Keeping up with Tax Banking and Capital Markets

December 2019

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Introduction

Welcome to December's edition of Keeping up with Tax Banking and Capital Markets, picking up on a range of current hot topics relevant to our industry. We have gathered input from a number of specialists across our Banking & Capital Markets tax team in putting this together and we hope you find it interesting and useful.

In this edition, we have seven articles covering the following areas:

- A discussion on some of the matters that are arising out of company Brexit reorganisations and the tax compliance implications to consider.
- An update on the OECD's plan for reforming the international tax framework in response to the increasingly digitalised economy.
- An update on the EU's proposal to introduce a "European Financial Transaction Tax".
- An overview of the 2019 Total Tax Contribution study for UK Finance, which gives insight into taxation within the UK banking sector.
- An overview of ATAD II implementation status and key areas to consider when performing an ATAD II impact assessment.
- An update on how the financial services VAT exemption extends to payments activity based on recent rulings by the ECJ.
- An update on the Corporate Criminal Offence for failure to prevent the facilitation of tax evasion two years on.

I hope you find the articles useful. Please get in touch with me or your regular PwC contacts if there is anything that you would like to discuss further. Please also let us know if there are any topics that you would like us to cover in upcoming editions.

Kind regards,

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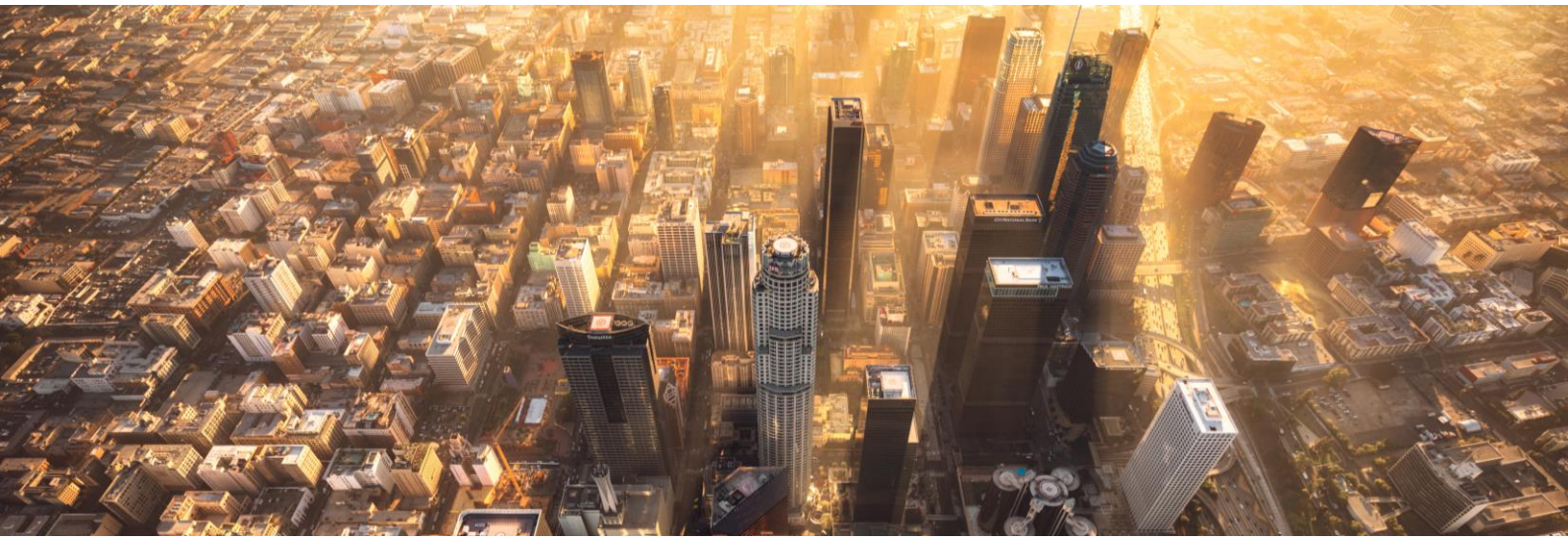

Brexit Reorganisations: tax compliance matters

In brief

Many groups in the banking and capital markets sector have either already implemented their Brexit reorganisation plans or else formulated plans for moving into an appropriate structure to operate post-Brexit (if required). This article discusses some of the consequential issues that should be considered now as we head towards the corporation tax deadline for those taxpayers with a 31 December year end.

In detail

Deductibility of Brexit related reorganisation costs

Taxpayers in the banking and capital markets sector may well have incurred significant costs in implementing reorganisations or planning for them. The deductibility of such costs will need to be determined and this can require complex analysis. Where it is considered appropriate to treat a particular cost as deductible, the rationale for this should be clearly documented. We understand that HMRC regards Brexit related restructuring as no different to any other reorganisation and expect taxpayers to undertake appropriate analysis and reflect these conclusions in corporation tax returns. We also understand HMRC recommends taxpayers provide high level disclosure relating to the deductibility of these costs in their UK corporation tax return filings to reduce the need for post-filing engagement.

Principles to consider

As a first step, it is important to determine whether the entity bearing the costs is the appropriate one. It may be relevant to consider whether, and to what extent, the entity is benefitting from those costs being incurred. It may also be appropriate to consider whether transfer pricing principles require allocation of costs to other entities within the group.

For trading companies subject to UK corporation tax, under general principles, the key conditions that need to be met for expenditure to be deductible are that it must be:

- incurred by the trading company (whether recharged or otherwise);
- incurred “wholly and exclusively” for that trade; and
- “revenue” rather than “capital” in nature.

Whether costs are “wholly and exclusively” incurred for the purpose of a company’s trade is a question of fact. The phrase is not defined in statute but has been considered in case law. In broad terms, it requires consideration of the company’s direct and immediate purpose (rather than a remote or underlying purpose). Furthermore, costs may not be seen as deductible if they are for the benefit of another trade / entity.

“Capital” and “revenue” are also concepts which are not defined in statute. In very broad terms, the relevant case law suggests :

- Where expenses are incurred on the maintenance of a trade or trade rights, they are revenue;
- Where expenses are incurred in relation to the acquisition or improvement of capital assets (whether tangible or intangible), they are of a capital nature.

It may be appropriate for groups to consider how their circumstances compare against the facts and principles in tax cases regarding the demutualisation of building societies through a conversion into a bank. In those cases, certain costs were argued to be deductible on the basis that it was necessary to incur them to allow businesses to continue trading effectively. It may be the case that a group considers similarities can be drawn between the need for conversion into banks in those cases and its need to restructure in the current Brexit environment. However, the aforementioned cases focused on companies incurring costs in the course of adapting a trade rather than splitting businesses or transferring activity, so there are not necessarily clean analogies. Careful analysis based on the specific facts and circumstances will be required.

For investment companies, it will be necessary to consider whether costs qualify as expenses of management of a company’s business. There is no “wholly and exclusively” test as there is with trading deductions, but the “capital” and “revenue” concepts remain relevant. In broad terms, costs which are incurred by groups in relation to decision-making on how to reorganise in response to Brexit could potentially be viewed as revenue; in particular groups will need to consider how their facts and circumstances allow them to draw on principles in *Camas plc v Atkinson*. For other costs, it may be appropriate to consider what principles can be applied by analogy from case law concerning the nature of trading income.

Brexit Reorganisations: tax compliance matters (cont'd)

Other tax compliance considerations

Although not an exhaustive list, other matters that groups may wish to consider from a UK tax compliance perspective in relation to Brexit reorganisations are highlighted below.

UK exit charge disclosure: Appropriate disclosures relating to any UK exit charges supported by an appropriate tax valuation should be included in the corporation tax return computation, as this may help reduce the need for future HMRC clarifications.

Transfer pricing: As part of any Brexit reorganisation, it will be necessary to reconsider the existing transfer pricing policies to ensure they are still fit for purpose and refresh them where necessary. Any consequential VAT impacts should also be considered.

Changes to group structure: Changes to the group structure, and migration of business/assets/employees/activities, could impact the availability of exemptions/application of gateways to controlled foreign companies ("CFCs"). This could also impact the taxation of any overseas branches of UK companies, particularly where the branch exemption election has been made, to ensure the branches continue to comply with the anti-avoidance provisions in place under those rules (which broadly mirror the CFC rules).

Corporate Interest Restriction: A change in the mix of loans/derivatives held by the UK group and non-UK group members may have an impact on a group's position under these rules where the company does not fall within the favourable banking company provisions. This will be of particular relevance for broker-dealers (where they do not qualify as "banks" for tax purposes) which may be relying on the Fixed Ratio or Group Ratio Rules.

Tracking of deferred gains: Previous reorganisations may have involved transferring shares intra-group in exchange for Qualifying Corporate Bonds ("QCBs") resulting in any gains on those shares being held over into the new debt and "frozen" until that debt is extinguished or restructured again (TCGA 1992, s116). Where taxpayers have held over gains attached to QCBs, it will be important to ensure these gains are tracked and subsequently brought into account where those QCBs are impacted by Brexit, or other reorganisation, steps.

EU Mandatory Disclosure Regime ("EU MDR"): Brexit-related reorganisations that involve transfers from the UK to an overseas jurisdiction or vice versa from 25 June 2018 may need to be reported under the relevant local EU MDR rules (by 31 August 2020 for transactions between 25 June 2018 and 30 June 2020). It is likely that the transactions would be reportable by EU intermediaries (e.g. external advisors) to the extent a relevant "Hallmark" is met. However, the obligation to disclose may fall to taxpayers where there is no such intermediary, or the intermediary is subject to legal professional privilege. In any event, companies should track which transactions have been reported and may be required to disclose them as part of tax return submissions.

Let's talk

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OECD Proposals for the reform of the international tax system

In brief

In May 2019 the OECD published a work plan relating to the international tax framework and how it should be adapted in response to the digitalisation of the economy. These proposals are expected to change the international tax landscape in a fundamental way and will impact all large, international businesses, not just those that are highly digitalised.

The momentum behind these proposals has been building with increasing changes to the political environment bringing this into focus on the global agenda. The work plan is comprised of two Pillars: Pillar 1, which aims to introduce a new 'tax nexus' and allocation of residual profits to user/market jurisdictions including in the absence of physical presence, and Pillar 2, which seeks to establish a global minimum tax framework.

In detail

On 9 October, the OECD released a public consultation document setting out an OECD Secretariat Proposal for a "Unified Approach" under Pillar 1, which aims to introduce a new 'tax nexus' granting countries taxing rights over the value derived by a business' activity or participation in user/market jurisdictions. The market jurisdiction is taken to be the jurisdiction where the 'end user' or ultimate consumer is located.

Firstly, it is important to note that the OECD is yet to clarify exactly which businesses are intended to be within the scope of the proposals. The extractive industries are explicitly referenced as "assumed to be out of scope" and further work is being undertaken to ascertain whether any additional carve-outs or exclusions, including for the financial services sector, will apply. As part of the public consultation process, the OECD received written responses from various multinational groups, including the International Banking Federation, SIFMA, Banco Santander and TransferWise, providing their input and articulating why they feel the proposals should not apply to banking and financial services. PwC's response to the proposals can be found here. This article outlines the consequences if the scope gives no specific carve out for the banking and/or financial services sector.

The specific impact of the Pillar 1 proposals for the banking sector is unclear, although at present we expect that certain sub-sectors are likely to be affected to a greater extent than others. Key to note is that the current scope of the Pillar 1 proposals would be large, consumer facing businesses, rather than wholesale businesses. Critical points therefore are how the term "consumer" would be defined, and how segmentation or bifurcation will be achieved. A working assumption is that the term "consumer" is intended to mean individuals who use services for personal purposes (i.e. outside the scope of a professional or business activity). Businesses which target institutional or professional clients, such as global trading or investment banking advisory firms, may therefore be considered to be outside the scope of the Pillar 1 proposals. That said, clearly the exact design of this rule may have significant implications (e.g. a trading strategy designed for a pension fund that represents consumers may be harder to exclude than inter-dealer broking where there is no direct consumer element, etc.).

The Pillar 1 proposal document considers the approaches available to determine the amount of profits that would be subject to new taxing rules in the market jurisdiction and proposes the following three tier mechanism:

- **Amount A** is a new formulaic allocation of a portion of deemed global residual profit (in excess of an agreed baseline and based on global consolidated group financial statements and by extension also on a group or business line basis), among countries where customers are located, regardless of where the business's physical activities are located. No percentages are confirmed in the OECD consultation document.

- **Amount B** envisages creating a fixed percentage return that would be allocated to some "routine" functions (specifically, marketing and distribution), which would remain taxable according to the existing transfer pricing rules. For the Banking sector, this fixed % return to marketing and distribution activity may apply to brokers, distribution locations and relationship management functions and the interaction with and impact on current transfer pricing models would need to be carefully analysed.

OECD Proposals for the reform of the international tax system (cont'd)

- **Amount C** would apply where the business' activities in a country are deemed greater than "routine" functions compensated by Amount B. In this case, a country could seek to assess non-routine amounts if warranted under traditional transfer pricing facts and circumstances tests, much like the existing transfer pricing system works today.

The outcome of the above is that market jurisdictions will be remunerated with a portion of deemed residual profits (i.e. a portion of profits in excess of an agreed baseline return). A portion of these deemed residual profits will be reallocated to jurisdictions based on the current transfer pricing rules (i.e. on current value drivers), but a portion of the remainder will now be used to remunerate the market jurisdictions from which the business derives a part of its value.

Pillar 2

The OECD published its international tax consultation relating to Pillar 2 of the work plan on 8 November. Pillar 2 seeks to address the remaining risk of 'profit shifting' to jurisdictions with no or low levels of taxation, where the risk is not deemed to have been satisfactorily addressed by the BEPS project.

The Pillar 2 proposal seeks to put in place globally agreed income inclusion rules, which would apply 'top up' taxes at shareholder level and could significantly increase tax cost and complexity. In addition, denial of tax deductions and treaty benefits are being considered with the aim of ensuring minimum levels of tax are paid on all income globally. There remain a number of 'unknowns' that make the impact difficult to assess.

For example, whether the minimum tax would be calculated on a group or entity level; how the 'minimum level' tax rate might be calculated or determined; and how the new rules might interact with existing domestic rules (e.g. would the UK CFC rules be redundant or would they still be used).

In addition, the proposal document leaves certain operational questions unanswered, including what the starting point would be for any calculations (local or consolidated accounts) and how the assessment methodology would incorporate differences in accounting standards, timing difference and tax bases. Similar to Pillar 1, the possibility of carve outs, either on the basis of industry, size or the scale of global presence remains, although industry-wide carve-outs may be less likely given the objectives.

For the financial services industry as a whole there are likely to be additional costs associated with compliance and risk assessments, regardless of footprint. More generally, the movement of the international tax system towards a minimum standard of tax may encourage multinational groups to review their global business model and structure in light of these changes and reassess the costs and benefits of locating their functions, assets and risks in lower tax rate jurisdictions. Any potential impact of Pillar 2 on the overall effective tax rate ("ETR") of a group will need to be taken into consideration when making strategic decisions regarding the global footprint of the business.

The takeaway

At present there is no indication of whether a 'financial services carve out' will be incorporated into the Pillar 1 and/or Pillar 2 proposals. In the absence of a financial services carve out under Pillar 1, the retail banking, private banking and wealth management sectors are likely to be most affected, due to the OECD's focus on consumer facing businesses. The changes would likely result in an increase in the taxable profit in market jurisdictions, as these locations become entitled to an allocation of residual profit, where previously these locations might only have earned a routine return for the local activity (if any) undertaken from these locations. Regarding Pillar 2, no particular sector is likely to be impacted more than another as impact is likely to be driven by the specific global footprint of the business.

The potential magnitude of the proposed changes should be evaluated and communicated to key stakeholders as early as possible, highlighting the commercial impact on the business and future implications for the Group's ETR. Consideration should also be given to the necessary compliance and system requirements that may be necessary to implement in order to ensure any associated compliance burden can be borne.

A 'public consultation' phase closed on 2 December 2019 for stakeholders to provide written comments on Pillar 2, with a public consultation meeting scheduled for 9 December 2019. The OECD are intending to reach agreement amongst the members of the Inclusive Framework on the underlying principles of the proposed changes by early 2020. PwC will keep you informed of the progression of the project throughout and communicate any key developments, particularly with regard to financial services carve outs.

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EU Financial Transaction Tax - latest developments

In brief

Following a meeting of EU finance ministers in March this year, a number of revised draft proposals have been prepared for the implementation of a European Financial Transaction Tax ("FTT").

We understand that the most recent draft is based broadly on the French FTT model. That said, if the proposal proceeds to implementation, it remains to be seen if local implementation (and local interpretation) is consistent across the participating Member States.

There have been reports of renewed support, particularly from Germany, to bring an EU FTT into force. However, this has frequently been the case since the tax was first proposed back in 2011. If the intended 1 June 2021 start date is to be achieved, there remain significant areas to be resolved, most notably agreeing a methodology for apportioning revenues from the tax across Member States and the building of appropriate collection and reporting infrastructure.

In detail

How did we get here?

A proposal for an EU FTT was first released back in 2011. However, the contingent of participating Member States struggled to reach agreement on the fundamental principles of the scope of the tax, jurisdictional reach and appropriate exemptions. In recent times consensus has moved to an issuance-based tax and in March of this year, at a meeting of EU Finance Ministers, a proposal for an EU FTT based on the French FTT model reportedly received wide support.

We understand the proposal is for an issuance-based tax, applying at a minimum rate of 0.2% to financial instruments issued by entities established in the territories of the participating Member States which have a market capitalisation exceeding EUR 1 billion. As with the French FTT, the tax would apply to the acquisition of shares or similar instruments (based on the net daily position) and the tax does not extend to derivatives (although physical settlement of derivatives with in-scope securities would trigger the tax).

The proposal allows for several exemptions, which fall into two broad categories:

1) those relating to transactions carried out by certain entities, e.g. CCPs, CSDs, etc; and

2) those relating to certain transaction types, including underwriting, intra-group / restructuring transactions, securities lending and repo transactions, and transactions carried out by financial institutions where pursuing market making activities ("the market maker exemption").

The current intention is for participating Member States to adopt and publish the necessary laws and provisions by 1 January 2021, with such provisions applying from 1 June 2021.

What does the latest draft include?

The market maker exemption is clearly of critical importance to the banking and capital markets sector. Its changing definition in recent draft EU FTT proposals has generated a lot of discussion in the industry.

The proposal appears to be moving towards a model under which the exemption applies to specific types of activity. This could be contrasted with the Italian FTT under which a regulatory exemption (under the EU Short Selling Regulation) must be held by the financial institution, limiting the application of the relief. Again, this approach within the EU FTT draft of exempting certain activities, rather than institutions that hold a particular status, is more consistent with the French FTT approach.

That said, it will be important to monitor this position: any reversion of the approach back to something defined by reference to EU Regulation, such as the Short Selling Regulation for example, does potentially introduce the risk that Member States overlay a domestic interpretation of the relevant Regulation when transposing the Directive into local law. This could result in different interpretations of the exemption across participating Member States.

EU Financial Transaction Tax - latest developments (cont'd)

Beyond the market maker exemption the same points of interpretation relevant to the French FTT will be relevant to the latest EU FTT proposals. Given many points were ultimately resolved through interpretation by the French tax authorities (or the market), it remains to be seen whether there could be inconsistent application of the regime across Member States in practice. Inconsistencies across Member States could become more acute if certain States move away from the minimum requirements established by the Directive (for example, by implementing a tax rate in excess of the minimum 0.2% prescribed).

Challenges

Beyond the risk of local variation in application, although there now appears to be agreement on the shape of the EU FTT proposal there remain significant challenges which will need to be overcome if we are to see an EU FTT come into force.

The EU FTT has the support of ten Member States: Austria, Belgium, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain. Under the enhanced cooperation procedure there must remain a minimum of nine participating Member States wishing to submit a proposal to the EU Council. Therefore, one challenge will be keeping the remaining ten Member States in support long enough to bring the tax into force.

Agreeing a fair and appropriate method for apportioning revenue generated by the tax will be a critical component of this (simply allocating revenues to the relevant issuance jurisdictions would result in the majority of the tax going to the jurisdictions with larger capital markets - e.g. France, Germany, etc). We understand that discussions on the revenue apportionment model are ongoing, and to date there does not appear to be clear consensus on any particular model.

In addition to the revenue apportionment, there is yet to be a clear plan for the collection mechanism of the tax, or for the reporting infrastructure required. Although not essential for the tax to be legislated, it will obviously be critical to have such mechanisms in place in advance of the tax coming into force.

In summary, it remains to be seen whether this new draft proposal will be implemented by 1 June 2021, or at all. To the extent that support for an EU FTT labours for an extended period, again, we may see Member States implement their own domestic FTT, at least for an interim period. In addition to the French and Italian FTTs already in force, Portugal has ratified a law which includes legislative authorisation to enable the Portuguese Government to introduce an FTT, and the Spanish Socialist Party has proposed an FTT (although it remains to be seen whether they will be able to implement this politically).

The takeaway

There reportedly remains a clear desire to bring an EU FTT into force. Whilst the shape of the regime appears to have settled, technical issues and points of interpretation could yet emerge (especially if the proposals proceed to domestic implementation across the Member States). More fundamentally, significant aspects are still to be agreed, namely the revenue apportionment model between participating Member States, and the collection and reporting mechanisms. Implementation in 2021 therefore remains an ambitious timeframe.

Let's talk

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ATAD II hybrid rules: A practical approach to impact assessment

In brief

On 12 July 2016, the EU formally adopted the Anti-Tax Avoidance Directive ("ATAD"). This included measures to implement the recommendations of BEPS Action 2 on hybrids and focused on mismatch arrangements between EU Member States. It was shortly followed by a subsequent Directive, ATAD II. Although the initial intention for ATAD II was an extension to also target hybrid mismatches between EU Member States and third countries, the Directive also introduces new measures to make the EU's hybrids rules more consistent with the Action 2 recommendations.

This is a particular concern for banks because of the impact on transactions with counterparties and customers (and related inventory management), including financing arrangements and a lack of any broad exemptions for the sector. The payment-by-payment analysis required is particularly problematic given the breadth of potentially impacted transactions.

In detail

UK implementation status

The UK has been an early adopter of the BEPS project recommendations and introduced domestic anti-hybrids legislation with effect from 1 January 2017. Further, the UK has committed to adopt the minimum standards required to be implemented by Member States under ATAD II by 1 January 2020.

Previous articles discussed the UK legislation (including changes applying from 1 January 2020), detailing the issues we have seen affect financial services groups in particular. These can be seen here and here.

EU implementation status

Following the implementation of the provisions of ATAD (including those in respect of hybrid mismatches) by 1 January 2019, Member States are required to implement the provisions of ATAD II in respect of third country anti-hybrids by 1 January 2020, with subsequent implementation of reverse hybrid entity rules by 1 January 2022.

There has been a lot of activity in recent months with various Member States releasing legislation to ensure they are compliant with the provisions of ATAD II. While a number of Member States have postponed consideration of the reverse hybrid entity rules for the time being, some Member States (for example, Austria) are pushing ahead with early adoption to make them fully compliant with ATAD II from 1 January 2020 (or 1 January 2019 in respect of Belgium). There are still however a handful of countries which are yet to introduce such rules.

Jurisdiction	Status of Rules
France	Draft legislation released. Rules will apply from 1 January 2020, including reverse hybrid measures.
Germany	Draft rules expected this year.
Ireland	Draft legislation released in October 2019. Rules will apply from 1 January 2020, excluding reverse hybrid measures (which are anticipated to come in from 1 January 2022).
Luxembourg	ATAD II rules will apply from 1 January 2020, including reverse hybrid mismatch measures. If a taxpayer takes the position that the anti-hybrid rules do not apply, the Luxembourg tax authorities can request that the taxpayer provides evidence of treatment of the income/expense in another relevant territory (e.g. tax returns, other tax documents or certificates issued by foreign tax authorities).
Netherlands	Draft legislation released. Hybrid transfers of securities made by financial traders acting in the ordinary course of business have not been excluded. Rules will apply from 1 January 2020, with reverse hybrid rules anticipated to apply from 1 January 2022.

A practical approach to impact assessment

In very broad terms, one might expect territories across the EU to ultimately all have anti-hybrid rules which are at least similar. Accordingly, in determining the potential impacts the rules will have on a group, a good starting point may be to look to issues that have emerged from implementation of the UK rules. Where rules in a particular jurisdiction do not yet exist, given that we have had the UK rules in place for some time now, it would seem to make sense to identify potential issues assuming similar rules to those in the UK are introduced. (However, as noted below, differences between Member States in local implementation are anticipated.)

Based on our experience of working with Financial Services businesses, the areas listed below should be considered as part of any review:

1. **Branch structures**: Assessment of branch structures, including consideration of deduction/non-inclusion mismatches for deemed branch to head office payments, or double deductions;

ATAD II hybrid rules: A practical approach to impact assessment

2. **Financial Instruments**: Consideration as to whether third party activity such as leasing, repos and stock lending might constitute a 'structured arrangement' due to tax potentially influencing their pricing. (A "structured arrangement" exists where it is reasonable to suppose a transaction is designed to achieve a hybrid mismatch, or where the economic benefit of such a mismatch is shared between parties.) N.B. The ATAD does not contain any form of carve out for financial traders generally nor for capital market transactions;

3. **US disregarded entities**: Identification of entities which are disregarded for US tax purposes, which might mean there are double deduction mismatches due to payments being deductible both locally and for UK tax purposes;

4. **Compliance/Documentation**: Consideration of how to meet the compliance burden, given the rules are anticipated to operate on a payment by payment basis.

The Directive lays down principles based rules and leaves the details of implementation to Member States so they can tailor the key components of the rules to fit their domestic tax systems. This is anticipated to result in a degree of inconsistent implementation between Member States. Areas where there might potentially be such differences between local implementations could include the following:

- The definition of 'associated enterprises'. Generally, enterprises are associated where one (indirectly or directly) holds a 25% or 50% interest in another (the applicable percentage depending on the category of hybridity being considered) or enterprises are consolidated for accounting purposes. Different definitions in Member States may bring fewer/more parties within the scope of the rules;

- Different concepts of 'acting together'. (The Directive extends the concept of associated enterprises to "a person who acts together with another person in respect of the voting rights". This acting together concept is newly introduced in ATAD II and may be defined differently in EU Member States, again potentially broadening the scope of the rules);

- Member States may or may not opt for an exception covering certain intra-group loss absorbing instruments held by banks;

- Differing application of the rules in cases of payees applying a special tax regime, e.g. REITs; and

- Member States may introduce different documentation requirements.

It will be important for groups to carefully monitor where there are differences between jurisdictions in relation to the areas listed above.

Experience with the UK rules also suggests that it is helpful to look at third party transactions and related party transactions separately, and to formulate a different approach for each category. Where a group does not knowingly enter into "structured arrangements", compliance and documentation requirements may be particularly burdensome in the financial services sector.

In view of this, there may be merit in considering the new EU Mandatory Disclosure Rules and ATAD hybrid rules together for third party transactions (as well as potential OECD Pillar 2 work, refer to the article on page 5). This is because there is a degree of commonality between some of the hallmarks in the former and the definition of "structured arrangements" in the latter.

Hallmarks B and C of the EU Mandatory Disclosure Rules require consideration of cross border arrangements which convert income into capital or another category of revenue which is taxable at a lower level or exempt from tax, and also arrangements where there are deductible cross-border payments with the corresponding income being taxable at a lower rate or exempt from tax. Both of these Hallmarks are subject to the main benefit test; i.e. in order to apply, a tax advantage must be the one of the main benefits expected from the arrangement under consideration. In this respect there is a difference with the ATAD hybrid rules, as these do not contain a main benefit test. However, groups may want to approach both sets of rules together by identifying all third party transactions where tax is of significance as a starting point.

If you would like a discussion to explore the efficiencies that might arise from such an approach, please contact one of the authors below or your usual PwC contact.

Let's talk

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Total Tax Contribution Study 2019

In brief

This year's Total Tax Contribution study for the UK banking sector found that the UK banking sector paid £39.7 billion in taxes in the financial year to March 2019, with banks seeing a 50 per cent rise in taxes borne over the past five years. The study showed that irrecoverable VAT was the largest tax borne in 2019. The Total Tax Contribution survey provides deep insights into taxation of the UK banking sector.

In detail

The purpose of the study is to generate robust data, collected in accordance with a credible and well understood framework, to quantify the contribution made by the UK banking sector to the public finances in taxes and the trends in contribution over time. The study shows that the contribution is broader than corporation tax, with bank levy, employment taxes, irrecoverable VAT, business rates, stamp duties, tax deducted at source and other taxes adding to the total.

The analysis uses the PwC Total Tax Contribution methodology which makes a distinction between taxes borne and taxes collected. Taxes borne are the company's own contribution in taxes that impact their results, e.g. corporation tax, bank surcharge, employer NIC, irrecoverable VAT and bank levy, etc. Taxes collected are those that the company administers on behalf of Government and collects from others, e.g. income tax deducted under PAYE, etc.

The research highlights the significant and sustained contribution in taxes from the sector in uncertain economic times. The banking sector is host to many overseas headquartered banks, demonstrating the ability of the UK to compete internationally and operate globally. To retain this leading position, it is important to ensure that the UK remains competitive in all areas, including fiscal policy. However, as this study shows, in recent years the fiscal competitiveness of the UK for banking business has declined relative to other global financial centres, such as New York. This analysis shows that there is a 13.6-percentage point difference in the total tax rate of a bank operating in London (47.1 percent) versus New York (33.5 percent).

While banks operating in the US have benefited from a recent reduction in the rate of corporate income tax, changes in recent years in the UK have increased the taxation burden on the banking industry. The bank surcharge, of 8 percent, has had the effect of increasing the 19 percent main rate of corporation tax to 27 percent for banks. Employment taxes and irrecoverable VAT, both significant taxes for the sector, further increase the burden of tax on banks operating in the UK.

At a time of considerable flux for the sector resulting from factors including technology change, regulatory pressures, macro-economic headwinds and political uncertainty, many banks are reviewing the structure of their global operations. In this context, maintaining fiscal competitiveness is more important than ever. This is also vital to ensure a healthy domestic banking market which can continue to provide credit to support future growth of the UK economy.

The analysis provided by this study is not available elsewhere and, therefore, provides a valuable resource for the UK banking sector, government and other stakeholders. From an individual company perspective, Total Tax Contribution feedback reports can be helpful for external communication and internal management, for example:

- In discussions with HMRC or client relationship managers about tax affairs
- In tax strategy and planning or risk management - particularly to demonstrate the significance of taxes other than corporate tax
- In board and audit committee briefings on UK taxes
- For corporate responsibility and investor relations reporting or other communications with stakeholders to highlight positive economic contribution
- To actively engage in discussions with policymakers on the future tax regime

If you'd like to further discuss, please do contact us with comments or additional questions.

Let's talk

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The narrowing approach to the scope of VAT exemptions for payment related activity

In brief

The ECJ has held that the VAT exemption for financial services does not encompass payment services involving technical and administrative assistance for cash withdrawals. Whilst this judgment appears to be largely in line with current HMRC policy on the VAT liability of ATM-related services, it evidences the continued, narrow approach being taken by the Courts in relation to the scope of the financial services VAT exemption and builds on a number of recent decisions in this area. We are also aware of a number of upcoming cases in this area which may have a significant impact on the ongoing scope of the exemption.

In detail

The Taxpayer supplied a range of services concerning ATMs to a bank. These services included the installation of ATMs inscribed with that bank's logo, the installation of hardware and software on those ATMs, replenishing those ATMs with cash provided by the bank, and the maintenance and operation of those ATMs.

Additionally, when customers used the ATMs to withdraw cash, software installed by the Taxpayer would read data from the customers' bank cards. Such software would verify that data and send an electronic request to a third party to authorise the transaction. That third party would forward the request to an internal banking network, which would in turn forward the request to the bank with which the customer at the ATM held his account.

That bank would then verify whether the customer had sufficient funds for the requested withdrawal before approving or refusing that withdrawal, at which point the Taxpayer would generate a data file for the transaction and, if authorised, implement the transaction and create a second data file relating to the withdrawal.

That second data file would be sent as a payment order to the bank which operated the ATM and that bank would forward all such data files to the German Federal Bank. Doing so would entitle the bank operating the ATM to claim reimbursement from the bank with which the customer held his account. (The Taxpayer also generated a daily data file containing details of all such transactions which it would send to the German Federal Bank.)

The German courts referred the following question for the ECJ to consider:

"Is technical and administrative assistance provided by a supplier of services to a bank operating a cash point (ATM) for cash withdrawals from the bank exempt from tax under article 13B(d)(3) of the Sixth VAT Directive (77/388) in the case where technical and administrative assistance of the same nature provided by a supplier of services for payments by card in connection with the sale of cinema tickets is, in accordance with the judgment of the Court of Justice of the European Union of 26 May 2016 in Bookit (Case C-607/14), not exempt from tax under that provision?"

The narrowing approach to the scope of VAT exemptions for payment related activity (cont'd)

Judgment

In the present case, it was apparent from the referral that the Taxpayer did not itself debit the bank accounts concerned, but processed the physical handing over of the sums of money withdrawn from the ATMs which it was responsible for maintaining and operating. In addition, the Taxpayer did not approve transactions itself and had no decision-making power over the transactions concerned, but transmitted data through a chain of intermediaries to the bank issuing the card, and acted on the instructions from the bank by processing the distribution of the requested cash. It then recorded the withdrawal of the cash and passed on an accounting instruction to its client, the bank that operated the ATM.

As a result, the services of the Taxpayer did not appear to transfer funds or to result in the legal and financial changes that characterise a payment transaction within art 13B(d)(3) of the Sixth Directive.

The ECJ noted that, unlike the situation in *Bookit*, the Taxpayer's services were not limited to an exchange of data between the issuing bank and the bank operating the ATM, as they also involved the physical distribution of cash. However, a cash withdrawal from an ATM did not constitute a transfer of ownership from the Taxpayer to the user of that ATM. It was the bank issuing the card that authorised the withdrawal of cash, debited the corresponding amount from the bank account of the user of the ATM and transferred ownership of the money directly to that user. And the daily data file of all the transactions of the day, generated by the Taxpayer and transmitted to the banking system, was intended only to inform the banking system of the authorised transactions carried out, and therefore could not be considered to have the effect of fulfilling the specific and essential functions of a payment.

The interpretation that the services provided by the Taxpayer did not appear to effect a transfer of funds resulting in the legal and financial changes that characterise a transaction relating to payments was not affected by the fact that the services, including data entry and transmission and cash delivery, were essential to carry out an exempt payment transaction.

The ECJ therefore gave the following judgment, available in other language versions on the Curia website:

"Article 13B(d)(3) of the Sixth Directive 77/388/EEC ... must be interpreted in the sense that it does not exempt from VAT, as a 'transaction concerning payments' within the scope of that provision, the supply of services to a bank operating ATMs which consist of making the ATMs operational, stocking them, installing computer equipment and software to read bank card data, submitting to the bank issuing the card being used requests for authorisation to withdraw, dispensing the requested cash and recording withdrawal transactions."

Implications

The ECJ's judgment appears to confirm and follow the recent line of cases which have emphasised that, in order to qualify for the exemption provided for by what is now art 135(1)(d) Principal VAT Directive, taxpayers' services must effect changes in the legal and financial positions of the parties to any such payments or transfers, and not merely consist of the handing over of funds and the provision of information.

This decision again highlights the need to carefully consider outsourcing arrangements, where the operation of an ATM, or ATM estate, is outsourced by a bank or other financial institution. The principles established may also have significant implications for other outsourcing arrangements which rely on the VAT exemption for payments services. ATM operators and other outsourcers will need to review their arrangements to determine whether those arrangements constitute solely the provision of technical or administrative services, as considered by the ECJ in the case at hand.

We are also expecting further decisions from the UK courts concerning the scope of the UK VAT exemption for payments services in the coming weeks which may further alter the landscape for exemption and we will be covering these in a future edition of KUWT as and when appropriate.

Let's talk

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The Corporate Criminal Offence for failure to prevent the facilitation of tax evasion

In brief

The Corporate Criminal Offences for failure to prevent the criminal facilitation of tax evasion ('CCO') were introduced on 30 September 2017 as part of the Criminal Finance Act 2017. The primary aim of the legislation is to hold relevant bodies, companies or partnerships, criminally liable where they fail to prevent those who act for, or on their behalf, from criminally facilitating tax evasion. The new offences were introduced to address perceived difficulties in attributing criminal liability to relevant bodies for the criminal acts of their employees, agents or those that provide services for or on their behalf. The only defence organisations will be able to rely on is to demonstrate that they have reasonable prevention procedures in place to prevent the facilitation of tax evasion. The key first step in demonstrating reasonable prevention procedures are in place is to carry out a risk assessment to evidence how you have considered the risks of facilitating tax evasion across your business, the mitigating controls that are in place and what additional actions need to be taken. We set out below our recommendations for approaching your CCO response, whatever your group's status.

In detail

Two years in – What is the current status?

Many financial institutions have undertaken a risk assessment based on assessing the inherent risk of different areas of their business, applying structured risk assessment methodologies to identify and rate risks, then reviewing existing controls in order to assess residual risk. Residual risk assessments have informed implementation plans to modify/introduce controls, update training programmes and issue communications from senior management, to demonstrate that reasonable prevention procedures are in place. In initially addressing CCO compliance, some common challenges and pitfalls encountered included:

- **Assuming legislation impacts UK operations only –** Failure to understand the extraterritorial nature of the offence as well as the UK nexus issue in respect of the overseas offence.
- **Assuming regulated entities don't face any risk –** Assuming that because an entity is regulated that this protects it from CCO risk and related prosecution.
- **Considering existing financial crime controls without a tax evasion facilitation lens –** Focusing on existing financial crime processes (such as AML and Anti-Bribery & Corruption) without giving explicit thought to the risk of tax evasion facilitation and if current controls mitigate that risk.
- **Focusing on facilitation of tax evasion by clients only –** Focusing only on the risk of facilitation of client tax evasion at the expense of consideration of wider tax evasion facilitation risks, e.g. supply chain, HR/Payroll processes and Finance processes.
- **Focusing on tax evasion rather than tax evasion facilitation –** Focusing on the risk of underlying tax evasion rather than the risk of facilitation of that evasion.
- **Believing a low risk profile precludes the need for a risk assessment –** Contrary to HMRC's view certain organisations didn't carry out a risk assessment as they felt they were low risk to begin with.

Why CCO remains relevant requiring continued focus

CCO should remain a key area of focus as it represents an important aspect of the international cooperation between HMRC and international tax and regulatory bodies in tackling tax evasion and the facilitation thereof. In addition, the potential impacts of getting it wrong are serious, including; corporate criminal convictions, unlimited penalties, reputational damage and regulatory censure. Other considerations include:

- **HMRC have started criminal investigations –** As disclosed in response to a Parliamentary question raised in February of this year, a number of criminal investigations with potential CCO implications have been started by HMRC. In addition, HMRC has recently written to many large businesses reminding them of their obligations in respect of the CCO rules.
- **Enhanced HMRC Business Risk Review –** HMRC's updated BRR process will include some focus on businesses compliance with CCO legislation.
- **Senior Manager and Certification Regime –** A key area of the regime's prescribed responsibilities focuses on ensuring firms are not used for the furtherance of financial crime and hence the overlap with CCO.
- **Increased international coordination amongst authorities –** Tax and financial crime agencies in the UK, US, Canada, Netherlands and Australia have established a new alliance (Joint Chiefs of Global Compliance ('J5Alliance')) dedicated to increased collaboration on tackling international tax crime and money laundering.

The Corporate Criminal Offence for failure to prevent the facilitation of tax evasion (cont'd)

Next steps –What should be the focus going forward?

If you are starting out on your journey

For those organisations who are still at the early part of or starting on their compliance journey in respect of CCO there are a number of key areas or 'quick wins' that should be the initial areas of focus. These include:

1. High level risk assessment – Based on a consideration of products/services offered, nature of clients and where they are based and how those clients are serviced identify where key risks may be faced and what actions are required to address them.

2. Senior Management Communication – Ensure that a clear message is cascaded across the organisation making clear that there is 'Zero Tolerance' for tax evasion and the facilitation thereof.

3. Training – Leveraging existing organisational arrangements ensuring staff receive appropriate levels of training given their roles and potential CCO risk faced.

4. Associated Persons – Identify potential population of Associated Persons with a view to identifying which may pose a higher risk level in respect of CCO and addressing those risks accordingly.

If you are well down the path to implementation

If you are well down the road to implementing your approach, you should be focusing on validating the approach that you have taken and gaining assurance that your 'reasonable assurance procedures' are in place and operating effectively through focusing on the following:

- Assessing the robustness of the risk assessment methodology applied, adequacy of risk factors considered, completeness of approach and conclusions reached;
- Reviewing the completeness of 'reasonable prevention procedures' being put in place;
- Evaluating the monitoring and review activities that have been defined.

Key areas of focus in these activities should include:

1. Review of risk assessment methodology – What coverage model was applied (UK/Global), what risk factors considered, what scoring mechanism applied and which Associated Persons were considered. How were inherent and residual risks assessed and what level of review and challenge were applied to the results.

2. Risk factors considered – Ensure an appropriate set of risk factors were considered e.g. country risks, product risks, sectoral risks, transaction risks, business partnership risks and any customer risks.

3. Completeness of approach – Evaluate the approach taken avoiding common mistakes in CCO reviews highlighted earlier.

4. Reasonable prevention procedures identified –Perform high level review to assess the completeness of the reasonable prevention procedures identified.

5. Implementation plan approach –Assess the approach to implementation ensuring a structured plan was put in place with appropriate ownership, accountability and resources along with appropriate monitoring of delivery and progress against plan.

6. Monitoring and review procedures –Assess whether effective monitoring and review procedures have been (or are being) put in place, e.g. are appropriate governance and oversight bodies reviewing relevant MI & Metrics and are controls and assurance testing being undertaken?

Let's talk

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