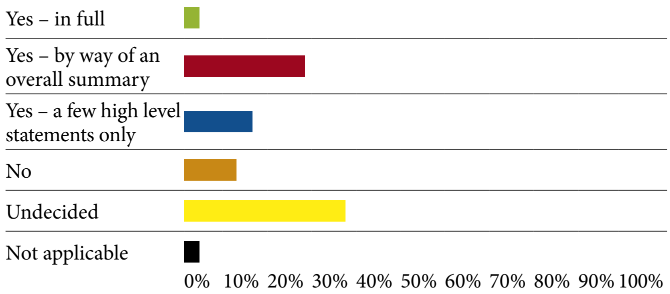


Publication strategy

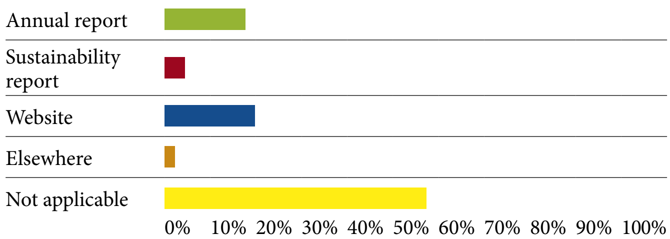
Q7 Do you currently publish your tax strategy?



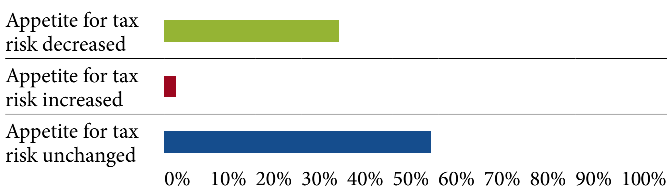
Q8 Do you intend to publish your tax strategy in the next 12 months?



Q9 Where do you give details of your tax strategy?



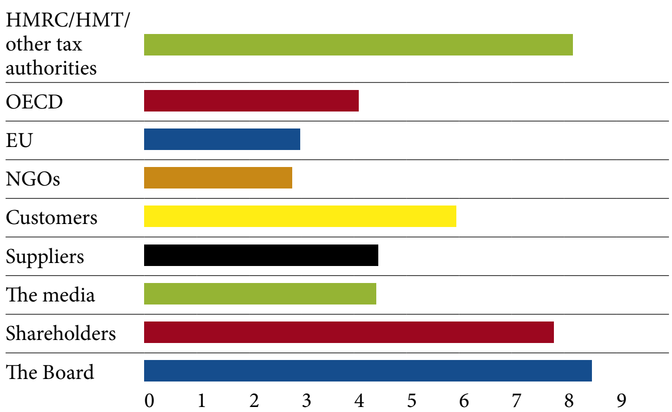
Q10 Has the increased scrutiny on tax affairs of businesses affected your approach to tax risk?



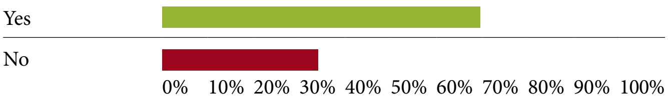
Stakeholders

Q11 Rate each of the following stakeholders on tax matters in terms of importance to your business?

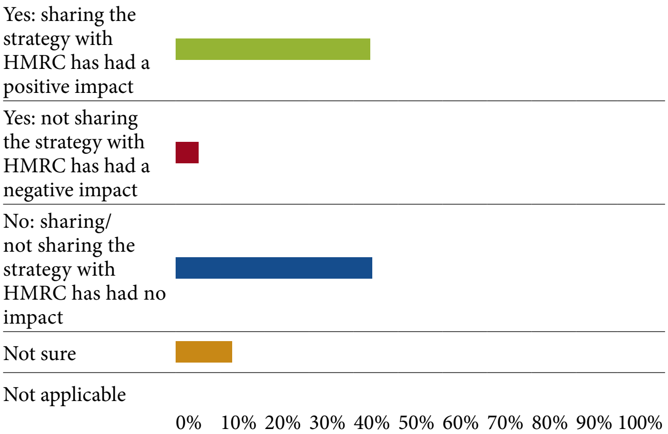
(The following are ranked in order of importance)



Q12 Do you share your tax strategy with HMRC?

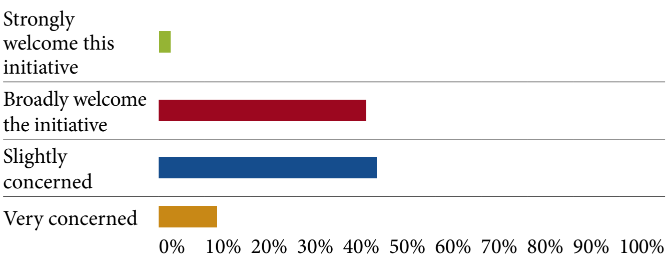


Q13 Do you believe that your decision on whether or not to share your tax strategy with HMRC has had an impact on your risk rating?

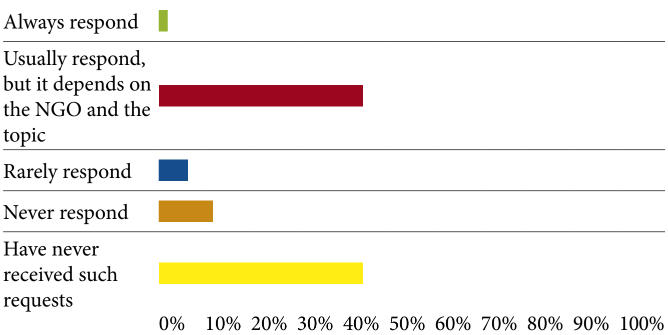


Q14 Views on the voluntary code of practice

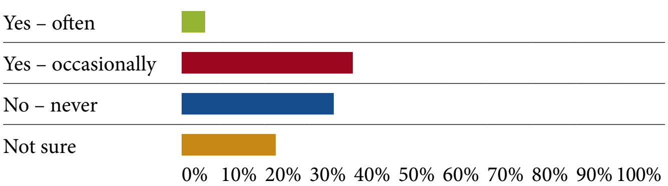
At the time of the survey, HMRC was consulting on a voluntary code of practice. The proposal involved a commitment made to HMRC covering three broad areas: openness and relationship with HMRC; internal governance; and the approach to tax planning. The code would be voluntary for businesses, and HMRC says it has no plans to make public those businesses that do (or do not) adopt it. However, it will challenge any businesses that publicly claim to have signed up when they have not done so. Which of the following best describes your view on these proposals?



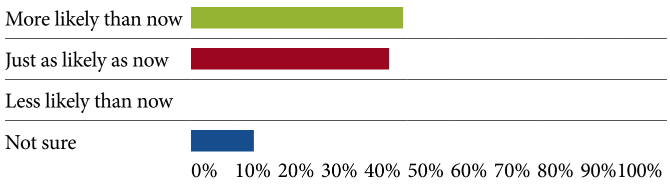
Q15 How do you respond to NGO requests on tax issues?



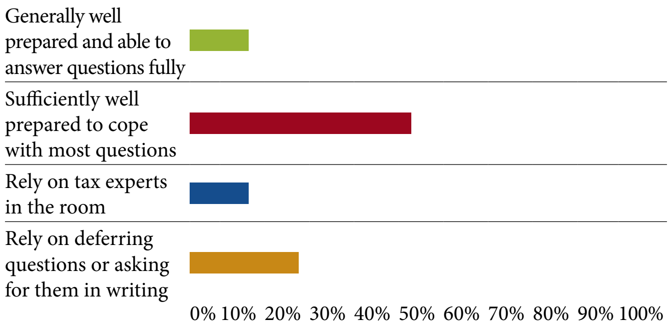
Q16 Have you received tax related questions at AGMs?



Q17 Do you think that tax related questions at AGMs (generally, not just your AGM) over the next five years will be...



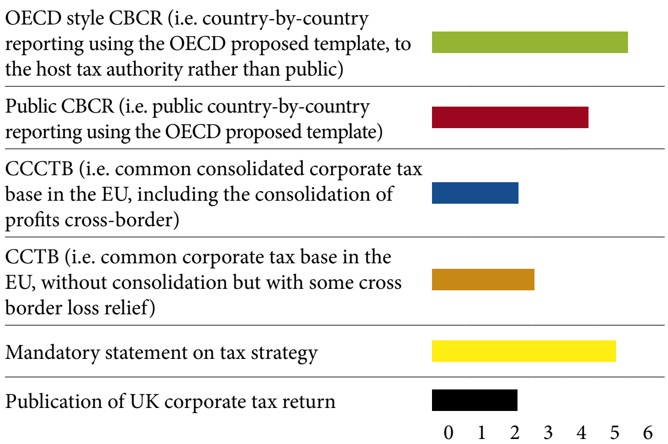
Q18 Do you think that Boards attending AGMs (generally, not just your AGM) are well equipped to face tax questions?



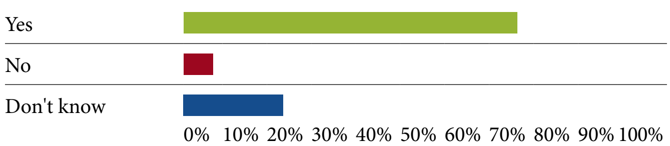
International and CBCR

Q19 Rank the following on how likely you believe they are to apply to your business over the next five years?

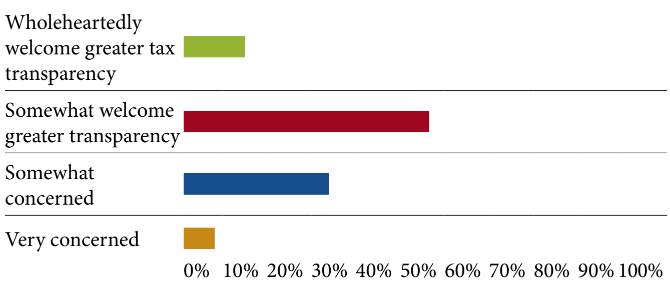
(The following are ranked in order of importance)



Q20 When OECD style CBCR applies in the UK, do you think the information will end up in the tax domain?



Q21 Overall, do you welcome all the various tax transparency initiatives?



EMI and ESS with growth shares

Lisa Stevenson
Parisi Tax
Lisa Stevenson is the founding partner of Parisi Tax LLP, which is a niche firm providing tax advisory services. Prior to setting up Parisi Tax in 2009, Lisa was a tax partner at Pinsent Masons for ten years. She advises on a wide range of tax issues, including tax advice to private companies and their shareholders, private equity transactions and employee share incentives. Email: lisa.stevenson@parisitax.co.uk; tel: 07747 100141.

My client is a high tech company. The company has recently gone through a funding round to raise new debt and equity capital which valued the company at £15m. The shareholders are hoping to achieve an exit in the next three to five years. In order to attract and recruit key staff (including a part time chairman), the company wants to implement a new share incentive arrangement for key employees. The employees will only benefit from future growth in value; however, the greater the value received on an exit, the bigger the percentage the employees will benefit from. The company wants advice on how to structure the arrangements.

The best way to structure this type of incentive arrangement is by using growth shares.

Growth shares

Growth shares are shares which have no current participation in share value, but which provide shareholder participation if the company grows in value. They can be designed in a variety of ways. For instance, they may only participate in the value of the company once a certain threshold is achieved on exit; or the right to participate could be stepped so that the higher the exit value, the bigger percentage of the growth the shareholder receives.

The key point is that any allocation of value as between share classes is dealt with in the articles of association (not, say, a shareholders' agreement or other contractual arrangement) and attaches to the shares themselves, not to the individual employee. Otherwise, this would give rise to income tax charges (i.e. the principle in *Grays Timber Products Ltd* [2010] UKSC 4 (see HMRC's *Employment-related Securities Manual* at ERSM80130)).

Previously, HMRC had expressed some concern about the use of growth shares which provide geared growth to employees. However, a recent research report published by HMRC – *Employment-related securities HMRC research report 372* – indicates that HMRC now recognises that growth shares are a potentially valuable incentive tool and that the use of growth shares is largely driven by commercial considerations rather than tax avoidance motives. Therefore, an HMRC challenge to arrangements using growth shares in the future is much less likely, as long as they are structured correctly.

It is usually better to combine the use of growth shares with either enterprise management incentives (EMI) options or employee share scheme (ESS) shares. One of the key advantages of this is that in each case there is a mechanism for agreeing the value of the shares with HMRC in advance, so that the parties then have certainty of the tax outcome.

The advantages of granting EMI options over growth shares

If the company and the employee meet the qualifying conditions set out in ITEPA 2003 Sch 5, then the employee can be granted EMI options over growth shares. In addition to the ability to agree a valuation, EMI options offer a number of advantages to both the company and the employee:

- From the company's perspective, EMI options are very flexible and easy to operate. The employee does not need to be issued shares at the outset (many EMI options will only become exercisable immediately prior to an exit), so shares do not need to be clawed back from leavers.
- The employee does not pay tax on the grant of the option and, provided the price paid on exercise of the option is at least equal to the market value of the shares at the time of grant, no tax will arise on exercise. The only tax to pay will be CGT on the eventual disposal of the shares. Provided the employee is still employed by the company at the time of the disposal and the disposal is at least 12 months after the grant of the option, he should qualify for entrepreneurs' relief from CGT on the disposal and so his tax rate will be 10%.
- The company benefits from a corporation tax deduction on exercise of the option by reference to the difference between the price paid and the market value of the shares at the time of exercise (CTA 2009 Part 12). In a high growth business, and particularly where the option exercise is linked to an exit, this can create a very valuable benefit, which may be useful in the negotiations with the buyer and even result in additional shareholder value.

Offering ESS shares as an alternative

An alternative to offering EMI options over the growth shares (for instance, if the EMI conditions are not met) is to offer the shares as ESS shares. ESS shares are shares issued to an employee in consideration for the employee entering into an employee shareholder agreement (whereby certain statutory employment rights are given up). ESS shares also offer a number of advantages (in addition to the ability to agree a valuation with HMRC):

- The first £2,000 of value is tax free, so the employee is liable to income tax (and potentially NICs) only on the excess. Growth shares work well as ESS shares because, by definition, growth shares are not worth much at issue; and the required minimum £2,000 of value can be achieved by giving the shares the right to be sold for £2,000 within a certain timeframe.
- To the extent that the total value of the shares at the time of issue is not in excess of £50,000, any growth in value is exempt from CGT on a future sale of the shares. Again, this works well with growth shares as, provided they are structured correctly, they should be worth much less than the £50,000 limit, so all future profit should be tax free (see TCGA 1992 ss 236B–236D). This exemption applies even if the individual is no longer employed by the company at the time of disposal of the shares.

Final thoughts

In summary, growth shares can work well to achieve the aims of the employer company and the shareholders. Having taken the company so far, the shareholders may wish to retain the value they have created but be very happy to share any growth in value with key employees who will be instrumental in achieving that growth. ■

One minute with...

Michael Thompson

Vinson & Elkins

Michael Thompson is head of the tax group in Vinson & Elkins' London office. He has more than 35 years' experience as a corporate tax lawyer advising on a great variety of UK domestic and international transactions. Formerly a partner at Freshfields Bruckhaus Deringer for 20 years, he joined V&E in 2010 to set up their UK tax department. Email: mthompson@velaw.com; tel: 020 7065 6065.

What sets Vinson & Elkins apart from other law firms?
Although the firm has a wide variety of clients and practices, it has a pre-eminent reputation as an adviser in the energy sector. Many lawyers here have a real passion for, and understanding of, the oil and gas industry in particular. The firm's Texan roots provide an attractive mix of entrepreneurism and friendliness.

Why did you join them?
Although my practice, like that of any other City-based lawyer, had included a large component of work for clients in the financial sector, I also had the luck to work from the start of my career for several companies operating in the North Sea. Joining V&E provided not only the challenge of setting up something new, but also the comfort of having an excellent platform for my specialised oil and gas tax practice.

What's of particular concern to your clients at present?
The current low oil price, combined with the natural difficulties of operating in the North Sea environment, means that the viability of many projects and even of some companies in the UK oil and gas sector is quite precarious and there are huge policy issues currently being debated with government. Removing some tax barriers from sales of infrastructure and late-life fields, so as to facilitate the transfer of assets into the hands of companies willing and able to exploit them to the full, is key.

What's in your in-tray?
These difficult times for the oil industry mean that a lot of consolidation in the sector is needed. So a number of clients are currently seeking advice on structuring and negotiating sales or acquisitions. I am also advising several companies in their appeal process towards litigating against HMRC on a common issue. This seems at first sight to be an esoteric oil tax point, but actually revolves around the meaning of the terms 'just' and 'reasonable'. So it will be interesting if we get to court.

If you could make one change relating to UK tax law, what would it be?
How about transferring responsibility for structuring the tax system out of the hands of short-term thinking politicians, leaving them only with discretion over rates of tax and allowances on a year to year basis? It sounds a bit undemocratic, but, instead of indulging in gesture politics by binding themselves not to increase the rate of income tax for a parliament, they could instead bind themselves to implement the conclusions of a non-partisan Tax Commission, set up for the long term to achieve a modern streamlined tax system!

Looking back on your career to date, what key lessons have you learned?
Although there is a time and place for a 50 page tax opinion (the introduction of the diverted profits tax has breathed fresh life into that beast), most clients need their adviser to help them 'see the wood for the trees' and give them concise advice which provides a clear steer on what decision to make. As we increase our understanding of the businesses of clients, we can be increasingly useful to them in helping them balance the tax issues in the context of all the other commercial issues they have to grapple with.

Tell us a secret.
Having suffered a work/life balance crisis some ten years ago, I have been fortunate to be able to work reasonably consistently for three days per week for several years, giving me time for other interests and renewed energy for my client work. This is thanks in large part to the support of my partner Jenny Doak who handles a lot of the urgent transaction work. It is also thanks to some very understanding clients, who will normally agree to wait a few days for advice, and to good IT back-up which helps me communicate from more pleasant locations than my office. Oh and another thing – I once trained as a pilot in the RAF and had the exhilaration of flying a fighter, an English Electric Lightning Mark II, at supersonic speeds along the East German border (before the Wall came down). ■

What's ahead

December

21 **Consultations:** Comments due for All-Party Parliamentary Group on responsible tax consultation on BEPS, www.bit.ly/1SVytde. **Parliament:** Lords debates VAT evasion by overseas online retailers. **Regs:** SI 2015/1941 ensures Brazil and South Africa co-produced TV programmes qualify for tax relief; SI 2015/1948 defines 'qualifying travel' and approved method of paying/reimbursing employee standard meal allowances for the new expenses exemption from 6 April 2016.

22 **Parliament:** House of Lords rises for Christmas recess.

29 **Consultations:** Comments due on Scottish government's *Consultation on landfill tax loss on ignition testing for waste fines* (www.bit.ly/1PK0hRQ).

31 **Disclosure facilities:** Closure date for Isle of Man, Guernsey, Jersey, and Liechtenstein (LDF) disclosure facilities. **OTS consultations:** Comments due on *IT/NICs review* (bit.ly/1POCth1) and *Small company taxation* review (bit.ly/1Lz8rK7). **Regs:** Amending regs (SI 2015/1960 to 2015/1963) come into force to prevent double accounting under the rules for both loan relationships and derivative contracts, following changes introduced by F(No. 2)A 2015. Insurance companies amending regs (SI 2015/1959) take effect.

January

1 **Bank profits surcharge:** 8% surcharge begins. **VAT groups:** UK-registered businesses belonging to a VAT group to treat intra-group supplies of services involving overseas establishments as supplies to another taxable person outside the VAT group, following *Skandia* (bit.ly/1MEsQBh). **Solvency II:** SI 2015/draft ensures that EU 'Solvency II' compliant instruments in the form of debt are subject to income tax under loan relationships rules. **VAT regs:** SI 2015/1978 implements VAT changes following *Crédit Lyonnais*; SI 2015/2015 reduces maximum value for small consignments on relief from VAT for goods imported on a non-commercial basis from outside EU. **EC:** EU member states' tax authorities can exchange financial information. **Consultations:** Comments due on OTS online mini-consultation, *Small company review of taxation survey.* **Other regs:** Lloyd's underwriters regs SI 2015/1983 & SI 2015/1999 take effect.

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

Coming soon in Tax Journal:
- The tax world in 2016.
- Examining the draft Finance Bill rules.