RPC

Corporate tax update

August 2019

Welcome to the latest edition of our Corporate Tax Update, written by members of RPC's tax team. This month's update reports on the key developments from July 2019 and includes a summary of the key business tax measures coming out of the publication of the draft Finance Bill 2020 legislation. There is also commentary on the draft regulations and consultation document published by HMRC on the UK's implementation of DAC6 (mandatory disclosure of cross-border tax planning arrangements).

High Court quashes "outrageous", "irrational" and "conspicuously unfair" HMRC decision to deny claim for repayment of under-recovered input VAT

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HMRC publishes draft regulations and consultation document on DAC6

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Draft Finance Bill 2020

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ECJ rules in University of Cambridge VAT case (recoverability of VAT on investment management fees)

On 4 July 2019, the ECJ held that the University of Cambridge (the University) was not entitled to deduct input tax on investment management fees. more›

Any comments or queries?

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High Court quashes "outrageous", "irrational" and "conspicuously unfair" HMRC decision to deny claim for repayment of under-recovered input VAT

On 26 July 2019, the High Court[1] in an application for judicial review of an HMRC decision to refuse a claim for repayment of under-recovered input VAT, held that HMRC's decision must be quashed.

A claim for repayment of the input VAT had been made in 2007 by the then representative member (PSGL) of the VAT group (VAT Group 2) of which, in 2007, PSGL and Pearl (the representative member of the different VAT group (VAT Group 1) which incurred the input VAT during the period for which the claim arose) were then members. PSGL made the claim in 2007 as the representative member of this VAT Group 2, as well as on behalf of Pearl and VAT Group 1.

The claim was submitted well in advance of the deadline for such claims (31 March 2009). However, HMRC did not object to the claim until 2012. HMRC argued that neither PSGL, nor Pearl, nor any other member of the Pearl (now Phoenix) group was entitled to make the claim. Rather, the right to claim belonged to the representative member of VAT Group 1 **at the time the claim was made**. In 2005, following completion of the sale of the Pearl group to new owners, another company (HAL) became the representative member of VAT Group 1. In 2013 HMRC stated that only HAL could have been entitled to make the claim in 2007.

The focus of the claimants' application for judicial review before the High Court was the HMRC decision to refuse the claim.

In a strongly-worded judgment, the High Court held that:

- HMRC's November 2017 decision to uphold their rejection of the 2007 claim was a "total reversal of HMRC's fully-informed determination" in 2008 not to object to the claim
- such November 2017 reversal was made at a time when the taxpayer could "no longer take the simple steps to reformulate and resubmit the claim (with the authority of HAL)" before the March 2009 deadline
- the November 2017 decision was "so outrageous in its defiance of logic or of accepted moral standards that no sensible person who had applied his mind to the question to be decided could have arrived at it" and was "irrational and, if a separate concept, conspicuously unfair".

Mr Justice Phillips quashed HMRC's decision and ordered HMRC to pay the claim.

Back to contents>

1. In *R (Phoenix Life Holdings Ltd and others) v HMRC* [2019] EWHC 2043 (Admin).

HMRC publishes draft regulations and consultation document on DAC6

On 22 July 2019, HMRC published draft regulations and a consultation document on the UK's implementation of Council Directive 2018/822 (DAC6).

DAC6 entered into force last summer (25 June 2018) and will require "intermediaries" and, in some cases, taxpayers to report details of certain cross-border tax-planning arrangements to HMRC and other EU tax authorities. Intermediaries will include lawyers, accountants and bankers.

Member States are required to implement the new rules by 31 December 2019 so that intermediaries (or in the absence of an intermediary, a relevant taxpayer) are required to report to local tax authorities details of any "reportable" arrangements they are involved with. First reporting under the new rules will not be required until July/August 2020, but all "reportable" arrangements taking place from 25 June 2018 will need to be reported in that first round of reporting. It would appear that the rules will be implemented in the UK regardless of what happens with Brexit.

Given the retrospective nature of the new rules, taxpayers and advisers have been grappling as to how to identify "reportable" cross-border arrangements in the absence of guidance from the EU and/or local tax authorities. The new rules, in defining "reportable" cross-border tax-planning arrangements, list features of transactions that point to tax avoidance or abuse (so-called "hallmarks"). In many, but by no means all, cases an arrangement will only be reportable if one of the main benefits of the arrangement is to obtain a tax advantage.

The draft regulations published by HMRC closely follow DAC6 and are, therefore, not of great help in adding clarity as to how the new rules will be implemented in practice. More helpful, to a degree, is the consultation document. There is a promise of further published guidance alongside the final UK regulations. It is to be hoped that the final guidance provides far greater detail as to HMRC's intended approach to DAC6.

Amongst the areas covered by the documents are:

- **Role of employees**: HMRC confirm that employees of intermediaries/taxpayers are not, themselves, subject to the DAC6 rules (any DAC6 obligations will rest with the employer).
- **Meaning of "tax advantage"**: as a number of the DAC6 "hallmarks" require the obtaining of a tax advantage as a main benefit of the arrangements, it has been clarified that (i) this can refer to tax advantages anywhere in the world, not just in the UK/EU, and (ii) tax consequences entirely in-line with the policy objectives behind particular tax provisions will not be caught.
- **What is meant by cross-border**: to be "reportable" an arrangement must "concern" multiple jurisdictions, at least one of which being in the EU. HMRC's view is that for this to be the case those jurisdictions must be of some "material relevance" to the arrangement. This would exclude, for example, from the scope of DAC6 the jurisdiction of residence of a company with a permanent establishment (PE) in another jurisdiction where that PE enters into an arrangement if the jurisdiction of residence of the company is not in any other way involved.

The consultation runs to 11 October 2019.

The draft regulations and consultation document can be viewed here.

Back to contents>

Draft Finance Bill 2020

On 11 July 2019, the government published draft Finance Bill 2020 legislation. Various policy papers, consultation responses and other documents were published at the same time. The highlights of the draft legislation include:

Digital Services Tax (DST)

Draft legislation and guidance has been published for the new DST, to take effect from 1 April 2020.

The latest proposals are broadly in line with those that were subject to last year's consultation. In particular the rate of DST (2%) and financial thresholds are unchanged. There is also no change to the activities that are caught by the DST (online market places, social media platforms and search engines).

The policy paper and draft legislation can be viewed here.

Off-payroll working rules for private sector

Draft legislation, together with responses to the March 2019 consultation and a policy paper, have been published in respect of the extension to the private sector of the "off-payroll working" rules, from 6 April 2020. This extension has been triggered by the government's continued concern as to the high-level of non-compliance with the 'IR35' regime.

The new regime will shift responsibility for operating the off-payroll working rules from the personal service company (PSC) of the worker caught by the rules to the organisation receiving the worker's services (via the PSC). A private sector organisation within the scope of the new regime will, from 6 April 2020, be responsible for assessing the worker's employment status and deducting the correct amount of tax and national insurance contributions.

As the new private sector off-payroll working rules will only apply to "medium and large" organisations, the rules commonly referred to as 'IR35' will continue to apply to workers providing services to "small" organisations in the private sector.

The policy paper can be viewed here and the consultation responses here.

Secondary preferential creditor status for HMRC on business insolvency

For insolvencies commencing after 6 April 2020, it is proposed that:

1. HMRC will become a secondary preferential creditor for VAT, PAYE, **employee** national insurance contributions and CIS[2] deductions.

2. HMRC will remain an unsecured creditor for corporation tax and **employer** national insurance contributions.

The justification for the change is that taxes within limb 1 above are intended to be passed on to the government for spending on public services. In a business insolvency, they are instead applied for the benefit of creditors of the business generally. According to the government, around £1.9bn each year in tax does not reach the government, as a result of business insolvencies.

The proposed change reverses, in part, the Enterprise Act 2002 abolition of the Crown preference.

The policy paper for this can be viewed here and the draft legislation can be viewed here.

2. Construction Industry Scheme.

Stamp duty/SDRT deemed market value rule – extension to "contrived" transfers of unlisted securities

In Finance Act 2019, a deemed market value rule was introduced for transfers of listed[3] shares and securities to connected companies.

Finance Bill 2020 will include an extension to this deemed market value rule for transfers of non-listed shares and securities under similar arrangements.

The policy paper can be viewed here.

Back to contents>

ECJ rules in University of Cambridge VAT case (recoverability of VAT on investment management fees)

On 4 July 2019, the ECJ held[4] that the University of Cambridge (the University) was not entitled to deduct input tax on investment management fees.

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

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

The University succeeded before both the First-tier and Upper Tribunals. The issue was however put to the ECJ upon a referral from the Court of Appeal.

Put simply, the ECJ held that as donations into the Fund were not consideration for an economic activity, input tax paid on costs incurred (ie professional managers' fees) in raising the donations was not deductible. Crucially (in the ECJ's view) the cost of the professional managers' fees was neither incorporated in the cost of a particular output transaction, nor in the cost of supplies made by the University as part of its economic activities.

The ECJ's decision can be viewed here.

Back to contents>

3. Listed securities being shares and securities regularly traded on a regulated market, multilateral trading facility or recognised foreign exchange.
4. Case C-316/18.

About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 78 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol. We put our clients and our people at the heart of what we do.

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

We have won and been shortlisted for a number of industry awards, including:

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- Best Legal Employer every year since 2009 – Legal Week
- Shortlisted – Commercial Litigation Team of the Year – Legal Business Awards 2019
- Shortlisted – Best Copyright Team – Managing IP Awards 2019
- Shortlisted – Insurance Team of the Year – Legal Business Awards 2018
- Winner – Best Employer – Bristol Pride Gala Awards 2018
- Winner – Client Service Innovation Award – The Lawyer Awards 2017
- Shortlisted – Corporate Team of the Year – The Lawyer Awards 2017
- Winner – Adviser of the Year – Insurance Day (London Market Awards) 2017
- Winner – Best Tax Team in a Law Firm – Taxation Awards 2017
- Winner – Claims Legal Services Provider of the Year – Claims Club Asia Awards 2016

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