Corporate tax update

July 2021

Welcome to the latest edition of our Corporate Tax Update, written by members of RPC's tax team. This month's update reports on some of the key developments from May and June 2021. Included in this update are news of the historic G7 agreement as to plans for global tax reform, summaries of two cases on the required formalities for bringing contractual claims for breach of warranty and pursuant to a tax covenant, and news of another win for HMRC in an 'IR35' case. As ever we hope you, your family and friends are all staying safe and are enjoying the summer.

An arresting case – settlement agreement payments made to satisfy "success fee" and litigation insurance premium not taxable as employment income

On 29 June 2021, the Upper Tribunal held that neither (1) a "success fee" payable to an employee's legal team, nor (2) an insurance premium payable on a policy against the risk of having to pay the employer's legal costs, were taxable as earnings. more›

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The beginning of the end for tax havens?

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ABOUT THIS UPDATE

Our corporate tax update is published regularly, and is written by members of RPC's Tax team.

We also publish other Tax updates on the first and last Thursday of every month, and a weekly blog, RPC's Tax Take.

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AG opines as to VAT treatment of parking fines

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TP Icap Ltd v Nex Group Ltd

On 27 May 2021, the High Court struck out large parts of the claimant's claim as (in the High Court's view) the purported SPA notices of claim were defective. The decision highlights the difficulties faced by Purchasers of companies in making so-called 'contingent' claims under warranties and indemnities, in particular when a Purchaser becomes aware of third party investigations close to the expiry of any contractual time limits for bringing claims. more›

Dodika Ltd v United Luck Group Holdings

On 7 May 2021, the Court of Appeal held that a purchaser's notice of claim under an SPA tax covenant was not invalid on the grounds that it failed to state "in reasonable detail the matter which gives rise" to the tax covenant claim. more›

OTS publishes 2nd report on CGT rules

On 20 May 2021, the Office of Tax Simplification (**OTS**) published its report *Capital Gains Tax Review – Simplifying practical, technical and administrative issues*. This is the 2nd report by the OTS on CGT. The 1st report, published by the OTS on 11 November 2020, considered CGT policy design. more›

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An arresting case – settlement agreement payments made to satisfy "success fee" and litigation insurance premium not taxable as employment income

On 29 June 2021, the Upper Tribunal held[1] that neither (1) a "success fee" payable to an employee's legal team, nor (2) an insurance premium payable on a policy against the risk of having to pay the employer's legal costs, were taxable as earnings.

A group of police officers brought claims against the Metropolitan Police (the Met) for alleged underpayment of overtime and other allowances. The officers and the Met reached a settlement and, pursuant to a settlement agreement, the following amounts were paid to the officers in "full and final settlement" of the dispute:

1. £4.2m as a "Principal Settlement Sum"
2. an amount of "Agreed Costs" (being defined as the officers' legal costs and disbursements, plus VAT).

The "Principal Settlement Sum" and the "Agreed Costs" were, when taken together, defined in the Settlement Agreement as the "Global Settlement Sum", which was to be paid as follows:

- £1.2m to the officers' solicitors as part of a "Damages-Based Agreement". This agreement documented the manner in which the officers had chosen to fund the proceedings against the Met. The £1.2m was, essentially, the "success fee" negotiated by the solicitors (and counsel) in return for agreeing to take on the officers' case. This was to be paid direct by the Met to the firm of solicitors
- £50,000 as a premium to an insurance company, with whom the officers had entered into a policy. Under the policy, the insurer agreed to meet any of the Met's legal costs, had the officers failed in their claim
- the balance was to be paid to the officers, in agreed proportions, subject to withholdings for income tax and national insurance contributions (NICs). But the tax and NICs withholdings were to be made on the whole of the £4.2m Principal Settlement Sum, and not the net amount after deduction of the success fee and the insurance premium.

When HMRC assessed Mr Murphy[2] to income tax on his share of the Principal Settlement Sum (without any deduction for the success fee or the insurance premium (such amounts, together, the **Disputed Amounts**)), Mr Murphy appealed on the grounds that these Disputed Amounts did not constitute "earnings" under ITEPA 2003. The First-tier Tribunal held that these amounts were taxable as they arose "from" employment and not from something else. Mr Murphy appealed to the Upper Tribunal (UT).

The UT noted that it was common ground that the Disputed Amounts could only be regarded as "earnings" under section 62(2)(b) of ITEPA 2003, ie as "*any…other profit…of any kind obtained by the employee [in relation to an employment]*" if the earnings were "from" an employment (as required by section 9 of ITEPA 2003).

The UT therefore considered two issues:

1. is the alleged profit derived "from" the employment? The First-tier Tribunal decided the case on this issue
2. does the reference to "profit" mean gross, or net, profit? The UT's view was that the First-tier Tribunal had erred in not considering this "profit" issue.

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The UT found that no distinction could be made between the Disputed Amounts and the Agreed Costs. They were all amounts which the officers had to incur in order to pursue their claim against the Met, and therefore to obtain the settlement payments. The UT's view was that even if the Disputed Amounts could be said to derive "from" an employment, it was then necessary to decide how much of the Principal Settlement Amount should be treated as "profit" properly taxable as employment income. The UT held that the Disputed Amounts should be deducted from the Principal Settlement Amount in arriving at a net "profit" to be taxed as earnings.

The decision can be viewed here.

VAT option to tax – further extension of deadline to 31 July 2021

On 29 June 2021, HMRC announced a further (continued) extension to the deadline (from 30 days to 90 days) for notifying a decision to opt to tax land for VAT purposes. This now applies to decisions made between 15 February 2020 and 31 July 2021.

This is the latest in a series of further continuations of this temporary relaxation, in light of the Covid-19 pandemic.

The updated guidance can be viewed here.

HMRC announces the end of physical stamping

On 18 June 2021, HMRC announced that its physical stamping presses would be decommissioned. As a result, the only method of stamping is now the electronic procedure introduced ("temporarily", at first) in March 2020 at the beginning of the Covid-19 pandemic.

So comes to an end the 300-year old process of having to show a manually stamped document to demonstrate payment of stamp duty in the UK.

The press release can be viewed here.

Upper Tribunal dismisses taxpayer's appeal in latest 'IR35' case

On 8 June 2021, the Upper Tribunal (UT) held[3] that the 'IR35' rules applied to services provided via a personal services company (PSC) to the Nationwide Building Society.

The UT dismissed the PSC's appeal against the decision of the First-tier Tribunal. The only issue before the UT was whether, under the 'hypothetical contract' between the individual worker and the Nationwide that was required to be considered by the IR35 rules, the worker would be regarded as an employee of the Nationwide. The now familiar, three-stage, approach was adopted for these purposes:

1. find the terms of the actual contracts between the PSC and the Nationwide on the one hand, and the worker and the PSC on the other, and the relevant circumstances within which the worker worked
2. ascertain the terms of the hypothetical contract between the worker and the Nationwide
3. consider whether this hypothetical contract would be a contract of employment.

The PSC's appeal was based on a number of grounds, including:

- that as the Nationwide could not move the worker from one project to another, this was inconsistent with a contract of employment (under the "control" test)

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- there was no obligation on the Nationwide to provide work to the worker once the specific project had been completed, even if this occurred before the end date of the contract. This was also inconsistent with a contract of employment (under the "mutuality of obligation" test)
- the right of substitution in the hypothetical contract was more than merely "theoretical", as had been found by the First-tier Tribunal
- that the First-tier Tribunal had failed to provide adequate reasons for deciding that the worker was 'part and parcel' of the Nationwide's operations.

The UT:

- rejected the taxpayer's submissions on the mutuality of obligation test, holding that the authorities did not support an argument that there would be insufficient mutuality of obligation in the hypothetical contract in view of the fact that the Nationwide would not have to offer work if a particular project ended before the expiry of the term of the contract. The UT took the view that until the contract is terminated there is mutuality of obligation in the sense of an obligation to pay for work done and to do the work
- held that the First-tier Tribunal was entitled, based on the evidence before it, to take the view that the right of substitution in the hypothetical contract in question was "theoretical" only
- rejected the taxpayer's submissions on the control test, finding that the Nationwide had control of when and where the worker worked.

The decision can be viewed here.

The beginning of the end for tax havens?

On 5 June 2021, the 'G7' nations agreed a deal on global tax reform. However challenges still lie ahead before reform of the international tax rules can be achieved.

Described by the UK government as a "seismic" agreement to ensure that the largest multinational tech giants pay their "fair share" of tax in countries in which they operate, the identity of the (US-headquartered) multinational companies that are the target of these proposals is no secret.

There are, in fact, 2 "pillars" to the announced 'agreement':

1. reform of the international tax regime so that certain multinational companies will be required to pay tax where they do business (this pillar has been driven by the major European economies)
2. a global minimum corporate tax rate of "at least" 15% in each country in which multinational companies do business (this pillar is of utmost importance to the US).

Any agreement to reform the international tax regime would be the first for over a century. The rules have been dismissed as no longer being fit for purpose, in particular in a world where business is increasingly digitalised such that it is no longer necessary for multinationals to have a physical presence in the jurisdictions in which they do business.

This first-step has been a long-time coming. Efforts to reform international tax rules started in 2013, with the publication of the OECD's Base Erosion and Profit Shifting (BEPS) action plan. It has been suggested that the change of administration in the US has provided momentum to reach this point. Another theory is that desperation to raise funds from tax revenues, driven by the Covid-19 pandemic, has also spurred governments into action.

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However, this is far from the end of negotiations and perhaps is better viewed as being the beginning of the final stage of reaching an agreement. There are numerous hurdles still to be overcome, including:

- agreement as to the precise details of the new international tax regime. The UK government's press release states that only the "largest and most profitable" multinational companies will be caught. Global firms with at least a 10% profit margin would have 20% of any profit above the 10% margin reallocated and subjected to tax in the countries in which they operate. Exactly how this threshold applies, and the detailed definitions and concepts that will undoubtedly be required in order to make this work, remain to be seen
- agreement as to a global minimum corporate tax rate. G7 ministers have proposed a global minimum rate of "at least" 15%
- countries such as the UK, France and Italy agreeing to abolish their 'digital' tax regimes. In the UK, the digital services tax (**DST**) has been in place since April 2020. The UK government has always stated that the DST is an interim measure only, to be repealed once an "appropriate international solution" has been agreed to the perceived problem faced by countries such as the UK; the inability to adequately tax highly digitalised businesses operating in a given jurisdiction without a *physical* presence there. The US has consistently labelled such unilateral digital taxes as unfairly targeting US tech companies. Whether the US requires these national taxes to be repealed before the US legislates to enact any globally agreed approach, is unclear.

There has already been criticism of the proposed 15% minimum corporate tax rate. Commentators, campaigners and charities say this has been set far too low and that at this rate it would fail to end the so-called "race to the bottom" of falling corporate tax rates. No doubt that G7 nation ministers will point to the fact this has been phrased as "at least" 15%, holding out the possibility that this minimum rate may rise. Indeed, the French finance minister has called this a starting point and has said that he will fight to make the minimum tax rate as high as possible.

The proposals were due to be discussed in more detail at the planned 'G20' meeting of Finance Ministers and Central Bank Governors in July. After that, the detail underpinning the proposed new regime will need to be agreed by the 139 nations that make up the OECD.

The G7 proposals, whilst historic, are surely only the beginning of a process. To succeed, the proposals will need much wider backing from nations such as China and India. Not to mention jurisdictions such as Ireland (with a current corporate tax rate of 12.5%).

Initial responses from the US tech companies most likely to be affected by any new rules were supportive. Those companies will almost certainly have much to say about the detail of any new global tax regime.

The UK government announcement on this can be viewed here.

AG opines as to VAT treatment of parking fines

On 3 June 2021, the Advocate General (AG) opined that a parking fine is consideration for VAT purposes (rather than a VAT-exempt amount of compensation). In the AG's view, there was a direct link between the parking fine and a service received by the motorist (being a space to park). Accordingly, VAT should be charged on the parking fine. The AG expressed the view that 'compensatory' payments should only be exempt from VAT where the payment is compensation for a supply having **not** occurred.

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In the UK, Revenue and Customs Brief 12 (2020) set out HMRC's view as to the potentially incorrect historic VAT treatment of so-called compensation payments. HMRC also set out their view as to the correct VAT treatment of parking fines in the VAT manual.

It remains to be seen whether the ECJ will follow the AG's opinion. Despite Brexit, the ECJ's decision could still influence HMRC's approach to parking fines and compensatory payments generally.

The AG's opinion (Danish language version) can be viewed here.

The HMRC Brief 12 (2020) can be viewed here.

HMRC's guidance on parking fines can be viewed here.

ECJ holds that leased land was not a fixed establishment for VAT purposes

On 3 June 2021, the ECJ held that the mere leasing of land (in Austria) did not amount to a "fixed establishment" of the landlord there for VAT purposes. The landlord had no staff in Austria, but instead relied on an independent agent to manage the property.

The ECJ confirmed that, for there to be a fixed establishment for VAT purposes, the landlord (a Jersey incorporated company) would have needed to have had its own staff located in Austria. This is consistent with current HMRC guidance.

The decision can be viewed here.

VAT and land – call for evidence published by HMRC

On 12 May 2021, HMRC published a *call for evidence* on the VAT land exemption. The consultation closes for comments on 3 August 2021 and seeks views on options for simplifying the VAT rules for land and property.

This follows on from the Office of Tax Simplification's 2017 review of VAT, which recommended the simplification of the VAT regime for land and property.

Ideas for simplification, as set out in the document, include:

- making all land transactions exempt from VAT (ie removing the 'option to tax')
- making all land transactions subject to VAT at a single rate
- making all commercial land and property taxable with an option to exempt.

The call for evidence can be viewed here.

TP Icap Ltd v Nex Group Ltd and *Dodika Ltd v United Luck Group Holdings*: two interesting decisions on SPA warranty/indemnity claim formalities

TP Icap Ltd v Nex Group Ltd

On 27 May 2021, the High Court[4] struck out large parts of the claimant's claim as (in the High Court's view) the purported SPA notices of claim were defective. The decision highlights the difficulties faced by Purchasers of companies in making so-called 'contingent' claims under warranties and indemnities, in particular when a Purchaser becomes aware of third party investigations close to the expiry of any contractual time limits for bringing claims.

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By way of an SPA dated 11 November 2015, which completed on 30 December 2016, the claimant purchased the entire share capital of the target company. The SPA included strict time limits for bringing (non-tax) warranty claims, being 30 December 2018. In particular, the relevant provision in the SPA stated that the Seller was not liable unless the Purchaser gave written notice of the claim "stating in reasonable detail the nature of the [claim] and, if practicable, the amount claimed" on or before 30 December 2018. This is a fairly common way of expressing the time limit for bringing SPA claims. The tax warranties and tax covenant were subject to more generous claim time limits, again as is typical in English law governed SPAs.

The facts which gave rise to the purported SPA claims were as follows:

- an investigation by the US and UK authorities into certain swaps transactions and swaps trading activity (the **CFTC/FCA Matter**)
- investigations by the German authorities into alleged "cum-ex" trading of German securities (the **German Tax Matters**).

The Purchaser brought claims under three heads:

1. damages for breach of certain non-tax warranties (in respect of both the CFTC/FCA Matter and the German Tax Matters)
2. damages for breach of certain tax warranties (in respect of the German Tax Matters)
3. a declaration that the Purchaser would be entitled to a future claim under the tax covenant in certain circumstances.

In a lengthy decision, in which Mr Justice Calver considered a number of decided cases on the interpretation of purported claim notifications, it was held that:

- the SPA provision setting out the time limit for bringing claims was a limitation clause. It is for the party bringing the claim to demonstrate that it has complied with the contractual notification requirement
- the contents of any claim notification must be determined by reference to the terms of the warranty (or indemnity) in question. Every notification clause turns on its own wording
- for a warranty that referred to something which had happened (in this case, the contravention of a law or regulation) the claim notification needed to describe the broad nature of what had taken place. The Purchaser's position – that it was entitled to notify a claim dependent upon a contingency – was rejected
- a notification within a specified time limit, that an unspecified contravention may be revealed at some future date, was ineffective
- this is the case even where, as here, the relevant notice clause amount to a "low threshold" (only requiring reasonable details to be provided)
- the claim notification must actually make it clear that a claim is being made (rather than the possibility of a clam being made in the future)
- if the Purchaser's position was correct, the time limit set out in the relevant SPA provision would be rendered redundant. A Purchaser could always get around the time limit by making an 'in time' claim notification for breach of the warranty in respect of some future, unspecified, issue
- the Purchaser's claim for an indemnity under the tax covenant was also ineffective as no actual tax liability had arisen. The purported claim was, therefore, premature.

The decision can be viewed here.

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Dodika Ltd v United Luck Group Holdings

On 7 May 2021, the Court of Appeal held[5] that a purchaser's notice of claim under an SPA tax covenant was not invalid on the grounds that it failed to state "in reasonable detail the matter which gives rise" to the tax covenant claim.

The purchaser acquired an English target company in 2016. The target company's business consisted mainly of the development of apps for mobile phones, including the hugely popular '*Talking Tom*' app. As part of the negotiated Sale and Purchase Agreement (SPA) for the acquisition, the purchaser obtained the benefit of a tax covenant from certain of the sellers. Just prior to the expiry of the time period for bringing claims under the tax covenant, in 2019, the purchaser gave to those sellers what it considered to be a valid notice of claim (by way of a letter, the "Claim Letter"). The trigger for the (purported) claim was an investigation launched by the Slovenian tax authorities concerning the transfer pricing practices of one of the acquired company's subsidiaries.

The issue was whether the purchaser, in making the claim, had complied with the requirements of the SPA. In particular, whether the Claim Letter stated "in reasonable detail the matter which gives rise" to the claim.

The Claim Letter stated that the purchaser's tax covenant claim(s) related to the Slovenian tax authorities' investigation and included a brief chronology.

The High Court held that the Claim Letter did not comply with the SPA requirements. The judge concluded that the "matter" which needed to be described in reasonable detail was not the tax authority investigation, but instead were the underlying facts, events or circumstances on which the claim is based.

Lord Justice Nugee considered two questions:

1. what is the "matter" that gives rise to the claim? On this, Lord Justice Nugee had little difficulty in finding that the "matter" was a reference to the underlying pre-Completion facts giving rise to the tax liability. To use the language of the tax covenant, this would be either (i) the occurrence of a pre-Completion event, transaction, action or omission, or (ii) the earning, accrual, receipt of pre-Completion income, profits or gains
2. did the Claim Letter state this matter in "reasonable detail"?

On this second question Lord Justice Nugee noted that the Claim Letter did not say very much about the underlying pre-Completion facts that gave rise to the tax liability. The sellers' position was that the Claim Letter should have contained more information, to include detail as to what the subsidiary had, in fact, done and detail as to the tax authority's position. However, the sellers accepted that they had full knowledge of this information, such that setting this out in the Claim Letter would have served little useful purpose. As the Lord Justice put it "*[if the sellers are right] it would mean that the Claim Letter was a non-compliant notice not because it failed to inform the [sellers] of anything that they needed to know, but because it failed to go through the ritual of setting out things that they already knew*".

For this reason, the Court of Appeal held that the Claim Letter did give reasonable detail of the matter giving rise to the claim, as required by the SPA. What amounted to "reasonable detail" was, it was found, dependent on all the circumstances – including what the recipients of the notice already knew. A businessperson would not expect to receive further detail, for the sake of mere formality, which served no commercial purpose.

The decision can be viewed here.

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OTS publishes 2nd report on CGT rules

On 20 May 2021, the Office of Tax Simplification (**OTS**) published its report *Capital Gains Tax Review – Simplifying practical, technical and administrative issues*. This is the 2nd report by the OTS on CGT. The 1st report, published by the OTS on 11 November 2020, considered CGT policy design.

In this latest report, the OTS has made 14 recommendations in total for the government to consider. They include:

- whether CGT should be payable upon receipt of cash (such that, for instalment payments, CGT would be payable on each instalment when paid). The OTS acknowledge that thought would need to be given to how the base cost of an asset is 'allocated' to instalment payments in such a scenario, and how to deal with changes (for example to a taxpayer's residence) in between receipt of instalment payments
- the possibility of an irrevocable provision in corporate bond documents, specifying that it is subject to CGT (rather than, as with the current rules, structuring bonds as non-qualifying corporate bonds in order to secure exemption from CGT)
- perceived improvements to the EIS and SEIS tax relief regimes, to include enabling investors to benefit from CGT relief in cases where they have not claimed income tax relief.

The OTS report can be viewed here.

ANY COMMENTS OR QUERIES

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ENDNOTES

1. In *Murphy v HMRC* [2021] UKUT 152 (TCC).
2. One of the officers involved in the group litigation.
3. In *Northern Light Solutions Limited v Revenue and Customs* [2021] UKUT 134 (TCC).
4. In *TP Icap Ltd v Nex Group Ltd* [2021] EWHC 1375 (Comm).
5. In *Dodika Ltd v United Luck Group Holdings Ltd* [2021] EWCA Civ 638.