Corporate tax update

Third 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 third 2018 edition we highlight some of the key tax developments of interest to UK corporates from the third quarter of 2018.

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International

Taxation (Cross-border Trade) Act 2018 – Royal Assent

On 13 September 2018, the Taxation (Cross-border Trade) Bill 2017-19 received Royal Assent. more>

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Something out of the ordinary (share capital)

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Corporation tax

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

On 6 July 2018, draft legislation (together with a further consultation paper) was published in respect of the impending changes to the UK tax regime affecting non-UK residents holding UK property.

Background

The UK tax regime has historically been very favourable for non-UK investors investing in UK real estate.

The UK tax rules applicable to UK real estate purchases, holdings, and sales have been the subject of considerable change over recent years. This has resulted in, arguably, a rather incoherent tax regime with different rules for (1) residents as opposed to non-residents, (2) residential property as opposed to commercial property, and (3) individuals as opposed to corporate and other "non-natural" entities.

The current UK tax regime also only applies to gains realised on **direct** disposals of UK residential property by (certain) non-UK residents.

From April 2019

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.

July 2018 update

The draft legislation and accompanying consultation paper published on 6 July will be of particular interest to tax-exempt investors and non-UK collective investment vehicles (CIVs).

The most recent proposals may mean that non-UK CIVs (such as JPUTs) may need to elect to fall outside the new rules on "indirect" UK property disposals. Details as to the timing and process requirements for any such election are expected later this year.

The majority of substantive responses received (and published by the Government in July) related to the complex new "indirect disposal" UK tax charge. The treatment of CIVs and exempt investors was a particular focus of concern.

It has now been confirmed by the UK government that:

- the new tax charge on indirect disposals of "property rich" entities will be relaxed slightly in that:
  - the period of "look back", for the purposes of determining whether a non-resident holds at least a 25% interest in the entity, is reduced to 2 years prior to the date of disposal (five years under the original proposal), and
  - a more limited concept of "related" person will be used for the purposes of determining which holdings to aggregate for the purposes of the 25% interest test
- there will be a "trading" exemption within the new rules for indirect disposals of "property rich" entities, akin to the UK's existing substantial shareholding exemption, so that a disposal of an otherwise "property rich" entity by a non-resident will not be caught by the new tax

charge if the UK land held by the entity is used in the course of a trade during the 12 months prior to the disposal, and immediately after

- there will be no SDLT "seeding relief" to encourage non-residents to move their UK properties into UK structures without incurring an SDLT charge
- requests for a new, more lightly-regulated tax-transparent UK fund vehicle (again, to encourage so-called "on-shoring" of UK real estate) are not being taken forward as part of this measure
- there will be no postponement of the new rules as they apply to CIVs
- however, the UK government appears to be listening to the key concerns raised by respondents to the consultation such that:
  - transparent offshore funds (such as JPUTs and limited partnerships) will be able to elect to be treated as transparent for the purposes of the new tax rules. Non-UK investors in such funds would be treated as making a direct disposal of any UK property sold by the fund. The indirect disposal charge would not apply, and
  - certain (non-close) offshore funds will be eligible for special exemptions, provided they comply with specified reporting requirements. The fund itself, and any other non-resident entities within the structure, would be exempt from tax on gains on both direct and indirect disposals of UK real estate. Non-UK investors in the fund would be taxed on disposals of their fund interest

for each of these measures, further discussions with stakeholders are proposed in order to refine and perfect the proposals. Given the inherent complexity involved, these are "high-level" proposals at this stage.

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VAT

VAT rules in a "no deal" Brexit – insurance and financial services

On 23 August 2018, the UK government published a number of "no deal" Brexit documents. One of which was a so-called technical notice giving businesses guidance as to how the UK's VAT rules will operate in the event of a no-deal Brexit.

The note includes the comment "For UK businesses supplying insurance and financial services, if the UK leaves the EU without an agreement, input VAT deduction rules for financial services supplied to the EU may be changed. We will update businesses with more information in due course."

The issue prompting this comment is that, currently, insurers and other financial services providers are able to recover VAT on supplies made into non-EU countries (but not on supplies made to the EU). Post-Brexit it would seem to make no sense to treat supplies to non-EU countries differently to EU countries.

Presumably the vague comment that the input VAT deduction rules "may" change, with no detail at this stage as to how, is due to the significant cost that would result from the obvious choice – for insurers etc to be able to recover input VAT on supplies made into all countries.

Hopefully there'll be more detail as to the likely no-deal rules (assuming of course there is still no deal at that point) at the next Budget (set for 29 October).

The document can be viewed here.

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VAT cost sharing exemption – HMRC guidance on "directly necessary"

On 31 July 2018, HMRC published further guidance[1] setting out a change in its policy (following recent decided cases) on the "directly necessary" test for the purposes of the VAT cost sharing exemption (CSE).

The CSE, broadly, provides an exemption for VAT on services provided within groups whose members make exempt (or non-business) supplies provided:

- the intra-group supplies are "directly necessary" to enable the group members to make such exempt (or non-business) supplies
- only each member's exact share of the cost of the intra-group supplies are recovered, and
- exempting the intra-group supply would not lead to distortion of competition.

Earlier this year[2], HMRC published a Brief[3] in light of recent ECJ decisions on the CSE. This earlier revised policy was disappointing for insurers and other financial services groups as it confirmed that the CSE is only available to groups engaged in a limited number of "public interest" activities. See here for our earlier commentary on this. That earlier Brief stated that HMRC was still considering the impact of these ECJ decisions on the "directly necessary" test.

Now, pursuant to this latest (July) Brief, it is clear that HMRC will no longer apply its 15% threshold (whereby costs could be treated as exempt under the CSE provided that no more than 15% of those costs were used by members to make taxable supplies).

1. In the form of Revenue and Customs Brief 10 (2018).
2. In March 2018.
3. Revenue and Customs Brief 3 (2018).

In its latest Brief, HMRC recognises that the ECJ[4] held that the CSE was not restricted to groups whose members exclusively carried on exempt (or non-business) activities. Under the revised policy, a CSE group member's expenditure on services that is attributable to both taxable and exempt (and/or non-business) activities will only be "directly necessary" to the extent that they are used for the member's exempt and/or non-business activities (within the scope of the exemption).

HMRC has introduced guidance on a "suitable apportionment calculation" for these purposes. HMRC will usually accept the member's partial exemption recovery percentage as a measure of taxable/exempt use. The detail is to be found in the updated VAT Cost Sharing Exemption manual pages 3850 to 3895.

This revised approach took affect from 15 August 2018.

The HMRC Brief can be viewed here and the updated Manual here.

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Adecco: VAT payable on supply of non-employed temporary workers

On 30 July 2018, the Court of Appeal held[5] that VAT was payable on the supply of non-employed temporary workers to clients.

Adecco UK Limited (the taxpayer), is an employment agency supplying its clients (the clients) with temporary staff, including non-employed temporary staff. These workers are not employed by the taxpayer but may be introduced to its clients to undertake assignments. During such assignments, there is no contractual relationship between the client and the worker.

The taxpayer and the clients enter into a contract, which is the same regardless of whether the worker is employed, not employed or contracted. The client is obliged to pay the taxpayer a fee for the work carried out by the worker.

The taxpayer and the temporary worker enter into a contract whereby the taxpayer is the employer and remunerates the worker.

The taxpayer attempted to reclaim overpaid VAT in respect of the non-employed workers' remuneration paid by the client following the decision in *Reed Employment Ltd v Revenue and Customs Commissioners*.

The taxpayer argued that it only introduced the non-employed workers to its clients and the workers (rather than it) provided the services to the clients.

HMRC refused the claim and the taxpayer appealed.

Both the First-tier Tribunal and the Upper Tribunal (UT) rejected the taxpayer's argument that it was merely supplying introductory and ancillary services to its clients. Both tribunals concluded that the taxpayer supplied the non-employed temporary workers in return for payment and it was liable to account for the VAT on the fees charged.

The taxpayer appealed to the Court of Appeal.

4. In *The Advocate General in Commission v Luxembourg* (Case C-274/15).
5. In *Adecco UK Limited and others v HMRC* [2018] EWCA Civ 1794.

Court of Appeal judgment
The appeal was dismissed.

The issue for the Court of Appeal to determine was whether the workers' fees charged by the taxpayer in relation to non-employed temporary workers was subject to VAT. To determine this, the Court considered whether the taxpayer or the non-employed workers, supplied services to the clients.

The Court concluded that no contract existed between the temporary workers and the clients, thus the workers did not provide their services under any such contract. Instead, the contracts existed between the taxpayer and the workers and taxpayer and the clients. The workers were under the control of the taxpayer rather than the clients.

In the Court's view, the taxpayer did not merely perform administrative functions. It held rights to terminate and suspend employment and remained responsible for paying the workers on its own behalf even if the client did not pay the taxpayer or decided to reject the temporary worker.

The Court noted the UT's point that the contract between the taxpayer and a temporary worker proceeded on the basis that unauthorised absence could breach the obligations owed by the taxpayer to the end clients.

The fees charged to clients were not split into workers' remuneration and commission for itself and instead, clients were charged one single sum.

The Court considered that as a matter of contract and of economic reality, the services were supplied to the clients rather than the taxpayer.

Accordingly, the taxpayer was liable to account for the VAT on the total fees charged to its clients. The Court held that the taxpayer had supplied the services of its non-employed workers to its clients and that their salaries did form part of its supply for VAT purposes.

Comment
In providing helpful guidance regarding the VAT treatment of supplies of this nature the Court said that *Reed Employment* had been wrongly decided. The VAT liability of other employment agencies will need to be carefully considered and a thorough review of all relevant contracts might be appropriate.

The decision can be viewed here.

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Taylor Clark: claims for the return of overpaid VAT not to be treated as having been made by or on behalf of the "single taxable person"

On 11 July 2018, the Supreme Court held[6] that a company seeking repayment of overpaid VAT is not to be considered to have made a claim for repayment, where another company, which had formerly been a member of its VAT Group, had made the relevant claims. The other company had claimed repayment in its own right and not on behalf of the first company.

Taylor Clark Leisure Plc (TCL) was the representative member of the Taylor Clark VAT Group for the years 1973 to 2009, when the VAT Group was disbanded. In 1990, TCL transferred its bingo

6. In *HMRC v Taylor Clark Leisure Plc* [2018] UKSC 35.

business to Carlton Clubs Ltd (Carlton), a newly incorporated subsidiary entity. The transfer was effected by a letter dated 30 March 1990 (the Asset Transfer Agreement). Carlton was a member of the VAT Group from 1990 until 1998, when it was sold.

In November 2007, Carlton submitted four claims for repayment of VAT which TCL (as representative member of the VAT Group) had overpaid in the period 1973 to 1998. The claims related to the VAT treatment of bingo. Following the ECJ's decision in *Rank Group PLC v HMRC* (Joined Cases C-259/10 and C-260/10), HMRC issued Revenue and Customs Brief 39/11, which accepted that repayment would be due (subject to verification).

The claims submitted by Carlton used the Taylor Clark VAT Group registration number but without authorisation by TCL. TCL maintained that it was able to rely on Carlton's claims because it was the representative member of the VAT Group at the time the supplies were made.

HMRC (eventually) rejected the claims on the following basis:

1. that the claims had not been made before the expiry of the time limit (because no claims had been made by TCL itself)
2. the claims predating 31 March 1990 had been assigned to Carlton by the Asset Transfer Agreement, and
3. because the VAT Group had since been disbanded, the claim for over-declared output tax must be made by the company whose activities gave rise to the over-declaration and Carlton had made that claim[7].

Carlton and TCL initially pursued rival appeals, however, Carlton withdrew three of its four appeals because HMRC had paid them. The remaining appeal was stayed. TCL maintained its appeals.

FTT decision

The appeal was dismissed.

The FTT found that:

1. the right to claim repayment for periods prior to 1990 had been assigned to Carlton under the Asset Transfer Agreement
2. the right to claim had been passed back to Carlton from the VAT Group when it left the VAT Group in 1998, and
3. TCL had not, itself, made a claim under section 80, VATA and could not rely on Carlton's claims; it was therefore out of time to make a fresh claim.

TCL appealed all three issues.

UT decision

The UT reversed the decision of the FTT in relation to issue 1. The UT found that the right to claim had not been transferred to Carlton. The UT also found that it was only TCL who could make a claim for repayment because it was the representative member of the VAT Group at the time.

With regard to issue 3, the UT agreed with the FTT that TCL had not made a valid claim under section 80, VATA, and accordingly, did not have a valid claim and was time-barred from issuing a new claim.

TCL appealed to the Inner House on issue 3.

7. Note that HMRC's policy in relation to claims from disbanded VAT Groups has since changed and as it currently stands, HMRC considers that such claims vest with the last representative member of a disbanded VAT Group.

Inner House judgment

The question for the Inner House was: "Can the VAT Group, represented by [Taylor Clark], rely on the claims for repayment of VAT overpaid by the VAT Group, when the claims were made in time but were made by another member of the same VAT Group?"

The Inner House took the view that the actions of individual members of a VAT Group could be ascribed to the representative member of a Group where they related to VAT. By adopting a purposive interpretation of the relevant legislation, the Inner House concluded that the claims made by Carlton were deemed to have been made by TCL as the representative member.

HMRC appealed.

Supreme Court judgment

The appeal was allowed.

The Supreme Court reversed the judgment of the Inner House. It did not accept that Carlton's claims had been made by or on behalf of TCL.

Firstly, they were made after Carlton had left the VAT Group. Secondly, the use of the Group VAT registration number was not determinative since it was necessary to use that number in order to identify the relevant VAT payments. Thirdly it was clear that Carlton was not acting as TCL's agent. Carlton had asserted its own belief that claims which existed before its incorporation in 1990 and related to periods going back to 1973, had been assigned to it in 1990 under the Asset Transfer Agreement.

Carlton relied on the case of *Triad Timber Components Ltd v HMRC* [1993] VATTR 384, which supported its position that it had the right to make a reclaim in relation to a period when it was in a VAT Group, when it left the Group and the Group ceased to exist. This position also reflected HMRC's policy at the time.

Comment

The position can become complicated when entities join and leave existing VAT Groups or the Group as a whole ceases to exist.

The effect of the Supreme Court's judgment is that where there has been an overpayment of VAT from a VAT Group, the entity entitled to make a claim for recovery is the Representative Member, or a person acting as agent for the Representative Member, unless the claim has been assigned.

In circumstances where corporates are intending to issue claims which relate to VAT Groups it is important that appropriate advice is sought at an early stage in the process so as to avoid the possibility that a claim which is valid on the issue of substance is not lost due to a deficiency in form.

The decisions can be viewed here.

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International

Taxation (Cross-border Trade) Act 2018 – Royal Assent

On 13 September 2018, the Taxation (Cross-border Trade) Bill 2017-19 received Royal Assent.

As part of the UK's preparations for leaving the EU (and, it would seem, the Customs Union) the Government has legislated for the UK's departure from the Customs Union and the impact upon goods moving to and from the UK from, and to remaining EU member states.

The Act covers customs duty, VAT and excise duty.

It provides for a new, standalone, customs regime (largely based on existing EU law) to provide for "import duty" on imports to the UK. The Act is intended to be flexible, to be able to apply in a range of possible negotiated Brexit outcomes (or, indeed, a "no deal" outcome).

The Act can be viewed here.

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Miscellaneous

Something out of the ordinary (share capital)

On 19 September 2018, the Chartered Institute of Taxation (CIOT) published a table setting out HMRC's views on the meaning of "ordinary share capital".

A number of key UK tax provisions turn, in part, upon the meaning of "ordinary share capital".

For example, in order to access the 10% CGT rate available under the UK's "entrepreneurs' relief" rules, it is necessary amongst other things for a seller of a trading company/group to have held, for a period of at least 1 year, at least 5% of the company's "ordinary share capital".

The statutory definition of "ordinary share capital" is "all the company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits".

The table published by CIOT sets out HMRC's views on a number of different types of share capital, each with differing dividend rights. All of the examples provided by HMRC are ones which they have come across in practice. Although described as HMRC's "initial" views, subject to further review, and potentially to be treated differently in "avoidance" cases, it would appear that:

HMRC consider the following as falling within "ordinary share capital"

- A share with no dividend rights. Such shares were the subject of discussion in the case of *HMRC v McQuillan* [2017], in which the Upper Tribunal held that a right to a dividend of zero was not a right to anything at all. Such shares therefore do not have a right to a dividend at a "fixed rate".
- A fixed rate preference share with a zero coupon.
- A fixed rate of 10% non-cumulative (as in some years no dividend will be paid, so there is no "fixed rate". The return is dependent on the results of the business, so more like equity than debt).
- A fixed rate of 10% non-cumulative, but dividend can only be paid if Regulator (eg FCA) authorises. It is irrelevant that a third party is involved. The right is not fixed as the dividend rights are non-cumulative.
- A preference share with a right to "tiered" dividends (as the rate of dividend is not fixed).
- A share which has a right to the greater of a specified sum or the dividend paid in respect of another class of shares (again, as the rate of the dividend is not fixed).
- A fixed rate preference share, but the holders receive a payment above the par issue price based on the figure for reserves when redeemed, or when the company is sold, or placed in liquidation (although the holder is entitled to a fixed rate of return, the entitlement to a payment above par is an "other right to share in the company's profits"). Note that HMRC flag this as being particularly "finely balanced", and therefore subject to further review.
- A fixed rate preference share, but the holders receive a further dividend payment were certain events to occur (usually unlikely except in exceptional circumstances eg breach of banking covenants). Again, although the holder is entitled to a fixed rate of return, there exists an "other right to share in the company's profits.
- A preference share with 2 alternate fixed rates, the rate used depending upon certain events during the year (eg level of profits).
- LIBOR plus a fixed percentage (LIBOR of course fluctuates daily).

HMRC consider the following as NOT falling within "ordinary share capital"

- A fixed rate preference share with a zero coupon of 0.000001% (ie negligible).
- A fixed rate of 10% cumulative.
- A preference share where the coupon compounds over time (if the rate is fixed and cumulative). Note that HMRC flag this as being particularly "finely balanced", and therefore subject to further review.
- A preference share where a rate of interest is added if the dividend is unpaid (if the rate is fixed and cumulative). Note that HMRC flag this as being particularly "finely balanced", and therefore subject to further review.
- A fixed rate of 10% cumulative, but dividend can only be paid if Regulator (eg FCA) authorises.

It remains to be seen whether HMRC's views find their way into published, official guidance, and whether they are further refined in light of further HMRC experience/reflection.

For now, however, this should provide some further certainty as to what HMRC, at least, would consider to be ordinary (or "extraordinary"!) share capital.

The CIOT publication can be viewed here.

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HMRC updates guidance on VCTs

On 10 and 13 August 2018, HMRC updated the guidance in its Venture Capital Schemes Manual on venture capital trusts (VCTs) to reflect changes made by Finance Act 2018. The changes include:

- guidance on advance assurance. HMRC will not routinely provide an opinion on "knowledge intensive company" status. It will consider such status only if the proposed investment would otherwise breach the rules for a qualifying holding. Companies seeking such status should carry out their own analysis to make sure that the conditions are met.
- additional guidance on the "operating costs" conditions. Guidance is provided on the extension to start-up companies.

Updates to the Venture Capital Schemes Manual can be viewed here.

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