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Key Developments

Draft rules to implement “DAC6” obligations to disclose cross-border tax planning arrangements

The UK has published draft regulations that will introduce new reporting requirements in relation to tax planning schemes with a cross-border element. The rules are required to implement recent changes made to the EU Directive on Administrative Co-operation (widely known as “DAC6”). The draft regulations are accompanied by a consultation document.

Comments are invited by 11 October 2019, with a view to the rules being made before the end of the year. Taxpayers and intermediaries that may be within scope will need to consider their obligations carefully.

There has been a lot of concern about DAC6, both in the UK and elsewhere in the EU. The drafting is broad and has led to various difficult points of interpretation. The UK draft regulations draw heavily on the definitions and concepts contained in DAC6 (at their heart, both require “intermediaries” that are participating in “reportable cross-border arrangements” to disclose certain information to relevant tax authorities). However, HMRC has added a gloss to the rules through both the implementing legislation and the approach to interpretation it has outlined in the consultation document. Overall, therefore, whilst areas of uncertainty remain and further work will be required, HMRC seems to be taking a pragmatic approach in seeking to ensure that the rules can be operated in practice.

*Draft regulations: implementation of disclosable arrangements - HMRC, 22 July 2019*

Employment Tax

Spotlight on another disguised remuneration scheme

HMRC has published a spotlight (Spotlight 53) highlighting another scheme designed to avoid the disguised remuneration rules in Part 7A ITEPA 2003, which HMRC considers does not work.

The arrangements involve an individual becoming an employee of an entity which he/she jointly (or mutually) owns. The individual receives two separate
payments from the entity on a weekly or monthly basis - a nominal salary and a "capital advance" (or loan). In due course, the capital advance is repaid out of dividends or capital gains (which amounts are subject to tax at a lower rate).

HMRC’s view is that these and other similar schemes do not work. HMRC cautions that users are liable for income tax and NICs. Penalties, including a 60% GAAR penalty, may also apply.

_Disguised remuneration: tax avoidance using capital advances, joint and mutual share ownership agreements (Spotlight 53) - HMRC, 22 July 2019_

**Bill to align NICs and income tax on termination payments receives Royal Assent**

The National Insurance Contributions (Termination Awards and Sporting Testimonials) Bill 2017-19 has received Royal Assent. This Act will (inter alia) amend the NICs treatment of termination payments.

In essence, the changes are designed to align the employer NICs treatment of termination payments with the income tax treatment - that is, to impose an employer NICs charge where the termination payment exceeds £30,000. The government confirmed at Budget 2018 that the measures will take effect from 6 April 2020.


**Contentious Tax**

**GLO members not entitled to interim payment pending resolution of substantive issues**

In a hearing in Jazztel plc (as Test Claimant for GLO issues 9A and 9B), the Court of Appeal (Lord Justice Floyd, Lord Justice Simon and Lord Justice David Richards) found that Section 234 Finance Act 2013 (which imposes a restriction on applications for interim remedies) denied the members of a group litigation order ("GLO") recovery of the taxes that had been unlawfully levied on them because some substantive issues remain under appeal.

The GLO in question concerns the legality of the 1.5% stamp taxes charge arising on issues and transfers of securities to depositary receipt systems and clearance services. Although certain matters have been decided in favour of the taxpayers (see UK Tax News 11 (2017)), other limitation issues remain unresolved pending appeal.

Jazztel, the lead claimant, has received a repayment of the stamp taxes it was unlawfully required to pay on a conditional basis; it will have to pay the tax back if the further appeals go against it. In this hearing, Jazztel applied for the remaining members of the GLO to be treated in the same way, i.e. to receive a conditional payment of the stamp taxes. However, the court declined to make
such an order, considering that the remedy sought was “interim” in nature and therefore Section 234 prevented recovery. This is a somewhat surprising result meaning that there is a substantive difference in the tax treatment of the test claimant in the GLO as compared to the other affected parties.

*Jazztel Plc v HMRC [2019] EWCA Civ 1301*

**Further High Court decision in Franked Investment Income litigation**

The High Court (Mrs Justice Falk) has delivered a further decision relating to the claims of certain non-test claimants in the long-running Franked Investment Income Group Litigation (“FII GLO”). These issues did not arise in the FII GLO itself (or the related CFC & Dividend GLO). Instead they emerged during the process of computing and reaching agreement on the values of various non-test claimants’ claims. Almost by definition, this decision may therefore be of limited wider application.

The first issue was essentially an evidential challenge. By way of background, one of the conclusions of the FII GLO was that the then existing provisions of national law, which subjected non-UK source dividends to corporation tax subject to a credit for foreign tax paid whilst exempting UK source dividends, infringed EU law. However, the FII GLO determined that this infringement could be remedied by, in appropriate circumstances, granting a credit at the foreign nominal rate of tax (“FNR”), where that exceeded the actual relief granted. The court noted that in order to benefit from a credit at the FNR the burden of proof fell on the taxpayer to show, on a balance of probabilities, that the dividends concerned were derived from profits subject to tax. This would exclude, for example, dividends that constituted a return of capital. The challenge for the particular taxpayer in this case was that it did not have full evidence showing the source of its dividends. The court therefore analysed the available evidence in relation to each dividend stream, determining whether on the facts - to the relevant standard of proof - the test was satisfied.

The second issue was a procedural one. HMRC argued that the drafting of the particulars of claim of one particular claimant meant that its claim was limited to dividends in accounting periods ending in 1992 onwards. The court disagreed, considering that the general language of the particulars of claim meant that it also extended to earlier periods from 1973 onwards (despite the fact that only dividends from 1992 onwards were separately listed in the schedule to the claim).

*Non-test claimants in the Franked Investment Income Group Litigation v Commissioners of Inland Revenue [2019] EWHC 2014 (Ch)*
Anti-Avoidance

*Ingenious* film scheme fails at Upper Tribunal as LLPs not trading

The Upper Tribunal (Mrs Justice Falk and Judge Tim Herrington) has considered appeals from both the taxpayers and HMRC in a number of film and computer game partnership schemes promoted by the Ingenious Media Group. The schemes were designed to create an enhanced tax loss for the individual members of the partnerships (the “LLPs”) in their first year.

In an extremely detailed and thorough decision, running to some 160 pages, the Upper Tribunal found in favour of HMRC on all grounds. Details of the First-tier Tribunal decisions are available in *UK Tax News Issue 28* (2016) and *UK Tax News Issue 17* (2017).

At the very highest level, the schemes were structured so that it appeared that the LLPs incurred 100% of the costs of producing a film or computer game in return for a smaller percentage of the resulting receipts. This was despite the fact that a substantial proportion of the funding for the production (in most cases, 70%) was in fact sourced from a separate “commissioning distributor”. The LLPs claimed that these arrangements resulted in a loss in the LLP in the first year, which was eligible for sideways loss relief by the individual investors.

To be successful, crucially, the LLPs had to be trading and doing so “with a view to profit”. The Upper Tribunal considered that:

> The LLPs were not trading. Their activities instead amounted to the acquisition and holding of rights in a potential income stream from a film or game.

> Even if the LLPs were trading, they were not doing so with a view to profit. Unlike the First-tier Tribunal, the Upper Tribunal considered that this was a wholly subjective test.

The first of these conclusions was enough to dispense with the case in favour of HMRC. However, the Upper Tribunal went on to consider various additional points that had been raised by the parties.

Looking at some more specific questions relating to whether the payments made by the LLPs would have been deductible if the LLPs had been trading, i.e. whether the payments were “incurred wholly and exclusively for the purposes of the trade” and were income rather than capital in nature:

> The “reality” of the arrangements was that the LLPs only “incurred” (i.e. bore the economic burden of) 30% of the costs (i.e. the amount that was not funded by the commissioning distributor).

> If, despite the conclusion above, the LLPs could be regarded as having incurred 100% of the costs, 70% of that amount would not have been incurred wholly and exclusively for the purposes of the trade. This was because the benefit flowing to the other parties to the scheme (i.e. the return realised by the commissioning distributor) was not merely a consequential effect, but instead was a fundamental, defining feature of the arrangements. It was also open to the First-tier Tribunal to conclude...
that the tax avoidance purpose “infected” 70% of the expenditure for the purposes of applying the wholly and exclusively test.

> The First-tier Tribunal had been entitled to conclude that the LLPs’ accounts did not comply with GAAP as they did not reflect the substance of the transactions. In particular, the accounts should have been computed by reference to expenditure of 30%.

> The expenditure was capital rather than income in nature: there was a once and for all acquisition of rights for the enduring benefit of the trade.

This decision marks a resounding success for HMRC. However, given the amounts at stake (collectively the loss claims in dispute amount to £1.6 billion, although the LLPs say that this is, in reality, just a deferral of tax), a further appeal may be likely.

*Ingenious Games LLP and Others v Revenue and Customs [2019] UKUT 226 (TCC)*

**VAT**

**Call for evidence on VAT partial exemption and capital goods scheme**

HMRC has published a call for evidence in relation to the simplification of the VAT partial exemption and capital goods scheme (“CGS”). This is in response to a report by the Office of Tax Simplification, which highlighted complexities in this area (see *UK Tax News Issue 34 (2017)*).

The call for evidence asks for insights specifically in relation to:

> Partial exemption special methods (“PESM”). In particular, HMRC is considering removing the requirement for taxpayers to negotiate and obtain approval from HMRC to use a PESM.

> Options for simplifying the *de minimis* rule.

> Options for simplifying the CGS. In particular, HMRC is considering whether to raise the current thresholds, change the duration of CGS intervals and exclude certain categories of assets (e.g. computers).

Despite focussing on these areas, the document states that HMRC does not want the evidence collated to be limited in its scope and therefore views on broader issues and options for reform are also welcome. The closing date for comments is 26 September 2019.

*Call for evidence: simplification of partial exemption and the capital goods scheme - HMRC, 18 July 2019*
**No price reduction for VAT purposes in absence of actual repayment of consideration**

In *Inventive Tax Strategies*, the Upper Tribunal (Mr Justice Mann and Judge Jonathan Richards) concluded that there will only be a “decrease in consideration” for the purposes of Regulation 38, Value Added Tax Regulations 1995 where an actual repayment is made to the customer.

The taxpayers sold SDLT avoidance schemes. They charged a fee for their services, plus VAT. However, under the terms of the contracts, the fees were repayable if the schemes were unsuccessful.

In the event, the schemes were unsuccessful. The taxpayers therefore fell under an unconditional obligation to repay the fees. However, before any repayment was made, the taxpayers went into administration or liquidation. Instead of repaying the fees, the taxpayers therefore simply issued credit notes to their customers and sought to claim a refund of the output VAT accounted for on the supplies.

The Upper Tribunal did not consider that any refund of the output VAT was due. The existence of the contractual obligation to repay the fees was not, in itself, sufficient to result in a reduction in the consideration subject to VAT. In the absence of any actual repayment, the commercial reality was that there had been no price reduction.

*Inventive Tax Strategies Ltd (in Liquidation) and Others v Revenue and Customs UKUT 221 (TCC)*

**International Tax**

**Commission notice on the recovery of unlawful and incompatible state aid**

The European Commission has published a notice on the recovery of unlawful and incompatible state aid. The purpose of the notice is to explain the EU rules and procedures governing the recovery of state aid, and how the Commission works with member states to ensure compliance with their obligations under EU law.

The notice includes a section on the recovery of unlawful tax reliefs. Given recent developments in this area (for example, the Commission’s finding that the finance company exemption from the UK’s controlled foreign company rules constitutes state aid in part (see UK Tax News Issue 13 (2019))), this may be of particular interest.

*Commission Notice on the recovery of unlawful and incompatible State aid - EU Commission, 22 July 2019*
Other Developments

Next steps in relation to plastic packaging tax

HMRC has published a response to the call for evidence published earlier in the year on the introduction of a plastic packaging tax. A record 162,000 responses were received, highlighting the strong public interest in this area.

The new tax will apply from April 2022. It will be charged on businesses that produce or import plastic packaging which uses insufficient recycled content. The tax has a clear purpose of driving behaviour: more specifically, to stimulate increased levels of recycling and collection of plastic waste.

The government will set out next steps at Budget 2019, which will be followed by a technical consultation and draft legislation in 2020.

Plastic packaging tax: summary of responses to consultation - HM Treasury, 23 July 2019