RPC

Corporate tax update

Second quarter 2016

Welcome to the latest edition of our Corporate Tax Update, written by members of RPC's tax team and published quarterly. On 23 June 2016 the UK voted to leave the EU in an historic referendum result. A period of some political, economic and social uncertainty will undoubtedly follow (and we've already had a turbulent few weeks) but as far as corporate tax is concerned there should be no immediate consequences. It remains to be seen what happens to the planned further reduction in corporation tax to 15% as announced by the then-Chancellor George Osborne. Some initial views on the likely corporate tax consequences of Brexit are set out below. It has also been announced that Royal Assent to this year's Finance Bill is not now expected before the Autumn. In the aftermath of the referendum result, it is perhaps easy to forget that some significant changes to the UK corporate tax regime are planned. Whether all of these changes now proceed, at the pace originally intended, will become clear in due course. In this edition we therefore also highlight some of the key tax developments of interest to UK corporates from the second quarter of 2016.

The impact of BREXIT on UK taxation

The most obvious EU influence on UK tax policy is in the field of indirect taxation, and in particular VAT which is an EU-wide tax with set minimum rates. In the event of the UK leaving the single market it is highly unlikely that the UK will abolish VAT (it currently accounts for nearly 20% of the total UK tax take) but it might well make changes to its VAT law that are not currently permitted, such as to extend some of the lower VAT rates to additional types of goods and services, and to introduce further VAT exemptions. The VAT position for businesses supplying or receiving cross-border EU supplies might become more complicated. more›

Consultation season

Following on from announcements made by the Chancellor in his March 2016 Budget, a number of consultations were published in May. more›

Corporation tax interest deductions – detailed rules

As announced in the Budget, and following the publication of the OECD's recommendations on interest expense deductibility, as part of the BEPS project, the Government intends to introduce (further) rules to limit interest deductions by companies. The legislation will be introduced in Finance Bill 2017, to take effect from 1 April 2017. more›

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Corporation tax loss reform

As announced in the Budget, from April 2017 companies with "large" profits will be subject to restrictions so that only 50% of profits over £5m will be able to be offset against carried forward losses. The better news was that, also from April 2017, all companies would be given greater flexibility as to how they can use any carried forward losses. more›

Substantial Shareholdings Exemption (SSE) reform

As announced as part of the 2016 Budget, a consultation, which will run to 18 August, has been published on possible reforms to the SSE to make it "simpler, more coherent and more internationally competitive". More generally, views are being sought as to what role the existing (or a reformed) SSE plays in making the UK an attractive holding company jurisdiction. more›

Double Tax Treaty Passport (DTTP) scheme review

The government has published a consultation document designed to:

- seek views on the DTTP scheme
- canvass opinion on the possible extension of the DTTP scheme, to cover funds and partnerships. more›

Secondary transfer pricing adjustments

On 26 May 2016, and again following on from a commitment made in Budget 2016, HMRC published a consultation document proposing the introduction of secondary adjustment rules into the UK's transfer pricing regime. more›

Corporation tax – general

First-tier Tribunal allows corporation tax loss to be offset against income tax profit

On 20 June 2016, the First-tier Tribunal held that a loss incurred by a UK permanent establishment of a non-UK resident company could be offset against that company's profits subject to UK income tax. more›

First-tier Tribunal rules that appointment of receiver amounts to change of "control" for purposes of group relief

On 17 June 2016, the First-tier Tribunal (in *Farnborough Airport Properties Ltd v HMRC*) held that the appointment of a receiver over a (would-be surrendering) group company meant that "arrangements" were in place for the company to no longer be under the same "control" as would-be claimant group companies. The group company in receivership was therefore unable to surrender group relief from the date the receiver was appointed. more›

VAT

TOGCs and VAT groups – HMRC accepts Intelligent Managed Services decision

On 24 June 2016, HMRC published Revenue & Customs Brief 11 (2016) in light of the Upper Tribunal's decision in *Intelligent Managed Services Limited*. more›

Recovery of input VAT in tripartite arrangements – Supreme Court dismisses taxpayer appeal in Airtours case

On 11 May 2016, the Supreme Court (by 3-2 majority decision) dismissed the taxpayer's appeal in *Airtours Holidays Transport Ltd v HMRC*. The Court agreed with the Court of Appeal that the taxpayer was not entitled to recover input VAT on accountants' fees it paid in connection with a report prepared for the taxpayer's lenders. more›

Employment taxes

Consultation on joint elections to transfer employer national insurance contributions

On 20 April 2016, HMRC published a consultation document proposing to abolish the mechanism whereby an employee and employer may jointly elect to transfer a liability for employer (Class 1) national insurance contributions (NICs) to the employee, where such NICs arise in respect of specified chargeable events in connection with employment-related securities and options. more›

Stamp taxes

Court of Appeal allows taxpayer's appeal in SDLT avoidance case

On 26 May 2016, the Court of Appeal upheld the taxpayer's appeal in the long-running *Project Blue* case, the first case to consider in detail the wide-ranging stamp duty land tax (SDLT) anti-avoidance provision (section 75A of Finance Act 2003). Although this latest decision is a clear win for this particular taxpayer, to HMRC's potential embarrassment the Court held that SDLT was in fact payable – just not by the taxpayer that HMRC has been pursuing. This decision has done nothing to overturn the earlier decisions' wide interpretation of the scope of section 75A. more›

Other developments

Large business annual tax strategy – HMRC guidance

On 24 June 2016, HMRC published (very short) guidance on the annual tax strategy to be required of "large businesses", from the first financial year beginning after Royal Assent of this year's Finance Bill. more›

First-tier Tribunal holds that shares with no dividend rights are not "ordinary share capital" for entrepreneurs' relief purposes

On 5 May 2016, the First-tier Tribunal in *McQuillan v HMRC* held (in an appeal against the disallowance of a claim for entrepreneurs' relief) that shares carrying no dividend rights could be regarded as shares carrying rights to a fixed dividend of zero per cent. As a result, such shares were excluded from the definition of "ordinary share capital" used in the conditions for entrepreneurs' relief eligibility (and also in other parts of UK tax legislation). Accordingly the appellants were eligible for entrepreneurs' relief as (ignoring the shares in question) they exceeded the threshold of a holding of 5% of ordinary share capital in the company concerned.more›

International

Member States reach agreement on anti-avoidance Directive

On 21 June 2016, the European Council announced that Member States had agreed on a final text for the proposed draft Directive addressing tax avoidance practices commonly used by large companies. more›

BEPS transfer pricing amendments approved by OECD Council; incorporated into UK law

On 15 June 2016, the OECD confirmed that the OECD Council had approved the transfer pricing guidelines amendments proposed by the OECD as part of the Base Erosion and Profit Shifting (BEPS) project. As a result, these changes are now incorporated into UK law. more›

The impact of BREXIT on UK taxation

The most obvious EU influence on UK tax policy is in the field of indirect taxation, and in particular VAT which is an EU-wide tax with set minimum rates. In the event of the UK leaving the single market it is highly unlikely that the UK will abolish VAT (it currently accounts for nearly 20% of the total UK tax take) but it might well make changes to its VAT law that are not currently permitted, such as to extend some of the lower VAT rates to additional types of goods and services, and to introduce further VAT exemptions. The VAT position for businesses supplying or receiving cross-border EU supplies might become more complicated.

Excise duties are the other main indirect taxes governed by EU rules. Tobacco, alcohol and energy are all subject to excise duties and there are agreed minimum rates for each of these, although states are free to set excise duties above the minimum rates. Again the UK may be able to make changes here.

With regards to direct tax, the EU plays a much lesser role and these taxes are principally a matter for each member state. However, there are a number of relevant EU Directives, which are primarily aimed at removing obstacles for businesses operating within the EU. These include the Merger Directive (which applies reliefs for mergers, divisions, transfers of assets and exchanges of shares which take place between companies in different member states), the Parent-Subsidiary Directive (concerned with profit distributions between associated companies) and the Interest and Royalties Directive (prevents withholding taxes on royalty and interest payments). The benefit of EU withholding tax exemptions may be lost to UK companies, but the UK does have a very comprehensive network of double tax treaties, which should lessen the consequences of this. There may be some impact for UK holding companies from the loss of the EU reliefs for group payments, however (eg, in relation to dividends paid from Germany to a UK parent). Future EU tax initiatives, such as the directive on anti-avoidance and the common consolidated corporate tax base, should not now affect the UK.

Post-Brexit, and were the UK also to leave the EEA, the UK would not be bound by EU law restrictions with respect to State Aid. The government would not then be prohibited from using state resources (such as a more favourable tax regime) to provide an advantage to any organisation or business.

Finally stamp duty reserve tax is imposed at the rate of 1.5% on issues of shares and securities to depositary receipt issuers or clearance service services, in certain circumstances. Following European case law, HMRC no longer seeks to impose this charge and so following Brexit, this charge could arguably be levied.

Overall Brexit will have no immediate effect on any tax legislation which has been incorporated into UK law, although the government might be able to amend the law as it wished. Whether it would want to do so is a different question and the extent to which it could will depend upon the nature of any post-Brexit UK/EU relationship.

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Consultation season

Following on from announcements made by the Chancellor in his March 2016 Budget, a number of consultations were published in May.

Corporation tax interest deductions – detailed rules

As announced in the Budget, and following the publication of the OECD's recommendations on interest expense deductibility, as part of the Base Erosion and Profit Shifting (BEPS) project, the Government intends to introduce (further) rules to limit interest deductions by companies. The legislation will be introduced in Finance Bill 2017, to take effect from 1 April 2017.

On 12 May 2016 a consultation document was published which set out detailed design proposals for the new rules. Comments are invited by 4 August 2016. The consultation makes clear that the target of the new rules are multinational groups who (i) borrow more in the UK than they need for UK activities, resulting in a "mismatch" between UK tax deductible interest and UK taxable income and/or (ii) enter into arrangements so that tax deductions are achieved both in the UK and elsewhere, in respect of the same interest expense.

The thrust of the new regime is that a group's "net tax interest expense" (ie excess of finance expense over finance income) will be restricted if and to the extent it exceeds the group's "interest capacity".

"Interest capacity", or the limit of a group's tax deduction, is to be calculated by using either the **Fixed Ratio Rule** or the **Group Ratio Rule**, if greater than £2m.

Under the planned Fixed Ratio Rule, corporation tax deductions for net interest expense will be limited to 30% of a group's UK EBITDA. It is the Government's view that 30% is sufficient to cover the commercial interest costs arising from UK economic activity for "most businesses".

As proposed, a group would be able to elect to adopt a Group Ratio Rule instead, which would substitute (in place of 30%) a % of UK EBITDA equal to the ratio of group 3rd party finance expense to group EBITDA. This could result in a reduced limit on tax interest deduction, and is designed for groups that are "highly leveraged for commercial reasons".

A de minimis group threshold of £2m (net interest expense) will apply before the new rules apply. This will, according to the Government, mean that 95% of groups will be excluded from the new rules.

Any restricted interest expense will be capable of indefinite carry forward. However if interest capacity for a year exceeds the net tax interest expense, the "spare" net tax interest expense will only be able to be carried forward for three years.

The current "debt cap" rules will be abolished, as the new rules will include provisions that ensure that a group's net UK interest tax deductions cannot exceed the group's global net third party expense.

The consultation can be viewed here.

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Corporation tax loss reform

As announced in the Budget, from April 2017 companies with "large" profits will be subject to restrictions so that only 50% of profits over £5m will be able to be offset against carried forward losses. The better news was that, also from April 2017, all companies would be given greater flexibility as to how they can use any carried forward losses.

On 26 May the government launched a consultation on the introduction of these two reforms, which set out the detail absent in the Budget announcement. The consultation will run to 18 August 2016. Taking each reform in turn:

- **greater flexibility**: by allowing companies to use carried forward losses against taxable profits arising from different activities, and/or against taxable profits of other group members, the government intends to prevent carried forward losses becoming "stranded". A "group" for these purposes will take its meaning from the existing group relief regime. The consultation document states that this will have a "significant impact on the Exchequer" and as a result this element of the reform package will only *apply to* losses *arising from 1 April 2017*.

  It should be noted that, under the proposals, some form of "streaming" of post-1 April 2017 losses would remain. As proposed, it will be necessary from April 2017 to separate out trading and non-trading profits to arrive at a trading and a non-trading proportion. Available losses will only be capable of being used against profits in these proportions

- **50% profit restriction**: the stated concern here is that profit-making companies can end up not paying tax for many years due to the availability of historic carried-forward losses. The proposal, it is suggested, is in keeping with the rules in a number of competitor jurisdictions and is described as a restriction on the "timing" of the relief (as any restricted carried forward loss relief can be carried forward indefinitely to periods when it can be used). Unlike the first limb of the reform package (which concerns only post-April 2017 losses), this proposed change will *apply equally to pre- and post-April 2017 losses*. However in light of the proposal to increase the flexibility of the use of carried forward losses:

  - the 50% restriction applicable to pre-April 2017 losses will be by reference to trading profit
  - the 50% restriction applicable to post-April 2017 losses will be by reference to profit across the group.

The consultation predicts that over 99% of companies should be unaffected by the 50% profit restriction. This is due to the proposed availability of a £5m annual allowance, per "group", allowing up to £5m of taxable profits to be fully relieved by available carried forward losses. It should be noted that for the purposes of the annual allowance the government is proposing a definition of group based on "control" or "association", rather than adopting the existing group relief definition. Groups will be given "full discretion" as to how to allocate the annual allowance within the group.

The consultation also confirms that the new restriction should not push loss-making companies into a tax-paying position. The final legislation will therefore ensure that current year losses can be used against profit otherwise "exposed" to tax by operation of the 50% restriction.

Finally the consultation recognises the possible impact of the 50% restriction on insurers, and seeks views as to the implications of the reform in terms of regulatory capital requirements.

The consultation document can be viewed here.

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Substantial Shareholdings Exemption (SSE) reform

As announced as part of the 2016 Budget, a consultation, which will run to 18 August, has been published on possible reforms to the SSE to make it "simpler, more coherent and more internationally competitive". More generally, views are being sought as to what role the existing (or a reformed) SSE plays in making the UK an attractive holding company jurisdiction.

The consultation's proposals range from technical changes to the existing SSE, to a more radical replacement of the SSE with something more akin to the "participation regimes" found in other EU member states. There are 5 options for possible reform, in descending order of magnitude of change:

1. **a new, wider-ranging exemption**: the government has said it is willing to consider a more comprehensive exemption for "substantial" share disposals, with fewer conditions regarding the companies involved. Any new exemption should not, however, apply to ordinary "trading" disposals. Nor should it allow for tax-free transfers of enveloped passive assets (eg land and IP)
2. **amend the SSE so that only the investee company must meet the "trading" test**: as a "significant simplification" of the existing SSE, this option would mean that whilst – for SSE to apply – the company (or sub-group) being disposed of must be a trading company or sub-group, this condition would no longer apply to the company making the disposal. In other words, SSE could be available to a non-trading company/group disposing of a trading company/group
3. **amend the SSE to impose some other test on the investee company**: the government has asked for views on whether an investee-level test other than "trading" would serve to ensure that the SSE only exempts the sort of gains that fall within the scope of the current regime. Three approaches have been suggested, all relating to the activities of the company (or sub-group) being disposed of, which would allow for (i) other business activities, (ii) significant management functions of investment companies, and (iii) certain activities to be prescribed in legislation to also result in availability of SSE relief
4. **retain (amended) SSE tests at both investee and investor level**: if there are compelling reasons to retain SSE requirements applicable to both the company disposing and the company being disposed of, the government has proposed either (i) limiting the "trading" test to consider only the immediate companies concerned (rather than the wider group/sub-group), or (ii) expanding the definition of "qualifying" activities to include the type of activities discussed as part of option 3 above
5. **amend the definition of "substantial shareholding"**: finally, the government has proposed lowering the existing 10% ordinary share capital requirement. Although the consultation states that the government is sceptical as to the merits of lowering the threshold, it does implicitly recognise that there may be occasions under the current SSE where an exemption for gains on large and long-term shareholdings is not allowed as the 10% threshold is not met. By way of example it refers to significant infrastructure projects where a less than 10% shareholding "may still represent multiple billions of invested capital".

Various combinations of these options (aside from option 1) are also possible, according to the consultation document.

The document also considers, amongst other things, possible reform of the SSE to provide exemption for indirect holdings of sovereign wealth funds and pension funds, and to holdings through tax transparent fund structures.

The consultation document can be viewed here.

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Double Tax Treaty Passport (DTTP) scheme review

The government has published a consultation document designed to:

- seek views on the DTTP scheme
- canvass opinion on the possible extension of the DTTP scheme, to cover funds and partnerships.

The DTTP scheme was launched in September 2010. The scheme acts as an administrative simplification, as an alternative to the rather cumbersome process whereby overseas lenders must, on a loan-by-loan basis, apply to HMRC for UK-source interest payments to be paid at reduced (or zero) rates of UK withholding tax under an applicable double tax treaty. Under the DTTP scheme, the status of an overseas lender granted a "passport" by HMRC can be checked by UK borrowers under multiple loans and, under a simplified administrative procedure, reduced UK withholding (or, as applicable, no UK withholding) can be levied on the interest payments.

At the most basic level, the consultation seeks views as to whether the current DTTP scheme should be continued. It is assumed that most respondents will answer "yes" to this question.

More interestingly, the consultation document proposes extending the DTTP scheme in a number of ways, namely:

- making the DTTP scheme available to loans made to a wider range of UK borrowers (ie not just UK corporate borrowers). In particular it is proposed that loans to UK partnerships should be brought within the scope of the DTTP
- making the DTTP scheme available to a wider range of overseas lenders. As well as overseas partnerships, the consultation also seeks views on permitting sovereign investors and overseas pension funds to access the DTTP scheme.

The consultation document can be viewed here.

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Secondary transfer pricing adjustments

On 26 May 2016, and again following on from a commitment made in Budget 2016, HMRC published a consultation document proposing the introduction of secondary adjustment rules into the UK's transfer pricing regime.

The focus of the consultation are arrangements whereby connected persons make payments to one another that exceed the "arms' length" amount. Although existing rules would ensure that the parties are taxed as though an arm's length amount were paid (the primary adjustment), the recipient is still able to retain and enjoy the excess. A secondary transfer pricing adjustment would ensure that cash benefits of incorrect transfer pricing are appropriately taxed.

The consultation notes that secondary adjustment is an "internationally recognised" approach. Although it seeks views on whether such rules should be introduced in the UK, it seems likely that the Government is committed to doing so. The key issues would therefore seem to concern how the rules should operate.

The Government's stated preference would be to treat the excess profits as a deemed loan (for tax purposes only) bearing imputed interest, which would be taxed as income for the deemed lender. The rate of deemed interest would be set at a pre-determined market-adjusted rate and would continue until such time as the excess cash is repatriated to the UK.

The deadline for response is 18 August 2016, and any legislation will be included in the Finance Bill 2017.

The consultation document can be viewed here.

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Corporation tax – general

First-tier Tribunal allows corporation tax loss to be offset against income tax profit

On 20 June 2016, the First-tier Tribunal[1] held that a loss incurred by a UK permanent establishment of a non-UK resident company could be offset against that company's profits subject to UK income tax.

The appellant was a BVI-incorporated company trading (in UK land) in the UK through a permanent establishment here. Had it made a profit from that trade, it would have been subject to UK corporation tax. As it happened, the company made a trading loss of over £2m for the period in question.

At the same time, the company also owned UK investment properties from which it received rental income subject to UK income tax (as the letting business was not carried out through the PE). The company sought to offset its PE trading loss against its non-PE rental income, to reduce its UK income tax liability to nil. HMRC rejected this claim.

The Tribunal agreed with the appellant company that, on a literal reading of the relevant legislation, it was entitled to set off PE trading losses against profit subject to income tax. There was no need for a purposive reading of the legislation as the drafting was clear.

First-tier Tribunal rules that appointment of receiver amounts to change of "control" for purposes of group relief

On 17 June 2016, the First-tier Tribunal (in *Farnborough Airport Properties Ltd v HMRC*[2]) held that the appointment of a receiver over a (would-be surrendering) group company meant that "arrangements" were in place for the company to no longer be under the same "control" as would-be claimant group companies. The group company in receivership was therefore unable to surrender group relief from the date the receiver was appointed.

It is perhaps not surprising, in this particular case, that the appointment of the receiver resulted in the receiver obtaining "control" of the company for section 1124 CTA 2010 purposes. Under the security documents the receivers were appointed as receivers over the whole of the company's property, with wide powers "to do or omit to do anything which he considers appropriate in relation to the Secured Assets" and "to carry on the business of the Company".

What is more surprising is the Tribunal's view that the appointment triggered a change of control for section 154 CTA 2010 purposes. As argued by counsel for the appellants in this case, section 154 tends to be regarded as an anti-avoidance provision to be construed narrowly, despite the wide drafting. The Tribunal rejected this argument, holding that section 154 was widely drafted with a clear and simple purpose; to deny group relief as between companies not under common control.

The Tribunal did not examine the legal process of receivership in contrast to administration nor did it explore in detail (beyond the wording of the security documents) the measure of "control" given in this particular receivership.

It remains to be seen whether this decision will be appealed to the Upper Tribunal. In the meantime it should be assumed that HMRC will challenge claims for group relief involving a

1. *English Holdings Ltd v HMRC* [2016] UKFTT 0346 (TC).
2. [2016] UKFTT 0431.

group member in receivership (where the receivership extends to more than just a single asset, or limited assets, of the company).

The decision can be viewed here.

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VAT

TOGCs and VAT groups – HMRC accepts Intelligent Managed Services decision

On 24 June 2016, HMRC published Revenue & Customs Brief 11 (2016) in light of the Upper Tribunal's decision in *Intelligent Managed Services Limited*[3]. See here for our commentary on the Tribunal's decision.

HMRC has now accepted that transfers of businesses into VAT groups can qualify as TOGCs provided:

- the transferee company intends to continue to use the transferred assets in operating the same kind of business as the transferor, but to other group members, and
- the other VAT group members use the services to make supplies outside of the VAT group.

HMRC has also confirmed it is changing its policy on business transfers out of a VAT group. It will no longer be the case that such transfers are automatically denied TOGC treatment.

Finally, the Brief sets out HMRC's views on voluntary VAT registrations for non-established transferees. In order for TOGC treatment to apply, it is HMRC's view that voluntary registration must be in place at the date of transfer.

The Brief can be viewed here.

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Recovery of input VAT in tripartite arrangements – Supreme Court dismisses taxpayer appeal in Airtours case

On 11 May 2016, the Supreme Court (by 3-2 majority decision) dismissed the taxpayer's appeal in *Airtours Holidays Transport Ltd v HMRC*[4]. The Court agreed with the Court of Appeal that the taxpayer was not entitled to recover input VAT on accountants' fees it paid in connection with a report prepared for the taxpayer's lenders.

In the context of Airtours' financial difficulties, PwC were engaged, amongst other things, to liaise with the group's creditors. PwC signed an engagement letter with the banks being asked to extend their facilities to Airtours. Although Airtours signed the engagement letter, it was clear from the face of the letter that PwC were being retained by the banks, that PwC assumed a duty of care towards the banks, and that PwC's reports were to be for the sole use of the banks. Airtours, however, were responsible for PwC's fees.

The Supreme Court held that, properly construed, the contract did not give Airtours the right to require PwC to supply the services in question. In the absence of such right, Airtours could not be the recipient of the supply. Airtours could not, therefore, recover input VAT in respect of the supply. The terms of the contract supported the conclusion that only the banks, and not Airtours, had the right to require the supply of PwC's services. Such terms included the following (some of which were more persuasive than others):

- the engagement letter was addressed to the banks
- PwC's reports were for the banks' sole use
- PwC's duty of care was acknowledged to the banks only
- Airtours was only entitled to a redacted copy of the PwC's reports.

3. [2015] UKUT 0341 (TCC).
4. [2016] UKSC 21.

The Court took the view that the fact that Airtours countersigned PwC's engagement letter was of little significance, as this was required primarily to ensure that Airtours paid PwC's fees.

The Court, acknowledging that the contractual position is not determinative if not reflective of the "economic reality" of the arrangements, nevertheless held that the contractual position and economic reality in this case were consistent.

Given that, as before the Court of Appeal, this was a majority decision, it is clear that the courts sometimes have difficulty in identifying the correct recipient of a supply under tripartite arrangements. This latest decision does however confirm the importance of playing close attention to contractual terms in tripartite arrangements. A taxpayer looking to recover input tax should ensure that the terms support an argument that it was the recipient of the supply in question, rather than merely an "interested party" to that supply.

To view the decision, click here.

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Employment taxes

Consultation on joint elections to transfer employer national insurance contributions

On 20 April 2016, HMRC published a consultation document proposing to abolish the mechanism whereby an employee and employer may jointly elect to transfer a liability for employer (Class 1) national insurance contributions (NICs) to the employee, where such NICs arise in respect of specified chargeable events in connection with employment-related securities and options.

Unlike the other mechanism for an employee to be required to meet an employer NICs liability, whereby the employee simply agrees to indemnify an employer for such NICs, a joint election constitutes a legal transfer of the liability to the employee. The election must also, currently, be approved in advance by HMRC.

HMRC appear to be concerned as to the administrative burden of the joint election route, and therefore keen to remove this paper-based process. The consultation does, however, recognise that the joint election route gives greater certainty than the agreement route.

The consultation makes it clear there are no plans to take away the ability for an employee to enter into an agreement to meet the cost of employer NICs.

To view the consultation, click here.

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Stamp taxes

Court of Appeal allows taxpayer's appeal in SDLT avoidance case

On 26 May 2016, the Court of Appeal upheld the taxpayer's appeal in the long-running *Project Blue*[5] case, the first case to consider in detail the wide-ranging stamp duty land tax (SDLT) anti-avoidance provision (section 75A of Finance Act 2003). Although this latest decision is a clear win for this particular taxpayer, to HMRC's potential embarrassment the Court held that SDLT was in fact payable – just not by the taxpayer that HMRC has been pursuing. This decision has done nothing to overturn the earlier decisions' wide interpretation of the scope of section 75A.

Broadly, the case concerned the 2007 agreement for an SPV to buy the Chelsea Barracks from the MoD (at a price of £959m). It was agreed that 20% would be paid on exchange with the balance in equal instalments over four years. To fund the remainder of the purchase price, the SPV used a sharia-compliant finance arrangement. This was arranged between exchange and completion. The SPV acquired the freehold of the property from the MoD in January 2008 and, pursuant to an agreement negotiated prior to completion of the purchase of the property, immediately transferred the freehold to a Qatari financial institution specialising in sharia-compliant finance, for £1.25bn. The bank then immediately granted a 999-year lease of the property back to the SPV.

The parties to these transactions filed three SDLT returns, claiming that no SDLT charge arose, relying on the following arguments:

- in respect of the sale by the MoD to the SPV: SDLT "sub-sale", or "transfer of rights", relief applied as the SPV was not the "ultimate" purchaser of the property
- in respect of the sale by the SPV to the Qatari bank: SDLT "alternative property finance" relief applied in respect of the sharia-compliant financing
- in respect of the 999-year lease to the SPV: SDLT "alternative property finance" relief again applied.

HMRC enquired into these returns but, crucially in terms of the implications of the latest ruling, accepted that relief was available for the sale and leaseback arrangements between the SPV and the Qatari bank. HMRC therefore closed its enquiries into these two returns. Instead, HMRC initially assessed the SPV for SDLT in respect of its purchase of the property from the MoD for £959m, relying on section 75A. HMRC later amended its argument to assess the SPV for SDLT on £1.25bn, in respect of the "notional" transaction under section 75A.

Before the First-tier and Upper Tribunals, the taxpayer had argued that the targeted SDLT anti-avoidance rule (section 75A) was not triggered as all steps were commercial transactions carried out for genuine commercial purposes. In each case the taxpayer lost as the Tribunals each held that although section 75A is described as an anti-avoidance provision, the language of the section does not require there to be a tax avoidance purpose for the provision to apply. The Upper Tribunal did, at least, partially overturn the First-tier decision, ruling that SDLT was payable only on the £959m actually paid by the SPV.

Before the Court of Appeal the SPV put forward a new line of argument, that in fact SDLT was payable (on £1.25bn) but by the Qatari Bank rather than by the SPV. This was because the technical conditions for the SDLT relief on sharia-compliant financing were not satisfied on the facts of this particular case due to the fact that the effect of the SDLT "sub-sale" rule is that the

5. *Project Blue Ltd v HMRC* [2016] EWCA Civ 485.

Qatari bank is deemed to acquire the land from the MoD (and not the SPV). The Court agreed with the SPV with the result that:

- the Qatari bank was liable for SDLT on £1.25bn
- section 75A could not apply as the amount of SDLT "payable" was not less than an amount of SDLT calculated on any "notional" transaction between the parties.

As the Court found in favour of (this particular) taxpayer on the sharia-financing exemption point, it was not necessary for the Court to consider in any detail the unsatisfactory drafting of section 75A that had so concerned the earlier Tribunals. However the Court did make an obiter comment that it agreed with the Tribunals that 75A can apply even if there is no tax avoidance purpose.

As up to £50m of SDLT is at stake here HMRC may well seek to appeal this decision to the Supreme Court, or else try to find a way to recover the SDLT from the Qatari bank. As HMRC have closed the enquiry into the bank's return, it is far from clear how (if at all) this might be possible.

The decision can be viewed here.

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Other developments

Large business annual tax strategy – HMRC guidance

On 24 June 2016, HMRC published (very short) guidance on the annual tax strategy to be required of "large businesses", from the first financial year beginning after Royal Assent of this year's Finance Bill.

Companies and partnerships will be required to publish an annual tax strategy if they had either turnover above £200m or a balance sheet over £2bn in the previous tax year.

The new guidance includes brief details as to what should be included in an annual strategy, and the penalties to be imposed for failure to publish a tax strategy on time.

The guidance can be viewed here.

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First-tier Tribunal holds that shares with no dividend rights are not "ordinary share capital" for entrepreneurs' relief purposes

On 5 May 2016, the First-tier Tribunal in *McQuillan v HMRC*[6] held (in an appeal against the disallowance of a claim for entrepreneurs' relief) that shares carrying no dividend rights could be regarded as shares carrying rights to a fixed dividend of zero per cent. As a result, such shares were excluded from the definition of "ordinary share capital" used in the conditions for entrepreneurs' relief eligibility (and also in other parts of UK tax legislation). Accordingly the appellants were eligible for entrepreneurs' relief as (ignoring the shares in question) they exceeded the threshold of a holding of 5% of ordinary share capital in the company concerned.

As well as contradicting published HMRC guidance, this decision also follows the decision of the First-tier Tribunal in *Castledine* (see our last update, here, for a summary of this case). The two decisions, by differently-constituted Tribunals, are hard to reconcile. It remains to be seen whether HMRC appeal this latest decision but, in the meantime, there is fresh confusion as to this aspect of the entrepreneurs' relief rules (and, indeed, other parts of the tax legislation using the "ordinary share capital" definition).

The decision can be viewed here.

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6. [2016] UKFTT 305 (TC).

International

Member States reach agreement on anti-avoidance Directive

On 21 June 2016, the European Council announced that Member States had agreed on a final text for the proposed draft Directive addressing tax avoidance practices commonly used by large companies (see here for earlier commentary on this). This development should, of course, now be considered in light of the Brexit referendum result. Nevertheless should the Directive be formally adopted by the Council, Member States will have until 31 December 2018 to transpose the Directive (to apply from 1 January 2019).

The Council press release can be viewed here.

BEPS transfer pricing amendments approved by OECD Council; incorporated into UK law

On 15 June 2016, the OECD confirmed that the OECD Council had approved the transfer pricing guidelines amendments proposed by the OECD as part of the Base Erosion and Profit Shifting (BEPS) project. As a result, these changes are now incorporated into UK law.

The OECD statement can be viewed here.

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