Tax and the City Briefing for October

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Root2tax: DOTAS

HMRC has been granted an order by the FTT (Judge Colin Bishopp) that arrangements are notifiable under FA 2004 s314A. This means that HMRC can now issue accelerated payment notices (APNs) to the many taxpayers involved. *HMRC v Root2tax* [2017] UKFTT 696 appears to be the first case to apply s314A (order to disclose) since that provision took effect in July 2007. In 2009, the Special Commissioners in *HMRC -v Mercury Tax Group* refused an application by HMRC for a penalty to be imposed for non-notification because, under the rules as they applied at the relevant time in 2005, the Mercury scheme was not notifiable. The rules have undergone significant change since then.

Obtaining the order in this case is an important win for HMRC. Now that notification carries with it the potential trigger for an accelerated payment notice, non-notification might seem attractive to some promoters. The £5,000 per day penalty on a promoter for failing to disclose 10 days after a notification order is granted under either s314A or s306A gives HMRC further ammunition to obtain disclosure.

Takeda Pharmaceutical: when should a Seller escape liability to the Purchaser for pre-completion tax liabilities?

It is sensible market practice for a seller to negotiate limitations on its liability under a tax covenant. A prime example of this is a cut-off point after which the purchaser is time-barred from bringing a claim against the seller. However, when the potential tax liability is known at completion (because the target company has already received a tax assessment) the purchaser will want to ensure that the seller is on the hook for it.

A purchaser would want to avoid being in the position of Takeda, the purchaser in the contractual dispute case of *Takeda Pharmaceutical Company Limited v Fougera Sweden Holding* 2 AB [2017] EWHC 1995 (Ch). The relevant limitation provided that the liability of the seller, Fougera, ceased after the sixth anniversary of closing unless, prior to that date, the tax had become "finally recoverable". (This would mean that it was the subject of a binding agreement with the Danish Tax Authority ("DTA"), or the subject of an unappealable or unappealed decision of a court or tribunal.) The risk of the tax issue not being finally resolved within the six year period was on Takeda but, with hindsight, this six year time limit was unrealistic.

Since closing, proceedings had been commenced in the Danish Courts to challenge the tax assessment on the basis that an exemption from the withholding tax applied. Due to a reference having been made to the CJEU to establish the beneficial owner of the interest, however, the case would not be concluded prior to the six year cut-off date. Takeda sought, therefore, with the consent of Fougera, to reach a settlement with the DTA, taking into account the residence of the ultimate investors to reduce the quantum of withholding tax due. However, this required information about the ultimate investors in Fougera's parent, a Luxembourg limited partnership (referred to as "the SICAR").

Takeda was unable to extract this information from Fougera and accordingly commenced proceedings

in the High Court. Takeda argued that Fougera has an express or implied obligation under the SPA and a subsequent letter agreement to provide it with the required information; and that Fougera is obliged not to obstruct or wilfully delay Takeda's efforts to obtain, procure or provide the information.

The High Court rejected Takeda's arguments, concluding that Fougera did not have this required information within its control because the identity of the investors in the SICAR was confidential to the four private equity funds who invested therein. Even if Fougera had been able to provide Takeda with the information it requested, the High Court found it was unlikely to have been sufficient to enable a settlement to be reached with the DTA (because in other similar cases it had been impossible to provide the DTA with the level of information required).

On this basis the High Court found that it was pointless and therefore not necessary for Fougera to provide the requested information. The High Court held that on the proper interpretation of the SPA and the letter, there was nothing in the agreement that required the seller to provide the requested information. Implying the terms Takeda had contended for was not necessary to render the SPA workable; and there was no room to do so, having regard to the express terms of the agreement.

This case illustrates how difficult it is to persuade a court to imply terms into a professionally drafted contract. The way to ensure that Fougera co-operated and provided the required information would have been to include express terms to this effect in the SPA; not that it appears this would have helped reach a settlement with the DTA on the facts of the case, however. More importantly, this case highlights the risk that a purchaser takes if it agrees to the tax liability having to become "finally recoverable" by a particular date in order to have a claim against the seller. If litigation is contemplated, the timing of the resolution of the proceedings is outside the purchaser's control, especially if a reference is made to the CJEU.

Other "dangerous" limitations a purchaser should be wary of are:

- a requirement to commence proceedings against the seller within [six] months of the purchaser's bringing a claim against the seller: this should not apply to tax claims for which there is an ongoing underlying dispute with a tax authority but should only kick in after the underlying dispute is finally determined;

- non-liability of the seller for contingent or non-quantifiable claims unless they cease to be contingent or become capable of being quantified before the end of the [six years] limitation period: if the purchaser has given notice of a tax claim within the period required under the tax covenant, the seller should be on the hook even if it is not until after the expiry of the relevant time limit that the tax lability is finally determined or quantified;

- the giving of notice being a condition precedent to the seller's being liable – ideally, the contract should make sure that this does not apply to tax covenant claims. In the *Teoco* case ([2016] All ER (D) 200) the High Court found that the relevant notice provisions were a condition precedent and, as the purchaser had not followed the precise notice provisions, it was unable to pursue a claim against the seller. If the purchaser cannot avoid the notice provisions being a condition precedent, it should take care to comply with them to the letter.

Irish Bank Resolution Corporation: taxation of permanent establishments

Is the attribution of a notional level of capital to a permanent establishment ("PE") incompatible with Article 8 (Business Profits) of the 1976 UK/Republic of Ireland Double Tax Convention (the UK/RI DTC)? This was the question the FTT had to answer in *Irish Bank Resolution Corporation Limited (In Special Liquidation) (2) Irish Nationwide Building Society v The Commissioners For Her Majesty's Revenue and Customs* [2017]

UKFTT 0702 (TC). If there were such an inconsistency between domestic legislation and a DTC, the latter must prevail (s788 ICTA, now TIOPA 2010, s6).

IBRC is a company registered in Ireland but which was also carrying on a business through a PE in the UK. IBRC is, therefore, chargeable to UK corporation tax on the profits attributed to its UK PE. In the calculation of such profits between 2003 and 2007, IBRC claimed deduction of interest expenses paid by the PE to IBRC. HMRC disallowed this interest on the basis of ICTA 1988, s11AA(3) (now CTA 2009, s21(2)(b) and s30). These provisions:

- require an assumption to be made that a PE is attributed a notional level of capital; and
- disqualify for deduction interest and other costs which would not have been incurred if the assumed level of capital was in fact held by the PE.

The FTT concluded that s11AA(3) does not offend Article 8 of the UK/RI DTC. In fact, it found it gives effect to the Article 8(2) requirements that it should be assumed that the PE is trading "under similar conditions" and that it has "such equity and loan capital as it could reasonably be expected to have", reflecting the Article 8(2) assumption that it is a "distinct and separate enterprise".

IBRC's main argument, presented by Philip Baker QC, was that the UK/RI DTC was based on the pre-2010 OECD Model Treaty; and that, until 2008 when the OECD Model Commentary was amended, there was nothing to support the attribution to a UK PE of an amount of capital which differed from the amount actually employed in the trade of that bank. Baker argued that the subsequent change to the OECD Model in 2010 represented a material change from the old version and was not merely for clarification; as, if it had been mere clarification, the 2008 change to the Commentary would have sufficed.

The FTT agreed with David Milne QC for HMRC that the 2008 Commentary was not the signal of a change but was a clarification; and nothing in it precludes the approach taken by s11AA. In addition, the 2008 Commentary can be taken into account in interpreting the pre-2010 Model and, with it, Article 8(2) of the UK/RI DTC. The FTT cited *The Queen -v- Prevost Car Inc*. case as authority for being able to rely on later OECD reports and Commentaries as a complement to earlier Commentaries, insofar as they are eliciting, rather than contradicting, views previously expressed.

The FTT held that it has been UK practice since the 1950s to determine the amount of free capital properly to be ascribed to a PE in order to assess the amount of profit chargeable to tax in the jurisdiction in which that PE operates. The OECD Model and Commentaries recognise the same necessity, even if until 2010 and 2008 respectively they did not spell it out. Accordingly, Article 7 of the pre-2010 OECD Model, reflected in Article 8 of the UK/RI DTC, did not preclude the attribution for which HMRC argued.

This case is relevant not just to the UK PEs of Irish companies but also to the UK PEs of any companies in other jurisdictions with which the UK has a DTC based on the pre-2010 OECD Model.

VAT costs sharing exemption

Financial services companies which have been considering using the costs sharing exemption in Article 132 of Council Directive 2006/112/EC will be disappointed by the recent CJEU cases: *Aviva* (Case C-605/15), *DNB Banka* (Case C-326/15) and *European Commission v Federal Republic of Germany* (Case C-616/15). According to these cases, the exemption is limited to activities of "public interest". Services provided by an independent group of persons whose members carry out insurance activities or financial services cannot, therefore, come within the exemption.

Any financial services companies which have already set up costs sharing groups and applied the exemption should be relieved that the CJEU also held that tax authorities, which have allowed the use of the exemption more widely, should not be able to take action against taxpayers retrospectively.

What to look out for:

- The consultation on the draft legislation to be included in the Finance Bill which will become Finance Act 2018 ends on 25 October.
- The consultation on the revised guidance on the corporate interest restriction rules (published on 4 August) ends on 31 October.
- The Court of Appeal is scheduled to hear a couple of cases concerning interest payments: first, the appeal by Lomas and others on 31 October or 1 November on whether statutory interest payable on insolvency is “yearly interest” for withholding tax purposes; secondly, the appeal by Ardmore on 7 or 8 November on whether the interest payments on a loan from an offshore trust have a UK source.

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Jeanette Zaman
T +44 (0)20 7090 5041
E Jeanette.zaman@slaughterandmay.com

Zoe Andrews
T +44 (0)20 7090 5017
E zoe.andrews@slaughterandmay.com

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For further information, please speak to your usual Slaughter and May contact.

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