SLAUGHTER AND MAY

Tax and the City Briefing for May

May 2017

Since the writing of our April Briefing, the calling of the snap election has led to a chunky 620 pages being lopped off the Finance Bill in order to get it through all its stages and enacted on 27 April before the dissolution of Parliament. It is not very satisfactory that key provisions (such as the corporate interest restriction, changes to the SSE and the revised carry forward loss rules) that were to have effect from 1 April, will now not be enacted until later in the year (assuming they are still enacted), with consequent uncertainty over their commencement dates. The upside, though, is that more time can be taken over their scrutiny which may lead to further improvements to the legislation. So this month we have decided to take a break from analysing Finance Bill provisions to pick up on a few recent VAT developments of interest to the City and to take a look at the Criminal Finances Act, which was granted Royal Assent on 27 April.

New guidance on VAT recoverability by holding companies

VAT recovery by holding companies is a difficult area and has been since the *Polysar* case nearly 25 years ago in which the CJEU held that the mere acquisition and holding of shares was not an economic activity. It is a shame, then, that HMRC's recently published revised guidance still leaves doubts as to the technical position. HMRC distinguishes between a holding company which is separately registered for VAT and one which is VAT grouped with its subsidiaries.

Ungrouped holding companies

The guidance is a marked improvement on the 2014 guidance for ungrouped holding companies. An ungrouped holding company should be able to recover input tax borne on supplies received for the purposes of acquiring a new subsidiary (Target) in one of two scenarios.

The first is that the holding company carries on a business of its own and acquiring Target is a "direct, continuous and necessary extension" of that business. Examples given in the guidance include the purchase of a competitor or key supplier to improve market share, and the purchase by a retail company of a company owning a property from which the retail company intends to trade.

The second is of wider application as it involves a holding company providing management services to the Target for a clearly defined consideration that is actually paid from the start. In this second scenario, HMRC now accepts, in the light of *Larentia + Minerva and Marenave Schiffahrt* (Case C-108/14 and Case C-109/14)), that input tax incurred by the holding company on the costs of acquiring Target must be regarded as belonging to the holding company's general expenditure (previously HMRC required that the input tax be apportioned between non-economic activity of shareholdings and economic activity). Another element of the previous guidance which has helpfully been removed is HMRC's proposition that the level of fees charged for the management activity had to be sufficient to recoup the acquisition costs in full over time. The revised guidance says the management services must be genuine and provided for consideration which is "more than nominal".

Grouped holding companies

The guidance is not so helpful for grouped holding companies. Where the holding company and

Target are grouped, HMRC says there is no automatic entitlement to recover VAT - there still has to be something else to link the inputs with the VAT group's taxable outputs in order for them to be recoverable. HMRC considers that what is required is for the holding company to provide management services to Target or make interest-bearing loans to Target in circumstances where those management services, or those loans, support, in some unspecified way, the making of taxable supplies by Target. This tracing requirement is difficult to reconcile with a VAT group being a single and indivisible taxable person and the express statutory requirement to "disregard" all transactions within the group for VAT purposes.

Given the technical difficulties with HMRC's analysis for grouped companies, a holding company seeking to recover input tax on fees incurred on the acquisition of a new subsidiary may find itself better able to recover input VAT if it is separately registered for VAT and makes supplies of management services to Target for a defined consideration over a commercially meaningful period, than if it is VAT grouped with the new subsidiary. However, keeping a holding company outside the VAT group creates an additional VAT compliance burden and it may in some cases not be practical or cost-efficient to keep a separate VAT registration for the holding company. We may in future see a legal challenge to this aspect of the guidance if HMRC seeks to deny input VAT recovery where a holding company is VAT grouped.

It is worth bearing in mind that we have not yet had a response to the consultation on changes to the UK's VAT grouping rules which closed at the end of February so there may be further developments in this area.

Supreme Court ruling in *ITC*

Although the case of *HMRC v Investment Trust Companies [2017] UKSC 29* was primarily concerned with remedies, the Supreme Court's judgment serves as a useful reminder of the basic principle of our VAT system that the supplier pays the tax and the customer pays the price. If the customer claims the price he paid was too high because it included an amount in respect of a VAT liability of the supplier that was determined not to exist, his remedy is to reclaim an appropriate part of that price from the supplier, not from HMRC.

The *ITC* case arose out of *Claverhouse (Case C-363/05)*, some ten years ago, which found that the UK's treatment of the management of an investment trust as a taxable supply was wrong – the CJEU required the supply to be treated as exempt. Consequently, investment trusts sought to recover amounts in respect of VAT erroneously paid to their investment managers over the years. Three key points to take away from the Supreme Court's judgment are:

- A customer that has made an overpayment to a supplier in respect of VAT on a supply can make a claim for recovery of that overpayment only against the supplier itself, not against HMRC (unless the supplier has become insolvent, or there is some other circumstance making the pursuit of a private law claim against the supplier genuinely impossible).

- That repayment claim by the customer will, generally, be restricted to the period of time for which the supplier can himself reclaim tax from HMRC by means of a section 80 VAT repayment claim (so the customer's private law claim will effectively be subject to the same 4 year time limit).

- However, a customer may be able to make recovery from the supplier for periods falling outside the 4 year time limit where, and to the extent that, the amounts paid by the customer to the supplier in respect of an erroneously assumed liability to VAT on a supply exceed the sums which the supplier accounted for to HMRC in respect of the same supply by reason of the supplier's having also made an over-recovery of input tax in consequence of the same erroneous assumption. To give an example, where a supplier has erroneously thought it

had a VAT liability of £100 but has only paid £75 to HMRC because it also erroneously claimed a £25 input tax recovery, a customer which has paid an amount of £100 to a supplier in respect of VAT may recover that £25 from the supplier outside of the 4 year time limit.

Criminal Finances Act

The Criminal Finances Act, which was first published as a bill on 13 October 2016, received Royal Assent on 27 April. The new corporate offences of failure to prevent the facilitation of UK or foreign tax evasion in Part 3 of that Act will come into force on a date yet to be specified, which is expected to be later this year.

The enactment is likely to prompt groups to re-invigorate their preparation for the introduction of the new offences. To date, the existing criminal offences of facilitation of tax evasion have generally applied only to the individual concerned: their employer is not liable even if it appeared that they had tacitly encouraged the behaviour. The Government has been explicit in its aim that the new offences should hold these organisations to account for the actions of their employees.

The scope of the new offences is deliberately broad. They are committed by:

- the failure by a body corporate or partnership (B) to prevent
- the facilitation by a person associated with B, namely its employee, agent or any other person performing services for or on behalf of B (in each cases acting in their capacity as such)
- of UK or foreign tax evasion.

The difficulty faced by many organisations is the extension (in common with the offences in the Bribery Act 2010) of the category of persons for whose behaviour B is responsible beyond employees or agents to persons performing services for or on its behalf. This can therefore extend to third parties with whom the group's relationship is only contractual, e.g., in supply chains or distribution networks.

Now is the time for groups to check internal policies, procurement processes and terms and conditions of business to ensure that they are well placed to rely on the defence that B had in place such prevention procedures as it was reasonable in all the circumstances to expect B to have in place (or that it was not reasonable to expect B to have any prevention procedures in place).

What to look out for:

- Further guidance on the corporate interest restriction was expected by 31 May 2017 but has now been deferred until after the measure has been re-introduced in the next Finance Bill
- First return due from reporting entities under CRS/DAC by 31 May
- 5 June – Upper Tribunal hearing in *Temple Finance and Temple Retail* (VAT - one business carried out by two companies)
- 5 June – first signing ceremony for the BEPS multilateral instrument (to implement the treaty-related BEPS measures)
- 13 or 14 June - Court of Appeal hearing in *Degorce* on whether film distribution rights transactions constituted trading

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