RPC

Corporate tax update

Fourth quarter 2018

Welcome to the latest edition of our Corporate Tax Update, written by members of RPC's tax team and published quarterly. In this final 2018 edition we highlight some of the key tax developments of interest to UK corporates from the fourth quarter of 2018.

Autumn 2018 Budget

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"Offshore looping" in insurance sector – order made

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HMRC guidance on transfers of business as going concerns (TOGCs)

On 5 December 2018, HMRC published an updated version of its guidance on TOGCs (VAT Notice 700/9). more›

Any comments or queries?

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HMRC guidance on opting to tax land

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VAT recovery on (failed) share acquisitions

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Miscellaneous

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On 31 December 2018, HMRC published revised guidance on the diverted profits tax (DPT). more>

Autumn 2018 Budget

On 29 October 2018, the Chancellor delivered the Autumn 2018 Budget. Some of the key announcements for businesses included:

Entrepreneurs' Relief (1)

From April 2019, the minimum holding period for entrepreneurs' relief (ER) purposes will be increased to two years (from one year, currently).

Entrepreneurs' Relief (2)

Effectively immediately (ie from 29 October 2018) it was announced that two new conditions would need to be met for a shareholder seeking ER. In addition to holding at least 5% of ordinary share capital and voting rights, it was announced that the shareholder would from that date also need to be beneficially entitled to at least 5% of the company's distributable profits, and to 5% of its assets available for distribution to "equity holders" in a winding up.

On 20 December 2018, further refinements to this new test were tabled such that (for disposals from 29 October 2018) it is now proposed that there will be a new alternative test to be met for a shareholder seeking ER. As well as holding 5% of the ordinary share capital and 5% of the voting rights the shareholder must **either**:

- be beneficially entitled to at least 5% of the company's distributable profits, and 5% of its assets available for distribution to "equity holders" in a winding up, **or**
- in the event of a disposal of the ordinary share capital of the company, be beneficially entitled to at least 5% of the disposal proceeds.

Digital Services Tax

From April 2020, a new 2% digital services tax will be introduced on UK revenues from search engines, social media platforms and online marketplaces. The exact scope of the new DST is to be determined by way of consultation, however it has been stated that (i) the new UK DST will not be introduced if an "international solution" to digital taxation is achieved before April 2020; (ii) the new UK DST is intended to hit the "tech giants" not start-ups (there is to be a £25m UK revenue threshold, and a separate £500m global revenue threshold); and (ii) the Government says it expects the new DST to raise £1.5bn over four years.

Intangible fixed assets de-grouping charge

From 7 November 2018, no IP de-grouping charge will arise in connection with sales of companies that qualify for the UK's "substantial shareholding exemption" (this aligns the IP de-grouping rules with the chargeable gains de-grouping rules).

Stamp duty on shares

A new market value rule (so that stamp duty is charged on the higher of actual consideration and market value of the shares) will apply for share transfers executed on or after 29 October 2018 where "listed" shares are transferred to a company and the transferor is connected with the transferee company (but not in such cases where stamp duty group relief is available).

VAT and "offshore looping" by insurance intermediaries

From March 2019, a form of VAT avoidance by insurance intermediaries is to be closed down. This, currently, involves insurance intermediary companies entering into arrangements with non-EU entities to resupply or "loop" services back to UK consumers. This arrangement takes advantage of current UK VAT rules which allow the insurance intermediary to recover its associated input VAT.

Insolvency

From April 2020, HMRC will regain "preferred creditor" status in respect of VAT, PAYE income tax, employee NICs and construction industry scheme (CIS) deductions (ie taxes the insolvent business collected on behalf of other taxpayers).

"IR35" rules for private sector employers

From April 2020, private sector employers will be subject to the same "IR35" rules as public sector employers are currently subject to. The IR35 rules apply (potentially) to payments made to contractors supplying services through personal services companies. Accordingly, from April 2020 it will be the responsibility of the private sector employer (and not the personal services company) to assess whether payments to the company should be subject to tax/NICs (and to account for the same to HMRC). Only large- and medium-sized employers will be affected by this change.

Termination payments and NICs

The introduction of employer NICs on termination payments over £30k has been pushed back another year (to April 2020).

Back to contents>

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Non-residents and UK property – further update on April 2019 tax changes – property funds

On 7 November 2018, the draft Finance Bill 2019 was published. The draft Bill includes provisions for the extension of the UK tax regime for non-UK residents holding UK property (following publication of draft legislation on 6 July 2018[1]).

By way of background, from April 2019, all gains from UK real estate realised by non-UK residents, whether of residential or non-residential (commercial) property and whether by way of direct or "indirect" disposal, will be subject to UK capital gains tax or corporation tax on chargeable gains (as applicable). This will be a fundamental extension to the scope of the UK tax regime.

The consultation paper published in July 2018 alongside the draft legislation contained proposals as to how tax-exempt investors and non-UK collective investment vehicles would be affected by the new rules, but only now do we have draft legislation in this regard.

Collective investment vehicles (CIVs)

As part of the new UK tax regime for UK real estate, from April 2019 a UK tax charge will arise on gains realised on disposals by non-UK residents of interests in entities that themselves hold UK real estate (so-called "indirect disposals").

This new UK tax charge will apply to disposals of interests in "property rich" entities. This will generally be the case if:

- at the time of disposal, at least 75% of the value of the interest (eg shares) disposed of is derived from UK land (whether directly or indirectly, and whether residential or commercial). The test is applied to the gross-asset value of the entity in question, using the market value of the assets at the time of disposal, and
- the non-resident making the disposal holds at least a 25% interest in the entity. Interests held by certain parties related to the non-resident will be taken into account. This test will also be met if at least a 25% interest has been held within the two years ending on the date of disposal.

The second, 25% interest, requirement does not apply to interests in CIVs, however.

This aspect of the new UK tax regime has caused much concern for the UK property industry as, without bespoke rules for CIVs, the new "indirect disposal" tax charge would have jeopardised a basic premise of UK real estate investment structuring; to ensure that from a tax perspective the investor is placed in no worse a position than if they had invested directly.

Finance Bill 2019

There is now some welcome clarity as to how non-residents investing in UK real estate through CIVs will be taxed when the CIV itself makes a direct disposal of UK real estate.

In all cases the rules apply only to CIVs that are "property rich" (as defined above).

1. See here for our earlier commentary on this.

In summary:

Default position: an offshore CIV which is not a company, nor a partnership (eg a JPUT), is treated as a company for the purposes of the new UK tax charge. Rights of investors in such an offshore CIV are treated, for these purposes, as shares. However certain offshore CIVs can elect out of this treatment (see below). The effect of this default treatment is that the offshore CIV will, from April 2019, be subject to UK tax on any gains from sales of UK real estate.

Transparency election: an offshore CIV that is not a partnership (eg a JPUT or a company) may make an election to be treated as a partnership for the purposes of the new rules. Any direct disposal of UK real estate by the CIV in this case would be taxed in the hands of the non-resident investors.

The election must be made with the consent of all investors, must be by way of notice to HMRC, and must be made within 12 months of the first acquisition of UK real estate by the offshore CIV. The election is irrevocable.

Exemption election: an election for exemption from UK tax on direct disposals of UK real estate by both (i) an offshore CIV and (ii) by companies held by the offshore CIV, can be made by:

- offshore CIVs that are companies, and
- non-CIV companies that are wholly-owned by CIVs that are partnerships.

For the “exemption” election to be available, the CIV must be “widely held” and must meet certain reporting conditions. In this case (unlike with the 'transparency' election) there would be no gain for the non-resident investors upon a direct disposal of UK real estate by the CIV.

Indirect disposals: note that, regardless of the making of any election, non-resident investors in offshore CIVs will be caught by the new “indirect disposal” UK tax charge from April 2019 on disposal of their CIV interests if the CIV is “property rich”. The draft legislation confirms that for disposals of interests in CIVs there is no 25% ownership threshold.

Back to contents>

VAT

VAT recovery and holding companies – link between consideration and "economic activity"

On 18 December 2018, the First-tier Tribunal[2] held that a holding company making (or intending to make) supplies to its subsidiaries in return for consideration was **necessarily** carrying on an economic activity for VAT purposes. However, as in this case the subsidiaries would not have to pay for the services received from the holding company until such time as they could pay for them, the supplies were not made "for consideration" until such date.

The Tribunal considered three issues:

- whether the holding company was making supplies to its subsidiaries
- whether those supplies were made for a consideration (and therefore were taxable supplies), and
- whether the holding company made those supplies in the course of carrying on an "economic activity".

Judge Beare had little difficulty in deciding that the holding company was making supplies to its subsidiaries.

Whether these supplies were made for a consideration, given that (on the facts) the subsidiaries would only need to pay for them once they were in funds to do so, was less straightforward. Relying on CJEU and UK decisions, Judge Beare held that this was only the case in respect of supplies made to the subsidiaries after the contingency (ie the subsidiary's ability to pay the amount due) had been satisfied. In other words, those supplies made by the holding company only became supplies for consideration, and therefore taxable supplies for VAT purposes, on and from the date they could be paid for.

Although Judge Beare said that, in respect of periods prior to the date from which the subsidiaries were able to pay for the services "left to my own devices, I would have been inclined to conclude that...[the holding company] was carrying on an economic activity by virtue of its intention to make supplies for a consideration in the future" he felt bound to follow the view of the Upper Tribunal in *Norseman*[3]. Accordingly it was also held that the holding company was only carrying out an "economic activity" from the same date that it started to make supplies for a consideration (ie from the date the subsidiaries became able to pay for the services).

The decision can be viewed here.

Back to contents>

Payments for goods/services not supplied – HMRC change of treatment

On 14 December 2018, HMRC published a Brief[4] setting out its "new policy" for "unfulfilled supplies".

From 1 March 2019, where customers pay for goods or services that they do not in fact collect/use, and the payment is retained by the intended supplier, VAT is payable. This will replace HMRC's current policy which is that any such payment is outside the scope of VAT.

2. In *W Resources plc v HMRC* [2018] UKFTT 746 (TC).
3. Even though obiter, [2016] UKUT 69 (TCC).
4. Revenue and Customs Brief 13 (2018).

The Brief states that this policy change is due to CJEU judgements[5], but in the *Air France-KLM* case quoted by HMRC it should be noted that the airline was entitled to re-sell the paid for (but not used) air ticket. It remains to be seen whether HMRC's stated new policy should apply equally to circumstances where the business is **not** entitled to re-sell the goods/services (such that, potentially, HMRC's current policy that the payment is correctly characterised as compensation due to cancellation might still have some merit). Whether this distinction is addressed in any resulting HMRC guidance should be watched closely.

The Brief can be viewed here.

Back to contents>

"Offshore looping" in insurance sector – order made

On 10 December 2018, an order was made to prevent so-called "offshore looping" in the insurance sector.

As announced in the Autumn 2018 Budget, the order has been refined to specifically target insurance intermediation. The type of arrangements being targeted involve insurance intermediary companies entering into arrangements with non-EU entities to resupply or "loop" services back to UK consumers. These arrangements take advantage of current UK VAT rules which allow the insurance intermediary to recover its associated input VAT.

Such arrangements were discussed in the case of *Hastings*[6] (for our earlier commentary on which, see here).

The order applies to supplies of services from 1 March 2019.

The order can be viewed here.

Back to contents>

HMRC guidance on transfers of business as going concerns (TOGCs)

On 5 December 2018, HMRC published an updated version of its guidance on TOGCs (VAT Notice 700/9). This updated version largely reflects developments based on decided TOGC cases and subsequent HMRC announcements, but the following are worth noting:

- new paragraphs addressing HMRC's views on lease grants/surrenders, in the context of TOGCs (following the First-tier tax tribunal decision in *Robinson Family Limited*) (see paragraphs 2.4 and 6)
- new guidance on VAT groups and TOGCs, in light of the decision in *Intelligent Managed Services Ltd* (see paragraph 4.3)
- new section dealing with "non-established" buyers of TOGCs (paragraph 2.2.6).

The updated Notice can be viewed here.

Back to contents>

5. Notably, *Air France-KLM* (Case C-250/14).
6. *Hastings Insurance Services Ltd v HMRC* [2018] UKFTT 27(TC).

HMRC guidance on opting to tax land

On 30 November 2018, HMRC published an updated version of its guidance on the VAT option to tax (VAT Notice 742A).

Of particular note is the expanded section on authorised signatories for VAT option purposes (at paragraph 7.6). It includes a list of authorised signatories for different types of legal entities as well as detailed guidance as to the requirements to be met for authorisation to be passed to another person.

The revised guidance can be viewed here.

Back to contents>

VAT recovery on (failed) share acquisitions

On 17 October 2018, the ECJ[7] ruled that VAT on professional fees incurred on a failed takeover bid was recoverable by the bidder. The case relates to Ryanair's failed 2006 bid to takeover Aer Lingus (AL). Ryanair's intention was to provide VAT-able management services to AL.

Although the ECJ decision agrees with the Advocate General's (AG's) opinion on the key issue of VAT recovery on the facts of the case, the ECJ did not confirm the AG's view that operating companies should be able to recover VAT on acquisition costs (whether successful or not) without the need (or intention) to provide management services to the acquired subsidiary (provided the acquisition is (or would have been) a strategic one relating to an existing business).

The decision can be viewed here.

Back to contents>

7. In *Ryanair Ltd v HMRC* (Case C-249/17).

Miscellaneous

DPT – revised guidance published by HMRC

On 31 December 2018, HMRC published revised guidance on the diverted profits tax (DPT). The revised guidance includes updated examples relevant to the insurance/reinsurance industry.

The revised guidance can be viewed here.

Back to contents>

About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 83 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol.

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

At RPC we put our clients and our people at the heart of what we do:

- Best Legal Adviser status every year since 2009
- Best Legal Employer status every year since 2009
- Shortlisted for Law Firm of the Year for two consecutive years
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We have also been shortlisted and won a number of industry awards, including:

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- Winner – Law Firm of the Year – The Lawyer Awards 2014
- Winner – Law Firm of the Year – Halsbury Legal Awards 2014
- Winner – Commercial Team of the Year – The British Legal Awards 2014
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