Tax and the City Review

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The UT overturns the FTT's decision in *Hargreaves Lansdown*, finding that the loyalty bonuses were "pure income profit" of the investors and, therefore, annual payments. The latest cases on tax indemnities (*Stobart Group* and *Zedra*) serve as further warnings to purchasers to comply with the exact terms of the relevant contract: in *Stobart Group*, the notice provision for the purpose of bringing a claim against the seller; in *Zedra*, the overprovisions clause requiring the purchaser to provide the seller with a copy of the full auditors report. Lawyers, accountants, financial institutions and other "intermediaries" pore over the UK's consultation on implementation of DAC 6, which requires the mandatory automatic exchange of information between tax authorities in relation to cross-border arrangements which meet one or more hallmarks. Draft legislation for Finance Bill 2020 is published and includes provision for payment by instalments following the *Gallaher* case; and a new restriction on the use of carried-forward capital losses.

Hargreaves Lansdown Asset Management Limited: annual payments

Although the facts of *Hargreaves Lansdown v HMRC* [2019] UKFTT 0246 (TCC) are very specific (involving loyalty bonus payments paid to investors by a platform service provider), the discussion about whether a payment is an annual payment is of more general interest. This case is a useful reminder that it is often necessary when considering payments made by financial services entities to think about whether they could be treated as annual payments.

The First-tier Tribunal (FTT) considered whether the loyalty bonus payments have the four characteristics established by the earlier authorities of:

- being payable under a legal obligation;
- recurring or being capable of recurrence;
- constituting income and not capital in the hands of the recipient; and
- representing "pure income profit" in the hands of the recipient.

The first three characteristics are self-explanatory and are usually satisfied. "Pure income profit" (shorthand for the principle that the relevant payment must be a gross receipt of the payee for which the payee does not have to do anything in return) is the characteristic that often saves a payment from being an annual payment (and did so before the FTT). If it is not a gross receipt of the payee, the deduction at source mechanism does not work properly (because it effectively taxes the payee on a gross basis and not on the net profit). The FTT established that the loyalty bonus is a mechanism for reducing the net cost of the investor for the use of the platform and cannot be treated as pure profit.

The FTT's decision went against HMRC's clear published view expressed in Brief 04/13 about "payments of trail commission" and endorsed in further guidance in 2014 following regulatory changes, so it was expected that HMRC would appeal. HMRC appealed successfully to the UT on the pure income profit point and Hargreaves Lansdown (HL) contended (unsuccessfully) that the FTT had been wrong to find that the payments were capable of recurrence.

The Upper Tribunal (UT) overturned the decision of the FTT on the pure income profit point on the

basis that the FTT erred in law in its approach to the issue by not basing its decision on the terms of the contractual arrangements. (The FTT had relied on marketing materials and a witness statement that were misleading.) For the UT judges, who described themselves as knowledgeable about the regulation and taxation of investment funds and the manner in which investment funds are structured, the contractual arrangements were crucial in establishing the bonus payments were taxable receipts in the hands of the investors without any deduction for expenses or the like.

According to the contractual arrangements, the fund (not the investor) paid the annual management charge (AMC) to the fund manager. The fund manager paid an amount to HL as platform provider which HL then paid in part (or after regulatory change) in whole, to the investors as a loyalty bonus. The loyalty bonus was in fact a further income distribution received by the investor in respect of his investment in the fund as a result of their continuing investment in the fund.

On the recurrent payments point, the UT agreed with the FTT that the fact that HL could reduce the loyalty bonus to zero at any time or that the investor could dispose of its investment (and so cease to receive the bonus payments), did not mean the quality of recurrence was not present. The UT endorsed the "business-like" approach rather than a "dry legal assessment" of the likely duration of the payments. For commercial reasons, whilst it was possible for HL to terminate its obligation to pay the loyalty bonus, it was unlikely to do that without adequate notice. Likewise, the investments were long-term investments and it was unlikely most investors would dispose of their investments within a short time frame.

Stobart Group and *Zedra Trust* : latest cases concerning tax indemnities

Stobart Group Ltd and another v Stobart and another [2019] EWCA Civ 1376 and *Zedra Trust Company (Jersey) Ltd & Anor v The Hut Group Ltd* [2019] EWHC 2191 (Comm) are the latest in a line of recent decisions in disputes concerning tax indemnities.

Stobart Group draws attention to the importance of complying exactly with the different requirements of different notice provisions. The purchaser had given notice to the sellers of a potential claim by a tax authority against the target company. The Court of Appeal decided that this was an effective notice for the purposes of the tax disputes clause which allowed the sellers to take conduct of the claim by the tax authority, but not for the purposes of the time limit, given that the notice did not refer to a claim being made against the sellers. Consequently, the purchaser was out of time to make such a claim.

Zedra Trust Company concerned the interpretation of the overprovisions clause under which the sellers were to receive the benefit of the amount by which the target's auditors' determined any provision for a tax liability to be an overprovision. In this case, the determination took the form of a report of which the purchaser sought to share only the introduction and executive summary. The High Court, however, decided that the sellers were entitled to see the full report, reading into the share purchase agreement an implied term that the sellers would be supplied with a full copy of the report or other documentation containing an auditors' determination. Business efficacy and obviousness require that the sellers be provided with whatever report comes from the auditors in response to the request for a determination. If all the auditors had provided was a one-line valuation, that is all the purchaser would have had to pass on. But the purchaser cannot take a full report and just share part of it.

International tax enforcement - DAC 6

The EU Directive known as DAC 6 requires the mandatory automatic exchange of information between tax authorities in relation to cross-border arrangements which meet one or more hallmarks. The intention is that tax authorities will find out about, and be able to react promptly to tackle,

aggressive tax arrangements. A tax advantage is required for some, but not all, of the hallmarks so it is possible that commercial transactions without a tax advantage may still fall within a hallmark (e.g., if a company in a low tax jurisdiction transfers all of its assets to a UK affiliate, this would be reportable even though it is exactly the sort of transaction which the BEPS project encourages).

Draft regulations to implement DAC 6 in the UK, together with a consultation document which will form the basis of guidance were published in July. HMRC requests responses by 11 October 2019. Legislation must then be introduced by 31 December 2019 and guidance will follow once the regulations are final. The UK regulations will then come into force on 1 July 2020 but (as required by DAC 6) will apply to reportable cross-border arrangements, the first step in the implementation of which took place on or after 25 June 2018.

Many articles will be written about this compliance headache (second only to the pain experienced in the first couple of years of FATCA!). In this article we highlight just three points about the required reporting which are causing concern in practice.

First, although the regulations provide that an intermediary is not required to disclose to HMRC any privileged information, the draft guidance shows that HMRC still expects lawyers to disclose information which is “factual in nature”. This was also HMRC’s starting point with the DOTAS rules in 2004 but HMRC later backed down, following advice that factual information provided to lawyers to enable them to provide legal advice is, itself, privileged. Under DOTAS, lawyers who are prevented by legal professional privilege from making full disclosure are not promoters (and accordingly do not need to make disclosures). Aside from concerns that the HMRC draft guidance, if followed, would cause lawyers to breach privilege, it does not make practical sense that HMRC should seek to obtain piecemeal reporting from lawyers for DAC 6 purposes when a full report will still need to be provided by a non-privileged intermediary or, failing that, the relevant taxpayer.

Secondly, as the timing of the reporting obligation will in some cases be triggered by the cross-border arrangement simply being “ready for implementation”, details of relevant taxpayers are required to be given to HMRC even if they decide thereafter not to implement the arrangements. Taxpayers are understandably concerned about the reputational issue of being named to HMRC in connection with arrangements they decide not to proceed with.

In order to prevent multiple reporting by different intermediaries, a report is not required by an intermediary who satisfies itself that a report has been made by someone else and the information they would have reported has been captured in that report. There are two practical problems with this. The first is timing: given the tight timescale for reporting, it is a brave intermediary who waits to see if another intermediary is going to report first, risking penalties themselves if that other intermediary does not report on time. The second problem is that to comply with the evidence requirement in draft regulation 10(b), an intermediary would have to obtain a copy of the reporting intermediary’s report (and obtain a translation if it is not in English), study it for any gaps in reportable information and then consider whether there is any further information that should be reported, all within the same tight timescale. Is any of this even possible in practice?

Finance Bill 2020 draft legislation

Carried forward loss restriction to be extended to capital losses

From 1 April 2017, there has been a restriction on the amount of taxable profit that carried-forward losses can be used against in each accounting period. From 1 April 2020, a similar restriction is proposed for carried-forward capital losses and the £5m allowance will then be applied across both types of losses. Basic Life Assurance and General

Annuity Business (BLAGAB) are excluded from the restriction so far as BLAGAB (ring-fenced) losses are offset against BLAGAB gains.

HMRC acknowledges itself that the proposed restriction of corporate capital losses is highly complex and will result in a significant additional administrative burden – including on companies that are excluded from the measure due to the deduction allowance. We await additional guidance to see how this will be addressed.

Deferred payment of exit charges after the Gallaher case

Not surprisingly, following the decision of the FTT in *Gallaher Ltd v HMRC* [2019] UKFTT 207 (TC), Finance Bill 2020 will amend the existing deferred payment provisions in TMA 1970 Schedule 3ZB to provide for payment in instalments over a five year period of the charge that arises under the group asset transfer rules in TCGA 1992 section 171, where a UK company transfers assets to a group company in a different EU or EEA state.

In *Gallaher,* the FTT found that the difference in treatment between a purely domestic transfer, and one to a group company in a different EU or EEA state, was a restriction of the Dutch parent company's right to freedom of establishment which could not be justified, unless the UK company was given the option to pay the tax over a number of years. In the absence of such an option, the judge concluded that the transfer to the Dutch company should be treated in the same way as a domestic transfer (and not subject to UK tax at all). Whilst the case remains subject to appeal, the policy note published with the draft legislation states that the decision of the FTT has created a degree of uncertainty as to whether and when such transfers will be subject to corporation tax in the UK. This measure removes that uncertainty.

From 11 July 2019, companies may apply, with immediate effect, to defer payment of up to the amount of corporation tax on profits or gains attributable to affected group asset transfers, for which the due and payable date given by TMA 1970 section 59D has not yet passed. The same rule applies whether or not the company is a large, or very large, company, which usually pays its corporation tax under the quarterly instalment provisions. In effect this means that corporation tax on group asset transfers during accounting periods that ended on or after 10 October 2018, can be the subject of an application for deferred payment.

What to look out for:

- Regulations amending the legislation on taxation of hybrid capital instruments (HCI) are expected to be laid in Parliament in early September. The regulations will apply retrospectively to extend the circumstances in which instruments convertible on a takeover or change of control can be HCIs.

- On 24 September, the General Court will give judgment on the appeals by the Netherlands, Luxembourg, Starbucks and Fiat against the October 2015 decisions of the European Commission that transfer pricing arrangements accepted by tax authorities when calculating the corporate taxation of Starbucks (in the Netherlands) and Fiat (in Luxembourg) constitute unlawful state aid (Cases T-755/15, T-759/15, T-760/15 and T-636/16)

- 30 September 2019 is the end of the extended period for electing into the HCI regime for issues before 1 January 2019.
- 11 October is the closing date for comments on draft regulations and guidance to implement DAC 6.

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