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PM-Tax

News and Views from the Pinsent Masons Tax team

Budget Special Edition

Due to the Easter break, the next edition of PM-Tax will be published on 17th April

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A Budget for Aspiration?

by James Bullock

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He is one of the UK's leading tax practitioners and has been recognised as such in the leading legal directories for many years. James has over nineteen years of experience advising in relation to large and complex disputes with HMRC for large corporates and high net worth individuals, including in particular leading negotiations and handling tax litigation at all levels from the Tax Tribunal to the Supreme Court and European Court of Justice.

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Welcome to the special Budget Edition 2013 of PM-Tax.

"A Budget for an Aspiration Nation" is how today's budget was spun by the Chancellor. Presumably he was referring to the proposals for a new "Help to Buy" scheme to shore up the UK's struggling housing market, with the Government using its balance sheet to guarantee mortgages and act as a lender for 'new build' housing. This was more than a 'genuflection' to Margaret Thatcher's "Right to Buy" Scheme in the 1980s. The difference was that at that time the Public Sector owned the housing stock in the first place. Hopefully we will not have a home-grown version of "Fannie Mae" and "Freddie Mac".

Another headline-grabber was the commitment to reduce the rate of corporation tax to 20 per cent with effect from 2015-16. This has been a much-heralded aspiration, which will give the UK the lowest such rate of any G20 nation. However, there are two concerns here. First, it could have an adverse impact under foreign CFC regimes, effectively turning the UK into a 'tax haven' with (perversely) punitive effects for UK subsidiaries of certain overseas parent companies. Secondly, and more fundamentally, a company cannot operate without individuals – and for those individuals the rate of income tax remains punitively high – with many of the benefits for 'non-UK domiciled' individuals, who might relocate to take advantage of the low corporation tax rate, being discouraged from doing so by the progressive removal of many of their own tax advantages in recent years.

There is a very welcome amendment to the Procurement Proposals (published in draft in February 2013 for a very short period of consultation). The concept, it will be recalled, was a cornerstone of the 2012 Autumn Statement. These rules - as originally drafted - sought to exclude corporates with non-compliant tax strategies from securing government contracts. Fortunately, the rules will now only operate prospectively (not retrospectively for up to ten years) and will only apply to transactions undertaken that would be subject to the GAAR, the 'Halifax' abuse principle, or DOTAS – broadly, 'abusive' transactions only.

Meanwhile - was the 2013 Budget the "last Hurrah for the TAAR"? It was certainly a big "hurrah!" with extensive targeted avoidance provisions affecting,

> *Was the 2013 Budget the "last Hurrah for the TAAR"?*

A Budget for Aspiration? (continued)

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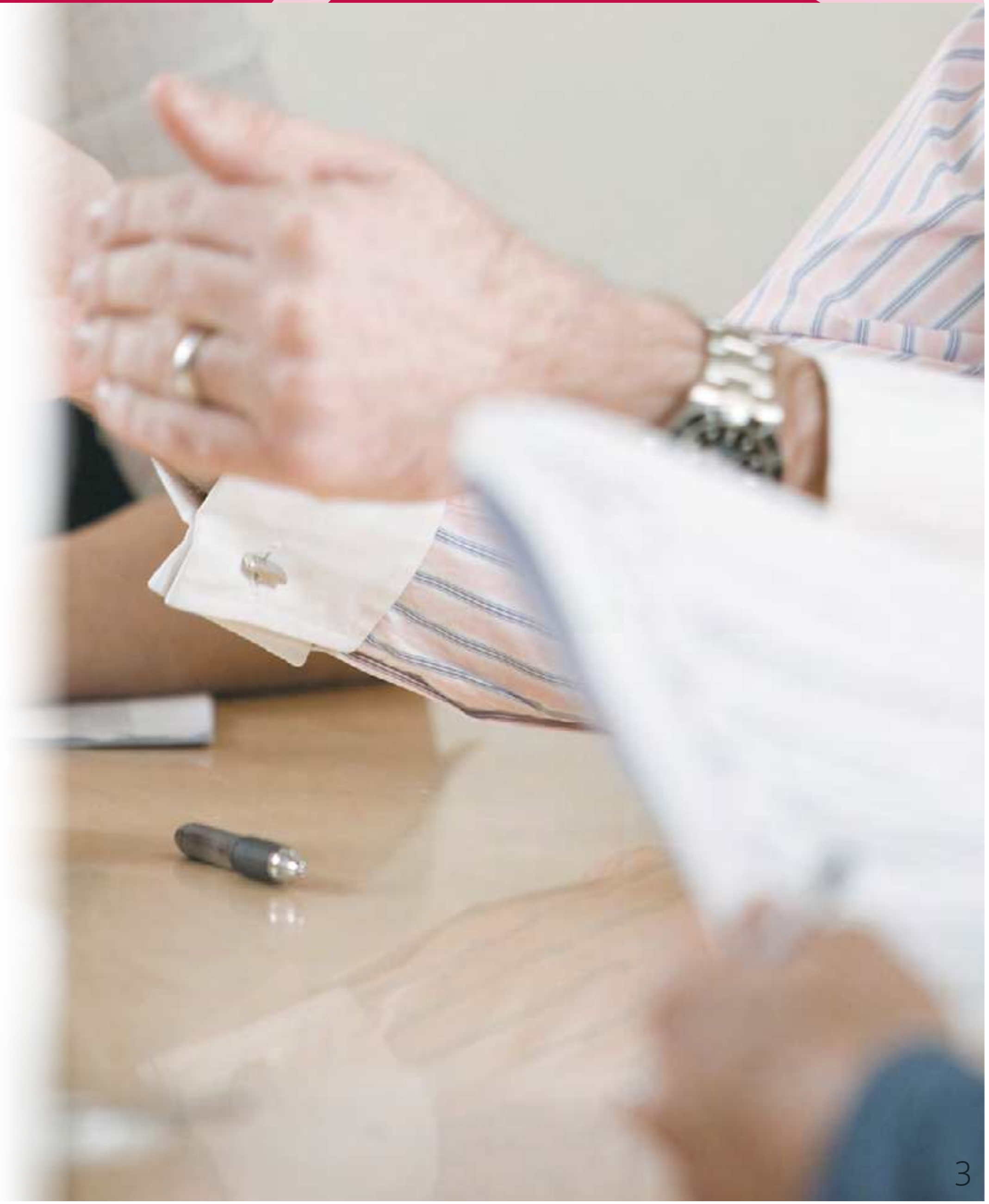
in particular, the acquisition of companies with losses. We suspect that the TAAR has by no means had its day as the GAAR (as originally envisaged) will catch only the most abusive transactions. Whilst this approach is to be welcomed, it doesn't give very much hope that the overall amount of tax legislation will be reduced!

On compliance and enforcement, relatively little in this Budget, apart from a somewhat self-congratulatory publication entitled No Safe Havens, with much emphasis on 'naming and shaming' scheme promoters and the non-compliant - and evidence that much of the £1 billion allocated to fight avoidance and evasion is being spent on enhanced technology. There are Disclosure Facilities announced for Jersey and Guernsey (following that for the Isle of Man and on broadly similar terms).

Finally, we have further confirmation that the "Tax Gap" increased slightly in 2010 – 11 (the latest year for which data is available), but that as much as 6 per cent is lost each year as a result of "taxpayer error". Given that "only" 14 per cent is lost to avoidance one might think HMRC could be doing more to reduce errors – possibly by making the tax system rather more simple? Or maybe that is just an aspiration…

We hope that you enjoy this special Budget edition of PM Tax and would be delighted to receive any feedback or thoughts emanating from these pages. ●



A welcome relaxation to the proposed new rules on procurement and tax

by Jason Collins

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Any company bidding for Government contracts needs to be aware that new rules will apply from 1 April 2013. In February, the Cabinet Office issued revised guidelines on Tax and Procurement. Thankfully, the Budget represents a substantial climb down by HMRC which has rightly recognised that the measure did more than necessary to achieve the policy aim. The measure will now only apply to planning featuring in returns filed after 1 October 2012 - and not any legacy positions.

Although we still do not have the final Procurement Policy Information Note, the details released at the Budget by HMRC show that the final rules will be much more proportionate and easier for bidders to manage. Key changes to the original proposals are a significant reduction in the retrospective application of the rules; the removal of Targeted Anti-Abuse Rules (TAARs) from the scope, and more clarity on the entities affected.

The aim of the new measure is to encourage compliance with the Government's view of tax law. Bidders will be required to self-certify whether they have had any "occasions of non-compliance" since 1 April 2013, in respect of tax returns filed after 1 October 2012. An occasion of non-compliance arises where additional tax has been paid as a result of an HMRC challenge under certain anti-avoidance rules. The previous proposal required bidders to disclose any non-compliance in the previous 10 years, which would have imposed an almost impossible due diligence burden.

All central Government contracts for more than £5m advertised after 1 April 2013 will include a new "pass/fail" question in the pre-qualification questionnaire. A bidder who has had an occasion of non-compliance will need to provide an "explanatory statement" setting out any mitigating factors - for example, that there has been a break from past behaviour and the bidder no longer engages in tax planning which might be affected by anti-avoidance measures. The explanatory statement is crucial, because the procuring department awarding the contract has discretion to pass the bidder, even if there has been past non-compliance.

The scope has also been narrowed to schemes caught by the "General Anti-Abuse Rule" (in operation in July this year), the 'Halifax' abuse principle for VAT and the Disclosure of Tax

> *All Central Government contracts for more than £5m advertised after 1 April 2013 will include a new "pass/fail" question in the pre-qualification questionnaire.*

A welcome relaxation to the proposed new rules on procurement and tax *(continued)*

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Avoidance Schemes regime - and not the many "Targeted Anti-Avoidance Rules" littered throughout the tax code. The threshold for relevant contracts has been raised to £5m - which is good for keeping smaller businesses out of the treacle, but contracting authorities now have an extra control to think about when preparing a PQQ.

There is also more clarity about the definition of the "supplier", which will (as predicted) follow procurement law and apply to the "economic operator", not the worldwide group. In practice, most contracting authorities treat that as being the bidding entity, plus any entity providing technical or financial assistance. Significant subcontractors will still need to certify but independently from the main contractor. This still leaves risk because each has no control over whether the other party will breach the measure during the contract, leaving the contract open to termination. The same goes for companies which form a JV to bid for a contract.

However, protest groups might argue that, by restricting it to new planning, HMRC has potentially missed an opportunity to leverage bidders to settle existing planning and pay more tax.

This could prove embarrassing for the Government if a supplier on a major contract loses a high profile Court case, or discloses a major settlement, in the future. Will the public understand that the planning pre-dated the measure but was only settled after it?

Local authorities, Universities and the Scottish Government now need to decide whether to implement these watered down proposals.

Bidders will need to ensure that there is close working between bid, legal and tax teams in order to ensure that any future tax settlements for relevant periods, and any future tax planning proposals, take into account the potential impact on bid opportunities. ●

No news is good news on transfer pricing rules

by Heather Self

Heather Self is a Partner (non-lawyer) with over 25 years of experience in tax. She has been a partner in Ernst & Young and Group Tax Director at Scottish Power, where she advised on numerous corporate transactions, including the $5bn disposal of the regulated US energy business.

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The taxation of multinationals has been very much in the news over recent months, and David Cameron even commented (perhaps unwisely) that companies need to "wake up and smell the coffee". The Chancellor did not propose any changes to UK rules, but confirmed that this issue will be addressed via the UK Presidency of the G8, with the OECD and at the G20. The OECD are currently preparing a detailed action plan to update the rules on transfer pricing and cross-border financing, which will be on the agenda for the G8 meeting in June.

Multinational problems require multinational solutions, so we are pleased that the Budget did not include any "knee jerk" reactions from the UK to the perceived issue of companies who do not pay their "fair share" of tax in the UK. In our view, there are three key areas to watch:

The definition of a permanent establishment ("PE")

A company resident in one country (Country A) will only be taxed on its activities in another country (Country B) if it has a PE in Country B. A PE is a "fixed place of business through which the business of an enterprise is wholly or partly carried on". Certain activities, such as the provision of a warehouse for delivery purposes, are expressly stated not to give rise to a PE.

> *Multinational problems require multinational solutions, so we are pleased that the Budget did not include any "knee jerk" reactions from the UK*

Hence the UK may be tempted to support an extended definition of a PE, which might increase the amount of UK tax Amazon has to pay. But the rules work both ways, and such a change could also mean that John Lewis becomes taxable in France on its sales via its UK website to customers in France. Any change in this area would probably not increase the total amount of tax collected by the UK Government, but would increase compliance costs and uncertainty for businesses.

Changes to interest deductibility

There is some suggestion that there will be global rules restricting the amount of interest which can be deducted by companies. The UK currently has a relatively generous system, and any change would reduce the UK's international competitiveness, as well as increasing costs for business and hence reducing the funds available for investment.

More anti-avoidance rules

The UK already has a large number of specific anti-avoidance rules, as well as the new GAAR (General Anti-Abuse Rule) which will come into effect in July 2013. Additional rules would increase complexity and are likely to add costs to many non-abusive business transactions.

In summary, no news is good news in this area – but there is a risk of more complexity being proposed over the next few months. ●

The wealthy remain a target of the government fiscal policy

by Ray McCann

Ray McCann is a Partner (non-lawyer) leading our private wealth tax practice and also advises corporate clients on a range of advisory and HMRC related issues, especially in relation to tax planning disputes.

Until 2006, Ray was a senior HMRC Inspector where he held a number of high profile investigation and policy roles including, work on cross border tax avoidance issues with tax authorities in the US, Australia and Canada. In 2004, Ray was responsible for the introduction of the "DOTAS" rules.

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The Chancellor maintained his efforts to re balance the tax base between the wealthy and the lower paid. The increases in personal allowance and extension of the start up relief introduced last year will be paid for by further crack downs on tax avoidance and the new property taxes.

Overall there is a lot of tinkering with the tax system and much of this will add significantly to the already growing library of legislation.

Due to the fact that under the Coalition the "Budget" occurs in December there were few real surprises and as always the devil will be in the detail.

Among the anti-avoidance changes is a retrospective change to the SDLT sub-sale rules that will mean that many taxpayers who used such planning after March 2012 will have to correct their SDLT return. They will have until September 2013 to do so. Whilst this appears targeted at two particular schemes, it is likely that a wider number of SDLT transactions will be caught in the net.

The expected changes to high value property tax will go ahead with some relatively minor changes. However, it is now proposed that taxpayers will be able to elect for any gain on sale of the property to be computed by reference to the entire period of ownership.

The underlying tax policy here remains of concern and it remains uncertain whether these changes will prove worthwhile in the long term. Taxpayers affected by them may find that in trying to minimise or avoid the new tax, potentially costly capital gains tax charges could arise.

Also on the anti-avoidance front, the General Anti-abuse rule will go ahead. The admission by the Government that the GAAR will be ineffective against the large corporate tax arrangements that have attracted so much press comment makes certain that wealthy individuals are likely to be in the front line of the GAAR.

For IHT new rules will be introduced to target the use of "soft debts" that reduce the value of the estate on death. The freeze on the nil rate band is set to continue and will mean that IHT is a significant problem for an increasing number of families especially in the South of England.

On the positive side, the extension of the SEIS relief introduced last year and the NIC relief will help many budding entrepreneurs. There will also be relief that no further changes to the taxation of non-domiciled individuals were announced although, since the new property tax changes largely affect non-doms, perhaps even the Chancellor could see that enough was enough .

The next few months will be busy months for tax experts digesting the various changes and helping clients adapt to a personal tax system that looks very different from what the Coalition inherited. ●

A few new measures but no earth-shattering changes for the real estate sector

John Christian

John Christian is a partner and head of our Corporate Tax Team. He specialises in corporate and business tax, and advises on the tax aspects of UK and international mergers and acquisitions, joint ventures and partnering arrangements, private equity transactions, treasury and funding issues, property taxation, transactions under the Private Finance Initiative and VAT.

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Following last year's surprise announcement of a 15% SDLT charge, with immediate effect, for residential property costing more than £2 million held in corporate and other vehicles, it will be good news for the property industry that no significant changes were announced in this year's budget.

> *It will be good news for the property industry that no significant changes were announced in this year's budget.*

A few 'tweaks' were announced to the draft legislation released in December which changes the stamp duty land tax (SDLT) sub-sale (or 'transfers or rights') rules. The main change is to introduce legislation retrospective to 21 March 2012 to block a specific scheme where the sub-sale remains uncompleted but the purchaser under the original contract takes possession. Tax payers who have used such arrangements will need to amend their SDLT returns and guidance is given on this aspect.

In relation to the general re-write of the sub-sale provisions, the broad structure has remained unchanged. The draft clauses substantially re-write the sub-sales rules but the broad effect of the relief remains, so that an intermediate purchaser under a sub-sale or contract resulting from an assignment of rights is generally relieved from SDLT. The relief now has to be claimed. A widely drawn provision denies relief where one of the main purposes of the intermediate purchaser is to obtain a 'tax advantage' from the arrangements. The changes will take effect from Royal Assent to the Finance Act.

The Chancellor's Budget Statement included a number of initiatives to generate new housing starts including mortgage guarantee arrangements and support for shared equity. The focus has clearly been on providing direct support, rather than through the tax regime as there are no new tax changes specifically directed at housing. In particular, the prospects of residential REITs seem firmly on the back burner as the Government has given no further indication of consultation around the identified deficiencies in the REIT rules in a housing context.

The property industry would also have welcomed any announcement of consultation on "mortgage REITs" – allowing REITs to invest in property debt. Changes to the REIT rules to allow investment in property debt would allow refinancing of distressed property lending by banks through REITs. Currently, debt portfolio refinancing generally takes place through

A few new measures but no earth-shattering changes for the real estate sector (continued)

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non-UK structures and the introduction of more flexible REIT rules would allow institutions to invest through UK structures.

The Government has indicated that it will informally consult on including REITs as "institutional investors" for the purposes of the Finance Bill changes allowing REITs to cross-invest in REITs. This issue had been identified as a gap in the draft legislation and would prevent REITs being used as joint venture vehicles in some cases.

There is more detail on the review of the taxation treatment of partnerships referred to in the Autumn Statement. The areas to be focussed on immediately are the use of LLPs to "disguise" employment relationships and issues around 'artificial' allocation of profits so these will not affect the usual LP or LLP investment structures in the property industry. There will also be a more general review of the partnership tax regime by the Office of Tax Simplification.

The property industry will be disappointed that their calls for reform on rates were not heeded. In the face of competition from internet retailers, the British Property Federation (BPF) had called on the Chancellor to extend the relief from business rates for empty properties to allow businesses to bring vacant shops, offices and factories back into use and had suggested a move away from RPI related business rates increases. ●

Corporate Tax Rate 20% -But Is This Good News?

by Eloise Walker

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Eloise's focus is on advising corporate and financial institutions on UK and cross-border acquisitions and re-constructions, corporate finance, joint ventures and tax structuring for offshore funds.

Her areas of expertise also include structured leasing transactions, where she enjoys finding commercial solutions to the challenges facing the players in today's market.

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The Chancellor announced today that from April 2015 the UK corporation tax rate will fall to 20%.

"Hooray!" I hear you cry, "We can scrap the complexities of the small companies rate and simplify things, and a lower tax rate has to be great for British business."

But is it? For activities in the UK it is good news, so if you only do business in the UK and have no offshore parent or subsidiary companies then it probably is an improvement, but a lot of business (especially big business) in the UK isn't in that position, and for them it may be a mixed blessing.

If you are a UK holding company with offshore group companies, you'll want to be able to offset the withholding tax your subsidiaries deduct from, say, interest and royalties, against your UK tax bill. But such companies can only set withholding tax credits against the amount of their UK tax, so if their UK tax rate falls, that doesn't necessarily mean they pay less tax as a group – it may just mean they have more absolute tax cost overall in the form of withholding tax they can't offset. And with increasing investment in non-EU countries, withholding tax is becoming more of a real problem for many UK groups.

There may be adverse consequences for offshore parent companies as well. Many jurisdictions (especially those in well developed countries) have controlled foreign company regimes – essentially rules designed to stop their local business from migrating offshore to low tax jurisdictions. These take different forms, but can focus on a percentage of equivalent local tax or an absolute tax rate. Reducing the UK corporation tax rate too far relative to others in the G20 may have adverse effects.

There may be adverse consequences for offshore parent companies

Take, for example, Japan's anti-tax haven regime. Where a Japanese company holds 10% or more in a controlled foreign company (CFC), the Japanese entity may become taxable on its proportionate share of the subsidiary's income whether or not distributed.

A CFC for these purposes is, broadly, one which is more than 50% owned by Japanese residents and either has its head office in a country which does not impose corporate income tax or is subject to an effective tax rate of 20% or less.

This means that, unless Japan changes its domestic law, any Japanese holding companies owning UK subsidiaries may find themselves owning CFCs from April 2015. A 1% cut in UK tax (from 21% to 20%) could result in an extra 5.5% tax bill in Japan, so that the total cost is the Japanese rate of 25.5%.

That is not likely to make those subsidiaries welcome members of those groups, and may result in restructuring that dispenses with UK companies. ●

No safe havens for offshore tax evaders

By Phil Berwick

Phil Berwick is a Partner (non-lawyer) and a former inspector of taxes.

Phil left the Inland Revenue in 1995. Since then he has been principally involved in investigations instigated by HMRC's Specialist Investigations and Civil Investigation of Fraud teams. He deals with complex investigations and those involving fraud (Codes of Practice 8 and 9).

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HMRC's document, "No safe havens - our offshore evasion strategy 2013 and beyond", was largely self-congratulatory, with half of the content dedicated to action taken to date. The rest of the document detailed how, to summarise, HMRC intends to make the world a smaller place for those guilty of, or considering, tax evasion.

HMRC has set-out the various ways in which it is going to get more information, and how it expects to be able to use that information quicker. In addition, HMRC is seeking to use the information in its possession more effectively, and also to become better at identifying, and tackling, offshore evasion. The document sets out HMRC's view on "offshore evasion" and explains what it means by that phrase. As a consequence, offenders will know what to expect if tackled by HMRC, and how HMRC will view a taxpayer who has committed offshore evasion.

As part of HMRC's efforts to tackle their concerns, there will be a review of incentives for whistle-blowers; this could see higher payments (perhaps as a percentage of tax recovered) being paid to those who provide information on evasion to HMRC. Also, HMRC are seeking to establish that offshore evaders only get the maximum possible mitigation of penalties (which can be a maximum of 200% of the tax) where they provide details of any third parties who have helped them to set-up their offshore arrangements.

A key part of HMRC's strategy will be an increase in the number of investigations, under both civil and criminal provisions

A key part of HMRC's strategy will be an increase in the number of investigations, under both civil and criminal provisions, into those suspected of offshore evasion. This has already started, and we can expect the numbers to increase further in the coming months and years.

It was also announced that the UK Government has signed agreements with the Isle of Man, Guernsey and Jersey for the automatic exchange of information on UK taxpayers with accounts in those jurisdictions and a disclosure facility to allow people to come forward to disclose their previous tax affairs in advance of the information being automatically exchanged. The Isle of Man agreement was announced in December and the Jersey and Guernsey agreements have been expected.

The new disclosure facilities are similar to the Liechtenstein Disclosure Facility ("LDF") in that they encourage taxpayers to come forward rather than wait and face higher penalties if found out. However, they are much less attractive than the LDF. Most importantly they do not offer immunity from criminal prosecution. ●

Today's Budget contained few real surprises for the Energy Sector

by Tom Cartwright

Tom Cartwright is a Director and his practice focuses on all areas of corporate tax, including the tax aspects of corporate acquisitions and reconstructions, involving the financing and structuring of UK and cross-border buy-outs, mergers and acquisitions. He has considerable expertise in tax structuring for debt restructuring and corporate recovery for distressed businesses. Tom has advised extensively in the energy sector for oil and gas companies.

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Decommissioning Relief Deeds

As expected, the Government confirmed that Decommissioning Relief Deeds will form part of this year's Finance Act. We expect a final version of the proposed deed to be released on 28 March. There has been considerable progress on the terms of this deed over the last two months. It is critical that the final version should be sufficiently robust that industry will be able to rely on it. The greatest impact will be on former participants in a field who become liable under the Petroleum Act to pick up the Decommissioning costs of a transferee. By effectively guaranteeing the rate of tax relief such companies will obtain on that expenditure, the hope is that the need for potential purchasers of North Sea assets to provide security will be reduced. It is hoped that this will enable greater M&A activity over North Sea assets, which in turn, should unlock more of the "hard-to-reach" reserves for exploitation.

Shale Gas

The second significant measure (which had also been trailed) is a new regime for shale gas. From a tax perspective, this will largely take two forms. Firstly, a specific field allowance is to be introduced for shale gas fields. The effect of field allowances is generally that corporation tax is chargeable at only 30%, rather than 62% up to a maximum volume of barrels of oil equivalent. The details of how this field allowance will work have not yet been released. A consultation document is expected to be released in May, with the legislation to be introduced from April 2014.

A further measure on shale gas is the proposal to extend the period for ring-fence expenditure supplement from 6 to 10 years (being the number of years for which the supplement can be rolled forward to offset against future profits). Interestingly, there has been some hope within industry that there might be a general extension of ring-fence expenditure supplement to all oil and gas exploration activities. However, it appears that shale gas is to be the only winner for now. Again, the details will be set out in the consultation document to be issued in May.

> *"...it appears that shale gas is to be the only winner for now.*

Offshore Employment Companies

Although not part of the formal budget releases, it was announced on Saturday that the Government would hold a consultation into the use of offshore employment companies for staff employed

Today's Budget contained few real surprises for the Energy Sector (continued)

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in the UK (and on the UKCS). In particular, offshore employment companies are widely used in the oil and gas services sector, which provides a saving from Employer's National Insurance contributions and makes the services provided cheaper for industry. The Government is currently planning to introduce legislation in April 2014 on this issue, following a consultation. It is to be hoped that the consultation results in a level playing field, without unduly advantaging non-UK contractors.

Mineral Extraction Allowance

The Government is proposing legislation in April 2014 to curtail mineral extraction allowances attributable to foreign branches, where the profits are not subject to UK tax (due to the foreign branch exemption).

Carbon Capture & Storage

The Government has also announced that it intends to take forward two carbon capture and storage (CCS) projects to the detailed planning and design stage of the competition. The Department for Energy & Climate Change is expected to provide further details in due course, including the details of the preferred bidders. ●

“Employee shareholders” – tax position and implementation date confirmed

by Matthew Findley

Matthew Findley is a partner and he advises companies in relation to the design, implementation and operation of share plans and employee incentive arrangements both in the UK and internationally. His experience extends to both executive plans (including tax-driven structures) and all-employee arrangements. Matthew also has considerable experience of the corporate governance and investor relations issues associated with executive incentives and remuneration planning generally.

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The Government has confirmed the tax treatment that will apply to shares acquired under its controversial “Employee Shareholder” proposal. It has also confirmed the revised implementation date of the arrangement under which companies will be able to offer tax-advantaged shares to employees in exchange for them giving up a number of employment rights.

Background

“Employee Shareholder” status is proposed as a third form of employment status, alongside “employee” and “worker” – it will essentially take effect as a new form of equity-linked employment contract. In exchange for giving up certain employment rights, employees will become owners of a stake in the business they work for by being given shares in the employer company (or, in a group situation, the ultimate parent company) worth between £2,000 and £50,000. The profit (if any) on those shares on sale will be exempt from capital gains tax (“CGT”). The arrangement was originally due to take effect from 6 April 2013.

Income Tax Treatment/Revised Implementation Date

“Employee Shareholder” status has, as might be expected, been looked at with interest by some companies given the potential CGT relief. It has, however, been difficult for companies to properly assess whether or not the new status would be of use to them given that, until now, the Government had not confirmed the income tax and national insurance treatment of “Employee Shareholder” shares. The Government has, however, now confirmed that the first £2,000 of “Employee Shareholder” shares will be exempt from income tax and national insurance. To the extent that “Employee Shareholder” shares are worth more than £2,000 on acquisition, the employee will either have to pay market value for those shares or suffer an income tax and national insurance charge on the value of the shares received in excess of £2,000.

As to implementation, it was, albeit discreetly, announced last week that implementation of “Employee Shareholder” status had been delayed until Autumn 2013. The Government confirmed in the Budget that “Employee Shareholder” status will now come into force on 1 September 2013.

Comment

Companies will now be able to fully assess whether or not “Employee Shareholder”

> *Companies will now be able to fully assess whether or not “Employee Shareholder” status is right for their business.*

"Employee shareholders" – tax position and implementation date confirmed (continued)

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status is right for their business. The deferral of its implementation is likely to be of limited consequence but, that said, we are aware of some situations where management equity acquisitions have been deferred pending the introduction of the new rules and so, for those companies, deferred implementation is potentially unhelpful.

As to the likely take-up, the now confirmed income tax position (which had been widely trailed) may possibly increase the popularity of the proposal. This is because the arrangement could be used as a quasi-all-employee share plan albeit without the administration which sometimes accompanies such plans. For small and medium-sized enterprises in particular, this may be an attractive proposition. The one major difficulty such companies will face is that the Budget announcement itself provides no further guidance on valuation beyond the definition of "value" previously provided for the purposes of the £2,000 threshold and the £50,000 cap. The valuation difficulties associated with providing shares to employees remain and this could limit take up of the new status by small and medium-sized enterprises.

Aside from the "all-employee" angle, it remains the case that the arrangement will present a significant tax-planning opportunity for senior management/substantial shareholders. A significant proportion of the equity of, for example, many private companies could fall under an "Employee Shareholder" arrangement and, if an individual is prepared to incur the tax charges which will arise on acquisition, and is willing to speculate on the potential share price appreciation (as they often will be), then the fact that any gain realised on disposal would be exempt from CGT could potentially be very attractive. Anti-abuse rules will apply but the scope of those provisions has yet to be announced and it is difficult to see how the Government could counteract this perhaps unintended benefit without undermining the objective behind the proposal.

Ultimately, the upshot of the Budget announcement is that "Employee Shareholder" status may increase in popularity on an "all-employee" basis. However, in practice, we would expect the minority of companies using the arrangement to be using it in this way. What is more likely is that "Employee Shareholder" status will provide a significant opportunity for more senior employees, some of whom may be viewed politically as the "wrong" people. The arrangement is likely to present management within privately-owned companies - be they family-owned or private equity-backed - with a potentially very tax-efficient way to receive shares in their employer. While the Government is rightly committed to extending share ownership within unlisted companies, it is doubtful this was the intention. It has, therefore, created a tax break for senior managers at a time when scrutiny of what amounts to legitimate tax-planning is at its peak. ●

Employee share plans – a time of change

by Lynette Jacobs

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Introduction

The Government confirmed in the Budget that it will proceed with a number of changes relating to employee share plans. The changes are part of an ongoing period of almost unprecedented activity for employee share plans.

HM Revenue & Customs Approved Plans

As announced at the time of the 2012 Autumn Statement, legislation will be introduced in Finance Bill 2013 to implement a number of the recommendations made by the Office of Tax Simplification ("OTS") to improve and extend the benefits of the regime for tax-efficient HM Revenue & Customs ("HMRC") approved employee share plans. All companies operating such plans will need to review their plan rules and employee communications to bring them into line with the revised legislation (some of which will apply automatically). While specific details are expected next week, we understand that the proposed legislation has been amended, including to:

- widen the range of circumstances in which tax free exercise of SAYE and Company Share Option Plan (or "CSOP") options, or tax free payments for Share Incentive Plan ("SIP") shares, will be available on cash takeovers;
- ensure that SIP partnership shares may not be subject to forfeiture provisions; and
- allow businesses flexibility to limit the amount of cash dividends that can be reinvested in SIP dividend shares.

One area on which further detail is awaited with interest is the introduction of self-certification for HMRC-approved plans. The new regime is due to take effect during 2014 but, for it to be workable, greater clarity is needed on some of the more subjective features of the current HMRC approval process. We expect the Government to announce further consultation on this important area ahead of the 2014 introduction of self-certification.

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"Unapproved" Plans

The Government will consult shortly on a number of the recommendations of the OTS's review of non-tax advantaged (or "unapproved") share plans with a view to legislation being introduced as part of Finance Bill 2014. Among its recommendations in this area, the OTS suggested simpler share valuation and

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PAYE processes, and the creation of an employee shareholding "vehicle" or trust to enable companies to better manage share arrangements and encourage wider employee share ownership. The OTS also proposed a radical change to the tax treatment of such plans by suggesting that the point at which employees are taxed on the value of unlisted shares is changed. It suggested that employees could be given the choice of whether to pay tax on acquisition of the shares, or at the point when the shares become marketable or are sold.

Enterprise Management Incentives – Extension of Entrepreneurs' Relief

With effect from 6 April 2013, an employee disposing of shares acquired on the exercise of an Enterprise Management Incentive ("EMI") share option will qualify for entrepreneurs' relief regardless of the size of his shareholding. This has the potential to reduce the applicable rate of CGT from 28% to 10%. The employee will not have to hold 5% of the company's shares in order to qualify for entrepreneurs' relief. The normal 12 months period for holding shares to qualify for entrepreneurs' relief will also not apply – so long as the EMI option was granted a year or more before the disposal, relief will be available. EMI share options are already a highly tax-efficient way to incentivise staff. The extension of entrepreneurs' relief in this way means that their attractiveness will increase still further and they will remain the incentive of choice for those companies that qualify.

Other Beneficial Changes

Other relevant changes include a proposal to introduce CGT relief on the sale of a controlling interest in a company into an employee-owned structure. It has also been proposed to double (to £10,000) the amount employers can lend to employees tax free. ●

A mixed bag for companies?

by Catherine Robins

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The reduction in headline corporation rate to 20% from April 2012 and increase in the rate of Above the Line Research & Development Tax Credit to 10% were unanticipated but in line with the Government's strategy of keeping Britain at the top of international rankings on corporate tax competitiveness.

A number of anti-avoidance provisions have been introduced with immediate effect to counter "loss buying" arrangements under which companies are able to pass the benefit of losses to third parties. As there are already anti-avoidance rules in these areas, the proposed changes are technical amendments to block loopholes. In outline, the new provisions will target arrangements to transfer losses through changes in ownership of a company which does not carry on any trade or business, and arrangements where a group reconstruction without change in ownership occurs before or after a change in ownership of the company. The details of the changes will need to be worked through to check the impact on commercial reorganisations, particularly in a restructuring or refinancing context.

There are also changes announced to counter structures involving the transfer of unrealised losses or structures in which profits are moved into companies where deductions will be available to shelter those profits. These are being introduced as TAARs and again, for most corporates, the impact of the provisions will be in relation to commercial restructuring. Despite the introduction of the GAAR, HMRC clearly feel the need to continue with specific TAARs.

Changes will also be made to the group relief provisions relating to the interaction of limits on group relief with profits apportioned under the CFC regimes.

An unexpected announcement was that the Government will consult on modernising the loan relationships and derivative contracts regime with a view to legislation in Finance Acts 2014 and 2015. The review looks to be wide ranging and it would be helpful for business to understand which aspects the HMRC and Treasury have identified so that business can take any areas of potential change into account. These provisions are a cornerstone of the UK corporate tax system and after finally removing uncertainty for international investors around such areas as CFC reform and the worldwide

> *For businesses in the investment arrangement industry, the HM Treasury paper on 'The UK Investment Management Strategy' will be welcome.*

A mixed bag for companies? (continued)

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debt cap, it would be unfortunate if UK corporates faced new uncertainty on the treatment of debt finance and hedging.

For businesses in the investment arrangement industry, the HM Treasury paper on 'The UK Investment Management Strategy' will be welcome. Key tax issues for the industry which are addressed include the abolition of SDRT on the surrender of units in UK domiciled funds. Changes are also announced to clarify that UK management of non-UCITs offshore funds will not put the fund at risk of being UK resident.

A consultation on changes to the "white list" also clarifies, in the context of the Investment Management Exemption, activities which will not be regarded as trading in the UK. The paper acknowledges the competitive pressures on the UK fund industry and though the changes are welcome, the industry may feel there is more to be done to ensure the UK ranks with jurisdictions such as Ireland and Luxembourg in relation to the tax and regulatory environment. ●

Good Economics, or Good Politics?

by Alastair Ross

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The Chancellor spoke of two objectives in his Budget – to energise the aspirations of British people and to confront Britain's problems head on. His unspoken, third objective was to set a political platform on which his party can campaign to win the 2015 general election.

That platform needs to show a state of improvement – in growth, in consumer and commercial confidence, and in consumption or economic activity. Those are difficult to achieve when the central theme remains austerity. From that perspective the opening remarks did not bode well and much hope is pinned to the tax cuts announced towards the end.

The Office of Budget Responsibility prediction of UK growth in 2013 has halved to 0.6% in just four months, yet the IMF predicts that the UK will see higher growth than France or Germany in the next two years. The OBR's growth predictions of 1.8% in 2014 rising to 2.8% in 2017 sound optimistic but are liable to revision.

While the deficit has been reduced by a third since May 2010 and borrowing predicted to keep falling, debt as a share of GDP is anticipated to increase to 85.1% by 2015/16.

The Eurozone continues to cast a shadow over the UK economy as Mr Osborne admitted a further economic shock would hit Britain hard, when it is the destination of 40% of our exports.

These are difficult messages for the electorate to digest and feel confident about as they consider which way they will vote in May 2015.

That is one reason why the Chancellor broke the statistics down in more personal terms – predictions of 600,000 private sector jobs created, a ratio of six new private sector jobs for every public sector job lost in the past year, and an anticipated 60,000 fall in the number of benefits claimants.

Tax cuts are usually popular and the further reduction in corporation tax, a pledge on decommissioning tax relief, the new employment allowance to offset National Insurance costs, the abolition of stamp duty on shares traded in AIM and other markets, and tax relief for social enterprise investments will all be welcomed.

The tax allowances to incentivise investment in shale gas extraction may sit less comfortably with the environmental lobby. It was

These are difficult messages for the electorate to digest and feel confident about as they consider which way they will vote in May 2015." or "this political dividend must pay out ahead of the next General Election.

Good Economics, or Good Politics? *(continued)*

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noticeable that while the Chancellor did refer to the low carbon economy he could not bring himself to say the r-word - renewables.

Anti–avoidance measures on taxation, including the agreements with the Isle of Man, Guernsey and Jersey to bring in over £1bn in unpaid UK taxes, should play well politically, although not as much as the promise to name and shame the promoters of tax avoidance schemes.

The single-rate flat pension, the cap on social care costs, tax relief on childcare vouchers, and payments to some Equitable Life policyholders are all designed to appeal to sections of the electorate and give them reasons to return the Chancellor and his colleagues to Government.

Freezing the fuel duty escalator and abolishing the beer duty escalator will generate immediate reward in terms of newspaper headlines. However, the London Evening Standard's breach of the embargo on publishing Budget details is an embarrassment that deflects attention.

The Chancellor set out three themes – monetary activity, fiscal responsibility and supply side reform. The monetary activity could include what he tantalisingly referred to as "unconventional monetary instruments". These and the agreement with new Bank of England Governor Mark Carney to consider using intermediate thresholds on inflation rates in order to achieve the ultimate 2% target. The Bank's remit will also be extended to include growth. If these are successful, they will doubtless be hailed as a political and economic masterstroke akin to Gordon Brown's decision to grant the Bank independence in interest-rate setting. From the Chancellor's point of view, this political dividend must pay out ahead of the next General Election.

Departmental underspends have generated an £11bn political windfall and some of this is to be redirected to infrastructure investment and this is welcome. Again though, in order to reap a political dividend the guarantees on infrastructure projects need to be delivering jobs and contracts well in advance of May 2015. The same applies to the progress of the two Carbon Capture and Storage projects.

The extension of public sector pay restraints into 2015 will not be popular, as while the Chancellor sets them against a background of pay freezes or cuts in the private sector, people are more likely to remember City bonus headlines and executive remuneration rates. Allocating money from LIBOR fines to armed forces good causes doesn't quite deflect the attention.

Unlike the 2012 Budget, this year's speech had the consent or acceptance of the Liberal Democrats who secured their priorities such as the basic income tax rate threshold increase, and so there were no pre-emptive attacks or leaks of details beyond the Chancellor's control.

Speculation continues about George Osborne's economic ability and his job security, but the latter is not in any serious doubt as he is the Prime Minister's closest political counsel and there is no compelling alternative Chancellor who would enjoy greater room for manoeuvre. However, Mr Osborne's reputation as a strategist is not as strong as it was. After two Budgets which upset key sectors and in some cases prompted u-turns, he simply cannot afford a third bad Budget performance. That is why the next few days of analysis and scrutiny are perhaps more important than his dispatch box speech which only ever tells part of the story.

In his Budget response the Labour leader Ed Miliband literally had to think on his feet with no prior notice of the Budget details (unless he read the Evening Standard) but he landed several political blows on the growth revisions, the omission of the AAA credit rating, the prospect of four more years of austerity, and a very public challenge to the Cabinet members to admit they were benefitting from the abolition of the previous top rate income tax reduction.

However, like the Chancellor, the Labour party will also need to find and develop sound reasons for economic optimism if they are to stand a chance of returning to Government in 2015. ●

CJ-EU rules that fund management services to Pension Funds are subject to VAT: Wheels Common Investment Fund Trustees & Others C-424/11

by Suzanne McMahon

On 7 March, the Court of Justice of the European Union ("CJ-EU") released a keenly awaited decision regarding whether VAT exemption was available for services provided to pension schemes, in particular, defined benefit occupational pension schemes.

Background

The story starts in 2007 with the decision in *JP Morgan Fleming Claverhouse Investment Trust and the Association of Investment Trust Companies* [2007] (Case C-363/05). Wealthy individual investors who benefitted from individual recommendations and execution of transactions were already not being charged VAT on commission charges, as the services were considered to be securities transactions benefitting from VAT exemption under item 6, Group 5 of Schedule 9 to the VATA. This was not the case for collective schemes, so the CJ-EU extended the scope of the UK VAT exemption in Group 5, Schedule 9 to the Value Added Tax Act 1994 ("VATA") for management of special investment funds to include collective investment undertakings in the form of open-ended trusts and authorised unit trusts, as well as closed collective investment schemes such as investment trust companies. The reasoning was based on the premise that member states' ability to define "special investment funds" was limited by the principle of fiscal neutrality, and accordingly persons wishing to invest collectively rather than individually should not be disadvantaged by the fact that fund managers would charge VAT on management services provided to collective investment schemes.

How did *Wheels Common Investment Fund Trustees* come about?

Following the *JP Morgan* case and the resulting change in the UK legislation from 1 October 2008, the fund manager for the Ford Motor Company made a claim to HM Revenue & Customs ("HMRC"), seeking repayment of VAT it had accounted for on its fund management services to Wheels Common Investment Fund Trustees Ltd, the trustee of the Ford occupational pension scheme, which was run as a defined benefit scheme. The grounds of the claim were that the services provided to the defined benefit pension scheme should have been treated as exempt from VAT, as the scheme was a special investment fund, under Article 135(1)(g) of the Principal VAT Directive – formerly Article 13B(d)(6) of the Sixth VAT Directive.

The Appeal

Not surprisingly, HMRC rejected the claim. Wheels, as recipient of the services, appealed to the First-tier Tribunal (Tax Chamber). The Tribunal referred the case to the CJ-EU for a preliminary ruling.

The CJ-EU

It was common ground between HMRC and Wheels that the services provided were fund management services capable of VAT exemption, however the key point was whether defined benefit pension funds were capable of constituting a special investment fund for the purposes of the exemption.

The CJ-EU decided that HMRC were correct to deny applying VAT exemption to services provided by fund managers to certain occupational pension schemes. The decision was made on the basis that the pension schemes in question could not be considered "special investment funds" within the meaning of the VAT exemption, because factually there were some key differentiating factors between defined benefit pension funds and collective special investment undertakings. The factors that the Court highlighted were:

- The pension schemes were employment related;
- The schemes were not open to the public for investment;
- The pension received by a member is not dependent at all on the value of the scheme assets or their performance, but on length of service and salary of the individual member; and crucially
- In a defined benefit scheme, the

CJ-EU rules that fund management services to Pension Funds are subject to VAT *(continued)*

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> scheme member does not bear the risk arising from the management of the investment. It is the sponsoring employer that bears the risk of the fund managers' decisions, so any deficit has to be funded by the employer, not as a cost of investment, but to meet obligations owed to the employee.

Analysis

Although following reports from the hearing, this decision was somewhat expected, it is still disappointing for a large number of occupational pension schemes who had submitted claims to HMRC via their fund managers for overpaid VAT and hoped to receive a refund of VAT incorrectly charged over a number of years, had *Wheels* been successful. This would have been welcomed in the current economic climate where many pension schemes are feeling under pressure to meet the liabilities of pension requirements of an increasingly ageing population in the UK. However for fund managers, the certainty that this decision provides means that they can now confirm the VAT treatment of the services they provide to pension schemes and manage both their VAT recovery position and their price structures accordingly to reflect the CJ-EU's decision.

Is this the end of the road for pension funds?

Although the CJ-EU was very clear that defined benefit pension schemes cannot be considered special investment funds for the purposes of the VAT exemption, this may not be the end of the story for pension schemes. Certainly, the *Wheels* decision may mean there is no further journey for defined benefit funds, but the door is still open for defined contribution schemes to try and argue that they are sufficiently similar to collective investment funds, and fall within the VAT exemption. The key difference could be that unlike in *Wheels*, in a defined contribution scheme, the employee does bear the risk associated with investment.

What do pension funds/fund managers with current claims need to do?

This issue was of extensive interest for the pensions and fund management industry, and there are a large number of claims and appeals stood behind Wheels from both fund management companies and pension funds. What will happen to these claims now?

At the time of writing, a formal announcement is awaited as to whether the *Wheels* case will be referred back to the UK First-tier Tax Tribunal. It is expected *Wheels* will formally withdraw its appeal. The appeals that have been stood over behind the case will have a defined period (usually 30 or 60 days) to decide whether to pursue an appeal or withdraw, from that point. Until this is clear, it is prudent for those claims and appeals to be maintained (and ensure that claims are up to date). This is important because there are alternative grounds for the claim that are still open to be argued. There are two other cases currently referred to the CJ-EU, due for hearing later this year, that the cases can be amended to be stood over behind (subject to Tribunal agreement).

The first case is *PPG Holdings* (C-26/12) where the questions are about exemption for pension funds and whether the sponsoring employer may recover input tax on the management of the fund. Appeals that are already before the Tribunal behind *Wheels*, can be now stood over pending the decision in *PPG Holdings*. It is not necessary to amend the actual grounds of appeal until after the stay is lifted after the *PPG* decision – so this could be some time away.

The second case is a Danish reference, *ATP* (C-464/12), which will address defined contribution schemes, and will be of interest to schemes that did not fit into the factual pattern of the *Wheels* case.

Ultimately, if a pension fund is successful in arguing that it is a "special fund" thus meeting the second leg of the test for applying the VAT exemption, consideration will also need to be given to the exact scope of claims. It appears that most of the current claims were submitted by fund managers. There may be scope to extend these to the fund administrators. If on the facts, it can be demonstrated that administration services are specific and essential to the pension fund management, then these services could also benefit from the VAT exemption, on the basis of *Abbey II* (C-169/04), *GfBK* (C-275/11) and *Deutsche Bank* (C-44/11).

In summary, although Wheels lost, all the cases mentioned, are providing further guidance as to how "special investment fund" for the purposes of the VAT exemption should be interpreted. It is not the end of the story yet. ●

Procedure

Farhana Weerasinghe v HMRC [2013] UKFTT 144

- The 12 months deadline for the amendment of a return by the taxpayer (Section 9ZA TMA) does not apply when the return has been submitted by the taxpayer in the absence of a notice to file issued by HMRC.
- In an appeal against a closure notice, the burden of proving the correct amount of tax due lies with the taxpayer but HMRC's conclusions must be supported.

This was an appeal against a closure notice following an enquiry into the tax year 2007/08.

Mrs Weerasinghe ran a petrol station with a convenience store. She had not been issued a notice to file a return for the tax year 2006/07 but had nonetheless filed a return showing a profit in February 2008. A second return amending the previous return was filed in January 2011, this return showed a loss.

HMRC argued that the second return had been filed more than 12 months after the filing of the first return and that therefore the amendment could not be taken into account under section 9ZA TMA. This was an issue for the taxpayer who wished to carry forward the losses made in the 2006/07 tax year to the 2007/08 tax year.

The FTT noted that section 9ZA expressly refers to returns filed under section 8, i.e. returns filed following the issue of a notice to file by HMRC. As the first return filed by the taxpayer had not been filed in response to such a notice, the 12 months deadline did not apply. The amendment was therefore valid and the losses were available for carry forward.

HMRC and the appellant also disagreed as to the appellant's profits in the tax year 2007/08. The appellant's previous advisers had misplaced all of the relevant records and so the appellant was unable to provide proper support for her submission. Furthermore, the FTT stressed that in such a case the burden of proof rested firmly with the taxpayer.

However, HMRC's suggested figure relied only on a survey of petrol stations which was supposed to be no more than a guide and presented some shortcomings. The taxpayer referred the FTT to the accounts of a company operating a petrol station with a similar turnover to the business of Mrs Weerasinghe. HMRC had refused to consider these accounts on the basis that a business operated by a limited company was not comparable to a business operated by a sole proprietor. The FTT did not see any significance in the distinction and concluded that the evidence submitted by the appellant was more reliable.

The appeal was allowed

David Testa v HMRC [2013] UKFTT 151

A penalty for careless error can be suspended subject to the condition that the taxpayer uses the services of a suitably qualified tax adviser going forward.

Mr Testa had received a severance payment following the termination of his employment. As his P45 was issued before the severance payment was made, it did not refer to it. Mr Testa therefore received a further payslip recording the severance.

He filed both the P45 and the payslip but forgot to use the payslip when completing his self-assessment tax return later on that year. This led to an under-assessment of his tax liability.

The mistake was spotted by HMRC who sought to impose a penalty for careless error. HMRC accepted that this was a genuine error and in view of the taxpayer's cooperation, mitigated the penalty down to the minimum of 15%.

Mr Testa wrote to HMRC arguing that the penalty should be suspended and suggesting that the use of a tax adviser going forward would be a suitable condition as it should avoid any further mistakes of this kind. In their correspondence back to Mr Testa, HMRC did not address his suggestion but simply reiterated that it is not HMRC's policy to suspend penalties when the error is a one-off.

The FTT noted that "the apparent underlying purpose of the legislation (Schedule 24 FA 2007) is not simply to allow a taxpayer the opportunity of "a last chance" if he mends his way (...) but only to allow him that last chance if he takes some specific and observable action which is specifically designed to improve compliance". The FTT added that Mr Testa's suggestion should have been considered in this context and should not have been ignored as a result of a policy that does not allow suspension in cases of "one-offs".

The FTT therefore allowed the appeal suggesting that "suitably qualified" individuals for the purposes of the relevant condition would include at least those holding ACA, ACCA and CTA qualifications. ●

Substance

HMRC v Aimia Coalition Loyalty UK Limited [2013] UKSC 15

Consideration paid by the promoter of a loyalty scheme to redeemers of goods and services (in exchange of "points") is a payment for services provided by the redeemers to the promoter and is therefore not "third party consideration". It follows that VAT incurred by the promoter is deductible.

Aimia Coalition Loyalty (formerly known as Loyalty Management UK "LMUK") was the promoter of a consumer reward scheme which worked as follows. Consumers ("Collectors") would earn points on their nectar cards when purchasing goods and services from ("Sponsors"). Those points entitled them to certain discounts on redemption with specified retailers ("Redeemers").

The Sponsors paid LMUK for the grant of the rights (i.e. the points) to Collectors. LMUK used part of its receipts to pay the Redeemers for the supply of goods and services to customers in accordance with their rights. The difference was LMUK's profit.

The issue was whether LMUK was entitled to deduct as input tax the VAT element of the payments which it made to Redeemers. LMUK contended that these were payments for services provided by the Redeemers for the purpose of LMUK's business and so the input tax incurred on those payments was deductible. HMRC considered that the payments represented third party consideration for the supply of goods and services by the Redeemers to the Collectors.

The tribunal found in favour of LMUK agreeing that the consideration paid by LMUK was for services provided to itself for the purpose of its business. HMRC's appeal was allowed by the High Court on the basis that goods and services were supplied by Redeemers to Collectors. The service charge paid by LMUK to the Redeemers was therefore third party consideration for that supply, particularly since there was no separately identifiable fee for the services provided to LMUK. LMUK's appeal was allowed by the Court of Appeal which found that the Redeemers made two different supplies; a supply of goods and services to the Collectors and the supply of the service of providing a reward to LMUK.

On appeal to the House of Lords, the issue was referred for a preliminary ruling to the CJ-EU. The CJ-EU confirmed that loyalty rewards were supplied by the Redeemers to the Collectors, that the supplies by the Redeemers to the Collectors were taxable supplies and that the sale of the goods and services giving rise to the awards and the supply of goods and services in return for points were separate transactions. The CJ-EU did not however address the position of LMUK as the supplier of the award of points and as the recipient of a service from the Redeemers.

The Supreme Court cited Redrow on third party consideration:" The matter has to be looked at from the standpoint of the person who is claiming the deduction by way of input tax. Was something being done for him for which, in the course or furtherance

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of a business carried on by him, he has had to pay a consideration which has attracted value added tax?".

Lord Reed reminded the court that the VAT system ensures the complete neutrality of taxation of all economic activities through the right to deduct input tax. He added that the payments made to Redeemers by LMUK constitute LMUK's cost of fulfilling its obligation to Collectors. LMUK should therefore be entitled to deduct the VAT charged by Redeemers as "only in that way will VAT be completely neutral as regards LMUK". Lord Hope agreed adding that Redeemers were therefore making both a supply of goods and services to Collectors and a supply of services of a different nature to LMUK.

The decision of the Court of Appeal was affirmed.

Our Comment

This case is important for two reasons. Firstly, it emphasises again the importance of taking into account the factual circumstances and the reality of what is happening on the ground, and what the parties to such arrangements intend, when characterising commercial arrangements for VAT purposes. Secondly, it shows that the *Redrow* principle is still alive. *Redrow* remains good law – so in arrangements where A pays B, but B supplies services to C, if A receives anything of value in return, then the supplier can be making two supplies to two different recipients at the same time, and A can recover any VAT as input tax (assuming the supply made is taxable for VAT purposes).

Colaingrove Ltd v HMRC [2013] UKFTT 116

Electricity and gas supplied as part of a holiday accommodation package can be subject to a reduced VAT rate even as part of a larger supply of standard-rated holiday accommodation.

Colaingrove owned holiday parks and provided accommodation to customers in the form of static caravans and chalets. Each pitch where a static caravan or chalet was located had its own electric and gas meter. Colaingrove required customers to pay a fixed charge for power which was collected separately at the time of booking. Colaingrove argued that the supply of power was zero-rated as it was a supply of power for 'domestic use' in 'self-catering accommodation' and that it should therefore be distinguished and taxed at a separate rate from the supply of holiday accommodation, which was a standard rated supply.

It was accepted (following *Card Protection Plan "CPP"*) that the supplies of accommodation and of power were part of a single composite supply. The question at issue was whether HMRC should deviate from the *CPP* line of jurisprudence and still charge the supply of power at a lower rate.

The FTT noted that the CJ-EU's jurisprudence (most notably *French Undertakers*) gives Member States authority "to legislate that a reduced rate of VAT will apply to a supply of goods or services in relation to which a reduced rate is authorised under the relevant European Union legislation (including natural gas, electricity or district heating), notwithstanding that the application of *CPP* jurisprudence would lead to the conclusion that such supply was merely an element in a larger single complex supply". The tribunal also noted that section 29(4) VATA (as well as Notes 4,5 and 6 to Group 1, Schedule 7A VATA) suggest that Parliament intended the reduced rate of VAT to apply to the "concrete and specific" element (the supply of domestic fuel and power) of a larger supply. This was in line with the notion that the reduced rate is charged not only by reference to the nature of what is supplied but also by reference to the beneficial social purpose to be achieved by the supply.

The FTT also stressed that HMRC's refusal to apply the reduced rate to the supplies of power by Colaingrove would undermine the principle of fiscal neutrality in circumstances where other holiday makers sojourning in the same park but paying for the supply of power directly to the power suppliers would benefit from the reduced-rate. Finally, the FTT added that treating the supply of accommodation and the supply of power as two separate supplies would also undermine the principle of fiscal neutrality as "the correct treatment on the application of the *CPP* jurisprudence must be discerned from the transaction actually entered into and not from equivalent transactions that might have been, but were not, entered into".

The taxpayer's appeal was allowed.

Substance

Catherine Rawcliffe v HMRC [2013] UKFTT 111

Payments in settlement of securities options can be taxable benefits in connection with employment-related securities options.

Ms Rawcliffe had been granted options to acquire shares in the US parent company of her employer. She was made redundant but was unable to exercise the options, due to a failure by her employer to comply with its SEC reporting obligations. Instead, her employer had offered her a cash settlement which she had accepted.

Ms Rawcliffe contended that the payment was effectively the same as the outcome of exercising the options and should therefore be taxed in the same way. She referred to published HMRC guidance which suggested that the exercise of an option under a non-approved plan would not trigger income tax if the exercise took place upon the employee leaving the company.

HMRC argued that, regardless of the guidance, the payment was a "benefit in connection with employment related securities options" (section 477 ITEPA 2003) and was therefore taxable.

The FTT noted that the guideline was "illiterate and potentially misleading". However, Ms Rawcliffe could not claim to have had a legitimate expectation as she would have had to take the offer of settlement in any event.

The FTT agreed with HMRC's view that section 477 applied as the payment received by Ms Rawcliffe was "in connection with failing...to acquire securities pursuant to the employment-related securities option." The fact that the failure was her employer's and not Ms Rawcliffe's was irrelevant.

The taxpayer's appeal was dismissed.

BAA v HMRC [2013] EWCA Civ 112

Fees incurred by an SPV in relation to the take over of a group are not recoverable in circumstances where it does not carry out an economic activity and there is no direct and immediate link between services supplied to it and services supplied by the group it acquires.

In 2006, ADIL ("Bidco"), a special purpose vehicle owned by a consortium, was set up to make a take over bid for BAA plc ("Target"). It entered into engagement letters with the investment bank Macquarie and with the law firm Freshfields.
The issue was whether Bidco was entitled to recover the input tax (approx. £6.7 million) incurred in relation to the services provided by Macquarie and Freshfields.

Under the Sixth Directive and the VAT Act 1994, the VAT was only recoverable if;

1. it was incurred in the course of an economic activity and;
2. it was used for the purposes of onward taxable supplies made by Bidco.

Both the First Tier Tribunal and the Upper Tier Tribunal found that Bidco was carrying on an economic activity. The purpose of the take over was not an end in itself but was the first step of a strategy which involved management. "That management included the provisions of services by Bidco".

However, the Upper Tribunal disagreed with the First Tier Tribunal's finding that the input VAT could be linked to onward taxable supplies. The Upper Tribunal found that because the Macquarie fee had been mainly concerned with the take over and not with any services to be provided to Bidco (or Target) after the takeover, it could not be a cost component of any taxable supplies made by (or attributable to) Bidco at a later stage. Using the formula from *BLP*, the Tribunal held that there was no direct and immediate link between Bidco's VAT and any onward taxable supplies.

The Court of Appeal has now dismissed Target's appeal, disagreeing with the FTT and UT's finding that Bidco had carried on an economic activity at the time the input tax was incurred. The tribunal had found no evidence that, at that time, Bidco made, or intended to make, taxable supplies. That finding of fact was fatal to the contention that Bidco was carrying on an economic activity.

The Court of Appeal also considered the following issues.

- Although there was a tenuous link between the services supplied to Bidco and the taxable services supplied by Target, in that it facilitated the acquisition of Target (which was making taxable supplies), the link was not "direct and immediate"; the taxable supplies made at that time by Target were not linked with the supplies received by Bidco.

- Target's taxable supplies could not be imputed to Bidco (so as to provide the direct and immediate link), either through its subsequent membership of the Target VAT group, or through the application of the *Faxworld* principle, which allows input tax recovery against supplies made by a successor entity.

Our Comment

HMRC has been looking closely at, and challenging, VAT recovery on corporate transactions for a while. This case illustrates the importance of thinking about VAT very early in a corporate transaction to maximise the chances of recovering VAT on acquisition costs. This would have been difficult in the hostile takeover situation initially faced by BAA, but where possible advisable steps include establishing any acquisition vehicle very early, registering it for VAT as soon as possible and thinking about VAT when drafting engagement letters with professional advisers. It is also advisable to ensure that a holding company supplies and charges for management services.

GfBk v Finanzamt C-275/11

The provision of investment advice to an investment fund falls within the VAT exemption for fund management.

GfBk disseminated information and advice about the stock markets, and provided advice in connection with financial assets.

In 1999, GfBk was engaged by an investment fund management company ("IMC") to advise the IMC "in the management of the fund" and "constantly to monitor the fund and to make recommendations for the purchase or sale of fund assets". From 1999 to 2002, GfBk made recommendations concerning the purchase and sale of securities to the IMC. The taxpayer did not issue detailed reports but, rather, specific recommendations, which the IMC entered into its order system. Once processed, those recommendations were analysed in order to check whether they contravened any statutory limits. At the end of the verification, the IMC would implement the recommendations, sometimes within a matter of minutes.

The issue was whether the services provided by GfBk consisted in the "management of special investment funds" which is exempt from VAT under the 6th VAT Directive.

The CJ-EU noted that the exemption could apply in the context of the provision of services by a third party as the application of the exemption depended on the nature of the services provided, not on the person providing them. The key question was whether the services provided by GfBk were "intrinsically connected" to the activity characteristic of an IMC. The court answered in the affirmative, noting that the principle of fiscal neutrality demanded such a finding as "operators must be able to choose the form of organisation which, from the strictly commercial point of view, best suits them without running the risk of having their transactions excluded from the exemption."

Our Comment

This judgment provides yet further guidance on the scope of the VAT exemption for fund management services provided to special investment funds. Whilst the *Wheel Common Investment Trustees* case (reported elsewhere in this edition) concentrated on what was required to be considered a special investment fund, *GfBK* looked at the scope of what services fall within fund management.

The implication is that some services currently received by special investment funds from third parties may now be exempt if on the specific facts, the services in question are necessary and essential to the management of the fund. Examples that may satisfy the criteria set out by the CJ-EU could be marketing services, financial data reporting, and advisory or information services. However it will very much depend on the exact factual arrangement. HMRC has yet to comment as to how it sees the scope of the exemption following the decision. It may seek to confine any extension to cases that are on all fours with the facts in *GfBK*. ●

Cathya Dajnogly speaks to Suzanne Mcmahon

1. Can you summarise your work experience so far?

I trained at the Solicitor's Office of HM Customs & Excise (as was, now HMRC) in Manchester where I worked in the whole range of areas they covered, including large criminal prosecutions and extradition which was very exciting to be involved in as a young lawyer. On qualification, I worked in the VAT Tribunal team and then a couple of law firms in Scotland. I then moved to PWC in Edinburgh for a few years before taking an in-house role in the VAT team in the group tax function of a major international bank where I spent over 7 years.

2. What made you choose Pinsent Masons?

I had been a client of McGrigors (before their merger with Pinsent Masons) whilst in my previous role, so I knew many members of the tax litigation team and was familiar with the type and quality of work they delivered and their outstanding reputation in tax litigation. At the time I was looking for a new challenge, they were looking to expand their team, so it seemed like a good fit and gave me the opportunity to do much more contentious work, as well as VAT advisory.

3. Can you share a quirky work-related anecdote with us?

I did appear in the Manchester Magistrates Court on a seizure case involving someone who had tried to unlawfully smuggle a live parrot from Kazakstan into the UK, and had to explain when asked where the parrot was (in front of visiting law students) that the parrot was in a breeding programme in Blackpool Zoo, and was doing very well from all reports!

4. What advice would you give a junior lawyer?

Be the best you can, listen to the client's needs and keep your advice simple and accessible – and above all , remember you are in a team and teamwork cannot be under-rated as a way to achieve results.

Other News

PM-Tax is now on Twitter. Follow us (@PM_Tax) to get the news and views of the largest tax practice in a UK law firm in real time!

Pinsent Masons congratulate the 84 barristers who have recently been appointed Queen's Counsel.

We are particularly delighted that both Andrew Hitchmough and Patrick Way have been successful. The new QCs announced will formally become silks when they make their declaration before the Lord Chancellor at a ceremony on 27 March. ●

Tell us what you think

We welcome comments on the newsletter, and suggestions for future content.

Please send any comments or suggestions to cathya.djanogly@pinsentmasons.com

You can also use this email address if you have any queries.

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