Keeping Up with Tax for Insurance

May 2020

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Introduction

Welcome to our May edition of Keeping up with Tax for Insurers.

As we find ourselves in the same extraordinary circumstances as we did at the time of our last edition, we hope, first and foremost, that you and your loved ones remain safe and well during what remains a worrying time. Whilst we might be becoming more accustomed to working remotely, and it remains likely that we will continue to do so for some time to come, the challenges of doing so have not gone away. Our thoughts remain with all of you, who are struggling through this period.

In terms of practical help on COVID-19, our dedicated web page (PwC COVID-19) continues to be updated regularly with the latest guidance that will be relevant to insurance groups. This includes our latest updates on the commercial, regulatory, legal and financial impacts of the current circumstances which we hope might assist you in your planning.

As we move through the COVID-19 crisis, one of the most complex issues facing many of our clients (and of course PwC!) is how and when employees may be able to return to work in offices, as we transition away from lockdown. We have prepared a publication here considering the issues around this for employers and some of the steps that you may wish to consider taking now on this. Dean Farthing and his team will be happy to discuss this with you and answer any practical queries you may have on this.

Additionally, it is recognised that COVID-19 will have longer term structural impacts on the insurance market. We expect that greater flexibility will be required to navigate this new insurance landscape post crisis and there are many steps that insurers can take now to prepare for this challenge. Our consulting colleagues have prepared a document here summarising some of the factors insurers should consider in preparing for this

The current crisis also dominated the results of our Q1 2020 PwC and Confederation of British Industry ('CBI') Financial Services Survey which we released in April. Unsurprisingly, the results underline the extraordinary challenges facing the sector and its clients, and drew out the emphasis being placed on trying to move back to something resembling business as usual, and the necessity of operational resilience in the current climate. You can see a summary of the results here, which include figures specific to the insurance sector.

On to tax matters, and as you will be aware, the tax system has been a key tool which Governments across the globe have tried to harness to support businesses through the current crisis. In the UK, we've seen a whole range of measures introduced by HMRC to mitigate the impact of the crisis, including the employee furlough scheme and tax deferral measures. We continue to see HMRC engaging pragmatically on these reliefs and also on COVID related operational challenges

On the international front, the OECD has released their guidance on the impact of COVID-19 on corporate residence and permanent establishment issues. Following this, HMRC and a number of other tax authorities across the globe have also released their own guidance with a number of clarifications on activities and changes which could impact an entity's tax status.

While insurers will no doubt welcome certain requirements being deferred (e.g. On Making Tax Digital and IR35) and the cash flow assistance being offered by Governments, it is important for insurers not to lose sight of upcoming requirements and deadlines on tax reporting. This will include the EU Mandatory tax reporting regime that will (finally) come into effect shortly (even if a short delay is possible) and the potential new UK disclosure regime on uncertain tax positions. We have included articles on both of these areas in this edition

As usual, we have a packed edition this month covering the latest updates on a number of open technical issues, including:

- HMRC and OECD guidance on PE and residence in light of COVID-19
- The large business notification regime
- Tax accounting and COVID-19
- EU Mandatory tax disclosure regime
- Updated HMRC guidance on the employee furlough scheme; and
- Update on case law on cross border group relief

I hope you enjoy the articles that we have put together, and as always please get in touch with me or your PwC team if there is anything that you would like to discuss further.

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HMRC and OECD guidance on PE and residence in light of COVID 19

On account of travel restrictions imposed by national governments or quarantine requirements, there are business concerns that workers may be present in a jurisdiction long enough to trigger a permanent establishment ('PE') or residence rules under applicable tax treaties (or similar instruments). On 3 April 2020, the OECD Secretariat released initial analysis on tax issues arising from cross- border workers affected by the COVID-19 crisis. The focus of the OECD guidance is the extent to which companies might face concerns around creating new PEs or residence issues due to the temporary displacement of staff or managing officials.

Some countries such as the United Kingdom, Australia, Ireland, US and Singapore have also published their own guidance. Some of these country specific guidance reflect the position adopted by OECD while some countries have provided additional guidance on corporate residence and PE issues.

The above guidance provided by OECD and various tax authorities can be accessed on PwC's COVID-19 site.

Snapshot of guidance across the globe:

OECD

In general, the OECD secretariat cautions that the 'exceptional and temporary' impact of COVID-19 crisis on employee displacement should not create changes to PE determination under most current tax treaties. Based on an analysis of existing treaties, the Secretariat stated that generally working from home or concluding contracts from an employee/agent's home under exceptional and more importantly temporary situations should generally not be sufficient to create a PE. That said, they noted it was important to consider what other activity might be occurring in the territory which could change this position.

Regarding interaction with 'place of effective management' in corporate residency determination, the OECD secretariat noted that temporary changes in location of CEOs and other senior executives due to COVID-19 should not trigger a residency change, especially after applying the tax treaty tie-breaker rules.

United Kingdom (UK)

In the UK, HMRC's guidance indicates that a change in the worker location over a short period should not necessarily affect corporate residence and PE position. The guidance also stresses that HMRC will take a holistic view, considering all facts and circumstances. This approach seems to align with the OECD guidance.

HMRC addresses the issues of corporate residence and PE as follows:

- Corporate residence: a company will not necessarily become resident in the UK because several board meetings are held here, or because some decisions are taken in the UK over a short time period.

- Permanent establishment: a non-resident company will not automatically have a taxable presence by way of PE after a short period of time. Similarly, whilst habitual conclusion of contracts in the UK would also create a UK taxable presence, it is a matter of fact and degree as to whether the habitual condition is met.

Australia, Ireland, Singapore and US

Australia also addressed the issue of corporate residency and PE issues in posted FAQs. The Australian Tax Office (ATO) stated that a non-tax resident forced to hold board meetings in Australia due to COVID-19 (or board members attending meetings from Australia) should not alter a company's residency. Similarly, the ATO stated that for a company without PE in Australia, the presence of company employees within the country due to travel restrictions arising from COVID-19 should not, by itself, change PE status.

Ireland issued a bulletin with similar advice that the presence of company employees generally would be disregarded for corporate tax purposes where arising from travel restrictions related to COVID-19.

Singapore has also issued guidance similar to the ATO FAQs wherein a Singapore company's inability to hold Board of Directors (BoD) meetings in Singapore, or a non resident company holding its BoD meeting in Singapore, will not automatically lead to challenge to the residency status. Also, where employees of a foreign company may have to remain in Singapore due to travel restrictions relating to COVID-19, Singapore will not necessarily consider such unplanned presence as creation of a permanent establishment in Singapore for the foreign company. That said, the Singaporean Tax Authorities have placed some restrictions on the applicability of the guidance.

The US has issued Q&As that state that foreign companies can elect a period of 60 days starting between 1 February and 1 April during which services or other activities performed by one or more non-US residents temporarily present in the US will not be taken into account to determine whether the non-resident or foreign corporation has a PE or a US trade or business, provided that the services or other activities of these individuals would not have occurred in the US but for COVID-19 Emergency Travel Disruptions.

HMRC and OECD guidance on PE and residence in light of COVID 19 (cont.)

Observations on the UK approach

Company Residence

- Occasional UK board meetings, or participation in such meetings from the UK, does not necessarily result in Central Management and Control (CMC) in the UK.
- Where a Double Tax Treaty is in existence, even if UK CMC were established, the appropriate test becomes either Place of Effective Management (POEM), which can only be in one jurisdiction such that short term UK CMC is unlikely to tip the balance, or Competent Authority which requires consideration of POEM and other factors.
- Whilst not covered in HMRC's guidance, for non-UK incorporated companies that are UK resident by virtue of CMC in the UK, a similar logic should apply. That is, HMRC would probably not take the position that occasional non-UK board meetings, or participation in such meetings from outside the UK, changes the residency position in and of itself.

UK PEs

- HMRC believe that current legislation, treaties and related guidance provide sufficient flexibility with regard to whether a PE has been created in the UK.
- HMRC consider a non resident company will not have a UK fixed place of business PE after a short period of time as a degree of permanence is required.
- Whilst the habitual conclusion of contracts in the UK would also create a Dependant Agent PE in the UK, this is a matter of fact and degree.
- The existence of a UK PE does not in itself mean that a significant element of the profits of the non-resident company would be taxable in the UK.

Overall, the guidance does not change the rules to be applied in the UK, nor offer a safe harbour for this period (as we have seen in other states - Australia, Ireland and Singapore). Instead HMRC are emphasising that temporary arrangements resulting from the COVID-19 crisis are unlikely on their own to change residence or give rise to PEs.

Next steps for insurers

Whilst HMRC have said that temporary arrangements resulting from the COVID-19 crisis are unlikely on their own to change residence or give rise to PEs, insurers should continue to monitor current operating models. This applies both in the context of existing transfer pricing arrangements and in considering whether the COVID-19 resulting activity in the state might create a PE in combination with activity already in the state.

It will be important to understand where key value driving functions are being performed, and to assess whether this is in line with the functional profile on which the transfer pricing policy is based. If current transfer pricing policies are based on the location of key decisions (and those decisions are now being made in a different location than normal, the potential impact on transfer pricing arrangements will need to be considered.

In addition to monitoring any impacts on the actual transfer pricing policies arising from the potential displacement of staff, careful consideration should also be given to any potential impacts to VAT positions, personal and employment tax consequences, or the regulatory position of the group.

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Large business notification regime

In brief

The government has announced a consultation into a new notification regime for large businesses to report uncertain tax treatments to HMRC, intended to be introduced for returns filed after April 2021. The proposed reporting regime is largely modelled on the Senior Accounting Officer rules though it is not clear at this early stage how the uncertainty is to be identified and measured.

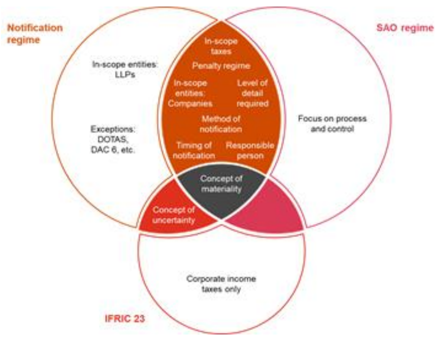
The detail of the consultation document suggests that a larger number of disclosures may be required than previously may have been expected to be the case and also presents other practical challenges. We recommend that impacted insurers make representations to ensure that a workable regime can be designed. Businesses have until 27 August 2020 to provide comments in response to the HMRC consultation.

In detail

The government's March 2020 Budget included the announcement of a new regime under which large businesses will be required to report their uncertain tax treatments to HMRC.

The stated policy intent behind the new rules is to close the 'tax gap' arising from differences in legal interpretation between HMRC and large businesses. This will be achieved by giving HMRC early visibility of positions it may disagree with and to aid HMRC to speed up its interventions.

A high-level summary of how the proposed Notification regime compares to the SAO regime and IFRIC 23 is provided in the diagram below:



The key features of the proposals are as follows:

Implementation - Following the consultation process it is intended that the new rules are legislated in Finance Bill 2020-21 and apply to uncertain tax treatments in returns filed after April 2021.

Affected businesses - The rules will apply to large businesses, principally those within the Senior Accounting Officer (SAO) regime. Businesses fall within the SAO rules if they have a relevant turnover in excess of £200m and/or a relevant balance sheet total of £2bn. Additionally, the notification requirement will apply to LLPs and other partnerships, but not UK branches of non-resident entities.

In scope taxes - The taxes covered by the new regime are Corporation Tax, Income Tax (including PAYE), VAT, Excise and Customs Duties, Insurance Premium Tax, Stamp Duty Land Tax, Stamp Duty Reserve Tax, Bank Levy and Petroleum Revenue Tax. These are the taxes currently within the scope of the SAO rules. It is likely that Corporation Tax and VAT will attract the most focus from HMRC.

Uncertain tax treatments - These are positions taken in a tax return with which HMRC is likely to disagree based on legal interpretation, i.e. interpretation of relevant legislation, case law or HMRC guidance. Whilst these are traditional tax judgements, HMRC's definition of legal interpretation also extends to accounting and more commercial judgements such as transfer pricing and VAT partial exemption. Whilst 'uncertain tax treatment' will be defined by legislation, HMRC will consider publishing guidance to clarify general issues it considers to be uncertain and list some common areas of dispute.

Exclusions - Large businesses will not have to provide a notification to HMRC under this new regime if they are already obliged to make a disclosure under an existing reporting framework. These include the Disclosure of Tax Avoidance Schemes (DOTAS) regime, the enablers rules and the EU Mandatory Disclosure Regime (DAC 6). Further, if the uncertainty has already been proactively been raised and discussed with the Customer Compliance Manager before the notification date or if the matter is already under enquiry, notification will not be required.

Materiality - The consultation proposes a de minimis threshold of £1m per financial year or accounting period. Accordingly uncertain tax treatments below this threshold will not be notifiable. For the purposes of applying this threshold, uncertain tax treatments for any in scope duties will need to be considered on an individual or combined basis, applying the principles of International Accounting Standards, specifically IFRIC 23.

Notification process - This is also modelled on the SAO regime. A single return or certificate, encompassing all in scope taxes, will be required annually, either six or nine months after the end of the accounting period of the entity. However there is no requirement to submit a 'clean certificate' i.e. if there are no uncertain tax treatments to notify then no return or certificate is required.

Responsible person - The notifying entity will also have to tell HMRC who the responsible person is that will be reporting. The person making the judgement about whether an uncertain tax treatment is notifiable could be someone other than the Senior Accounting Officer.

Large business notification regime (cont.)

Penalties - Again, this is modelled on the SAO rules. A £5,000 penalty would apply to the entity for failure to notify HMRC of the responsible person. A separate £5,000 penalty would apply to the responsible person for a failure to notify HMRC of an uncertain tax treatment. Where no such person has been identified this penalty would fall on the entity. There will be an appeals process and a reasonable excuse provision.

Whilst the final form of the rules may change as a result of the responses that are submitted to HMRC about the details presented in this consultation, the current proposals from HMRC do present a number of challenges to large businesses:

Identification of uncertain tax treatments - It is clear that significant judgement may be required in determining whether a tax position represents an uncertain tax treatment for the purposes of the notification regime. Whilst it is helpful that HMRC is considering publishing guidance to provide clarity on general issues it considers to be uncertain and to list some common areas of dispute, there will inevitably be some positions where it will be difficult to determine whether HMRC is likely to challenge.

Tax judgements vs commercial judgements - HMRC's definition of legal interpretation includes matters such as transfer pricing where there is usually a range of acceptable positions. Establishing whether HMRC is likely to challenge such a treatment, even where guidance has been issued, may be particularly problematic.

Leveraging of accounting processes - Despite the references in the consultation to IFRIC 23, the parallels with the new regime are very limited. IFRIC 23 is mainly concerned with assessing whether a tax authority is ultimately likely to accept a tax position in a return. The notification regime asks a fundamentally different question, which is whether HMRC is likely to challenge a tax treatment. Aside from the application of uncertainty, the list of in scope taxes goes well beyond the corporate income taxes falling under IFRIC 23. This means that the ability of large businesses to easily leverage their existing tax reporting processes is limited and a new or enhanced framework will be required.

Materiality - The threshold of £1m will apply to all large businesses, whatever their actual size. Therefore for some it will be well below the de minimis currently applied for accounting purposes or for disclosing uncertainties to HMRC in the normal course of open and transparent relationships. Implementing a process to identify, analyse, conclude on and report all such uncertain tax treatments will mean an additional compliance burden, potentially significant. Further, the notification requirement applies to returns filed after April 2021. Accordingly this may not allow much time for large businesses to implement the required processes and governance once the final requirements are known.

Responsible person - HMRC has not at this stage given a view on whether the person liable to notify under the new regime should be the same as the Senior Accounting Officer. Despite the parallels between the two sets of rules, it is fundamentally a tax judgement being made under the notification regime. On the other hand, the SAO regime requires judgement over processes and controls. Ultimately large businesses will need to decide whether they wish to align the roles under one person (perhaps with an attestation from the tax team to the Senior Accounting Officer) or to assign responsibility for the new regime to another individual such as the head of tax.

Timing of notification - In the case of corporation tax, the notification deadline of six or nine months after the end of the accounting period is likely to be in advance of the filing of the tax return. This means that a notification will be required before an uncertain tax treatment may have been determined or concluded upon under self-assessment.

Next steps for insurers

We recommend that insurers review the consultation document in detail, with a clear focus on any practical challenges this will present. Whilst various bodies (including ourselves and no doubt the ABI and ILAG) will be making representations on this consultation, we recommend insurers consider making representations themselves before the end of August 2020 highlighting any specific practical challenges and compliance burdens these new rules will impose.

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Tax accounting and COVID-19

In brief

COVID-19 will impact the way that tax is reported in annual financial statements and for interim reporting. For balance sheet dates up to and including 31 December 2019 you should consider whether there is a requirement to disclose the impact of COVID-19. For balance sheets after this date any impact should be adjusted for in your accounts. In either event, areas of focus include:
deferred tax valuation;
the impact on interim reporting under IAS 34; and
how and when to account for new measures.
The new operating environment will also drive changes to reporting processes and levels of disclosure.

In detail

Announcements from the PRA, the FCA and the FRC have addressed a number of specific areas of consideration for the preparers, auditors and users of financial statements as a result of COVID-19. From an insurance perspective these naturally have a heavy focus on reserving impacts and the valuation of investment assets. While these announcements haven't had a particular focus on the tax reporting aspects, there are a number of key points worth highlighting in addressing the potential impact on tax as reported in the financial statements, both for year end accounts and interim reporting.

When to adjust - In drawing up balance sheets for periods up to and including 31 December 2019, the general consensus in the UK is that COVID-19 should be considered a non adjusting post balance sheet event. Critically for tax, this means that forecasts supporting the recognition of deferred tax assets on the balance sheet should be prepared on the basis of and supported by pre COVID-19 forecasts for December 2019 balance sheets (including in Solvency II reporting). However, appropriate disclosures will be required to the extent that the impact of revised forecasts could be material, potentially in both the financial statements and the SFCR.

Balance sheet dates from 1 January 2020 onwards will need to be adjusted to reflect the impact of COVID-19, including in Solvency II QRTs.

What typically changes - The change in the economic environment as a result of COVID-19 will typically impact tax reporting in a number of ways:

Impacts on deferred tax: There are two key areas of focus here:

- Firstly - large market value movements on investment assets have the potential to significantly impact the deferred tax asset / liability profile of an entity. A reduction in deferred tax liabilities against which deferred tax assets should reverse may increase reliance on forecasts of future taxable profits against which deferred tax assets will reverse.

- Secondly, this increased reliance on forecasts comes at a time of uncertainty around their reliability given the changed economic outlook - and these judgements will be more challenging in nature given the rapid rate at which the market situation is changing and the evolving future insurance market.

In the life insurance sector, particular attention may be required to I-E results given the volatile market conditions. This may include consideration of tax attributes for which credit is given in unit pricing (especially capital losses) and the treatment of any 'tax synergies' between funds. Policyholder deferred tax attributes may be particularly volatile in the present market circumstances so additional consideration (and disclosure) may be required around these.

Tax accounting and COVID-19 (cont.)

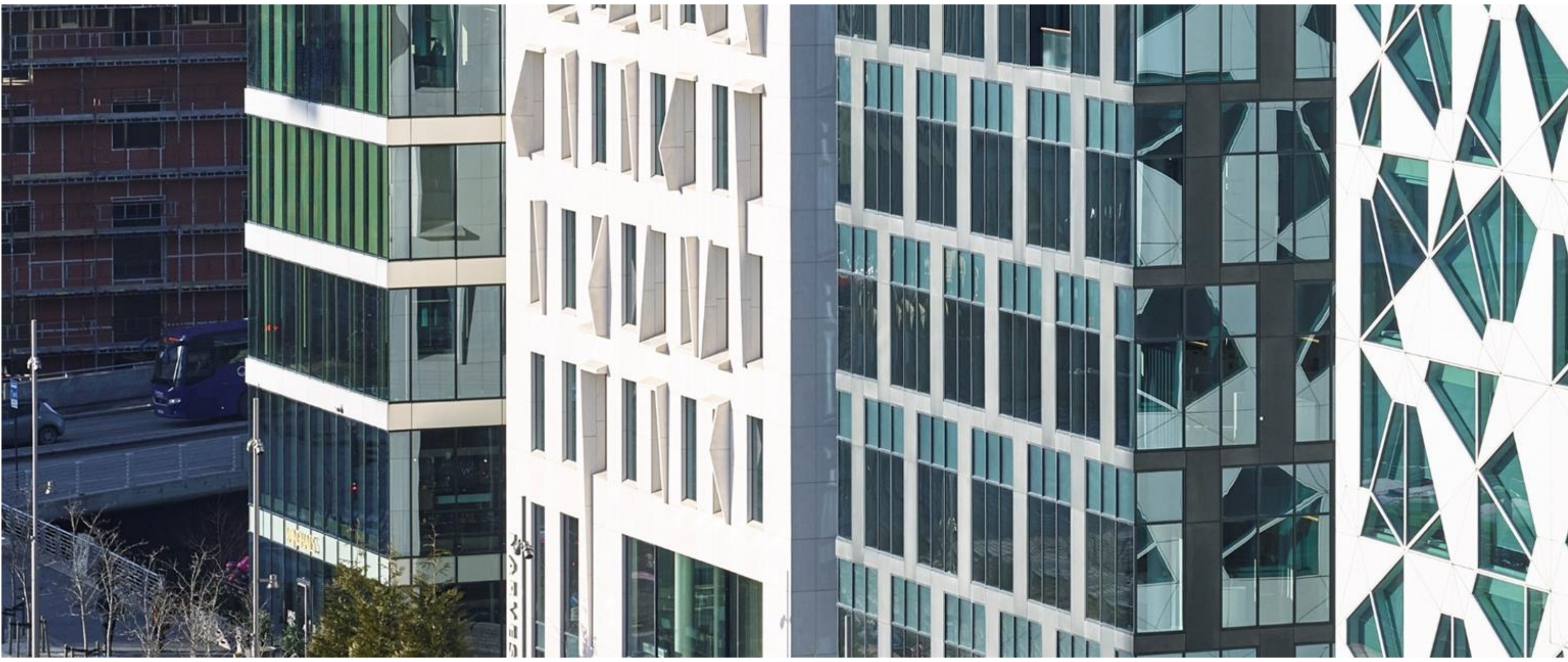
Interim reporting - IAS 34 & the impact on Annualised Effective Tax Rates:
Calculating the annualised effective tax rate at interim reporting periods is more difficult in times of significant volatility. Again, challenges around generating accurate forecasts could give rise to greater differences between actual quarterly results and annual forecasted rates. Judgement will be required to identify how this should be reflected for interim reporting in a way that is most meaningful to the user of the accounts.

The impacts of COVID-19 reflected for tax reporting purposes should be consistent with those reflected in other areas of the accounts, including in future profit forecasts (e.g. those used for going concern and impairment testing). Where there is significant uncertainty around forecasts, and to the extent that these are not relevant to other areas of the accounts, disclosure of the key assumptions and judgements made under IAS 1 will be key.

It is also worth noting that in April the European Securities and Markets Authority (ESMA) issued guidelines on the use of Alternative Performance Measures (APMs) in the context of COVID-19. These encourage issuers to exercise caution when issuing new or adjusted performance measures with the objective of describing the impact that COVID-19 will have on performance or cash flows, particularly where these impacts are pervasive throughout the accounts. This guidance does, however, encourage additional narrative disclosure, including how these impact assumptions or estimates.

Changes to tax measures – COVID-19 has driven a raft of new tax measures (both domestic and international), as well as changes to the timetable for the enactment of proposed measures. There are a number of key principles to bear in mind in thinking through the tax reporting impacts of these –

- Which standard applies - is it an income tax relief (in which case it should be reflected in the tax line) or is it, for example, a grant or loan which should be reflected elsewhere in the accounts?
- Is it a relief (typically an income statement adjustment) or a deferral (balance sheet only with an impact on cash flow)?
- How to account for measures with retrospective impact (for example the measures in the US).
- It's also important to bear in mind the principles of substantive enactment (for IFRS or UK GAAP) or enactment (for US GAAP) in thinking through whether to recognise or disclose the impact of material measures.



Tax accounting and COVID-19 (cont.)

How to report - Given the practical and judgemental difficulties associated with running a reporting process in the current working environment, the PRA, FCA and FRC extended filing deadlines for regulated entities with an encouragement that businesses take full advantage of these extensions. In practice however, the majority of finance teams in insurance (and FTSE 100) businesses have continued to - or plan to - report in similar timelines, but with contingency plans in place in the event of a greater risk to business continuity.

There is a balance to be struck here between streamlining processes in the context of a challenging operational environment, but also providing guidance to the markets (and potentially a wider group of interested stakeholders) to explain the impact the changes in outlook can have on effective tax rates and tax balance sheets. This has perhaps been particularly relevant as part of the Q1 reporting; where interim reports are typically fairly light on disclosure given the proximity to year end, but in 2020 so much has changed in terms of expectation and tax profile in relatively short period of time.

This is therefore a key time to reflect on -

- Firstly, the operational resilience of the tax reporting process; and
- Secondly, what additional disclosures a user of the accounts may need or find helpful in order to interpret tax disclosures, and how these should fit with potentially changed formats for accounts and interim reports.

Next steps for insurers

Tax teams at insurance groups will need to remain close to the ongoing conversations in finance and actuarial teams on the future business profile. This has the potential to significantly impact on tax reporting numbers even in the short term (if interim reporting is applied).

More broadly, COVID-19 presents significant operational challenges and tax and accounting technical judgements for tax reporting. Now is a good time to reflect on your tax reporting balances, disclosures and process, and to consider what might need to change.

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EU Mandatory tax disclosure regime – an update

The EU Mandatory Disclosure Regime ('EU MDR') comes into force on 1 July 2020. From that date, reportable arrangements that are implemented or made available for implementation must be reported within 30 days. For arrangements implemented during the transitional period of 25 June 2018 to 30 June 2020, required reporting must be completed by 31 August 2020.

The EU has publicly acknowledged that a deferral of the regime of up to 3 months is currently being contemplated due to COVID-19. However, it remains unclear whether, or when, this will be approved. This raises the uncomfortable proposition that a deferral might not be confirmed until shortly before, or indeed after, the 'live' date of 1 July. Given the uncertainty, our recommendation is that where possible insurers and brokers proceed on the basis that implementation dates will not change.

One of the key practical issues around EU MDR is local country implementation, and the guidance provided by each country's tax authority as to how the regime should be interpreted. On 13 January 2020, final regulations to implement EU Directive 2018/822 ('DAC6') on the mandatory disclosure and exchange of cross-border arrangements were laid before Parliament and became law. Draft guidance was published in March 2020 for further consultation, which we explore further in this article.

It appears that HMRC would like EU MDR to be applied in the UK in a **pragmatic** and **targeted** way, and in general the draft guidance reflects this intention. However, if insurers and brokers have reporting obligations in other EU countries, they will need to consider the regulations and guidance in those countries, which may well be different from the UK. For example, Ireland has specifically eschewed the UK approach to discerning whether tax is a main benefit of an arrangement. Aspects of the draft guidance are helpful, although questions remain.

Welcome clarifications in the draft guidance:

- Main benefit test – The definition of 'tax advantage' has been restricted to taxes which DAC6 applies, i.e. EU taxes (and generally excluding VAT in most EU countries). This may reduce the number of arrangements disclosable under hallmarks subject to the main benefit test.

- Meaning of 'concerning' – Helpful guidance is included explaining that HMRC only consider an arrangement to 'concern' a territory if that territory is of 'material relevance' to the arrangement and provide several examples to illustrate the concept. One specific example given by HMRC is where there is an arrangement between a permanent establishment and counterparties in the same jurisdiction. The arrangement will not be a cross border arrangement merely because a permanent establishment of a company that is resident in another country is involved; the head office would need to be a material part of the arrangement.

Hallmark A3 – HMRC have confirmed that industry standard framework agreements (such as an ISDA) should not normally satisfy this hallmark, on the assumption that they are usually subject to significant contract-specific customisation. We would expect this to generally apply for insurance policies – although care should be taken when relying on this position if the main benefit test is met.

Points specific to C Hallmarks –

- 'Recipient' – HMRC have confirmed that the recipient for the purposes of these hallmarks will generally be the person/people who is/are taxable on the receipt, In the case of transparent vehicles such as general partnerships, it will be the partners, rather than the partnership, who are taxable on the receipt so in this case, it would be the partners who are the recipients for the purposes of judging whether this hallmark is met.

- Territories without the concept of corporate tax (e.g. Cayman Islands) 'Resident for tax purposes' – HMRC have clarified whether payments to entities incorporated in territories without the concept of corporate tax should fall within hallmark C1a or either of the C1b hallmarks, and have confirmed that an entity incorporated in a jurisdiction without corporate tax should be considered under the C1b hallmarks. HMRC indicate that they consider that C1a is targeted at situations whether the non-residence arises due to a mismatch of taxing criteria between territories rather than due to the lack of tax residency concept in a jurisdiction.

- C1b(ii) – notably the Cayman Islands – The draft HMRC guidance has clarified that it is necessary to consider whether the territory is on either of the EU or OECD list of uncooperative tax jurisdictions **<u>both</u>** at the time of the first step of implementation and 1 July 2020, to determine if an arrangement is disclosable under this hallmark. It follows that relevant arrangements involving the Cayman Islands that were implemented before the Cayman Islands was added to the 'Blacklist' earlier this year may not be reportable under this hallmark (although do consider other hallmarks) and not is reporting required for jurisdictions moved off the 'Blacklist' such as Bermuda.

- C4 – HMRC have set out their view that 'material' in this hallmark refers to a difference in consideration which does not result from the normal operation of the tax legislation, such that it would be reasonable to conclude that the tax authorities would want to understand more about the arrangement and its operation. This is significantly different from, say, an accountant's interpretation of 'material'. HMRC give the example of a transfer by a UK company of shares to a non-UK resident and that disposal benefits from SSE. As long as the transaction is undertaken in a manner consistent with the normal operation of the SSE legislation, there should not be a material difference, irrespective of the tax basis available to the transferee.

EU Mandatory tax disclosure regime – an update

- HMRC indicate that, where the D hallmarks and the OECD's Mandatory Disclosure Regime rules cover the same ground, then HMRC will interpret the D hallmarks in line with the OECD's rules. Accordingly, the OECD's guidance on MDR should be capable of being used to interpret the D hallmarks. HMRC have also clarified that, just because an arrangement results in no CRS report being made, if this is in line with the policy objective of the CRS rules, this should not be disclosable under D1.

Potential challenges remaining following the draft guidance:

- Hallmark E3 – HMRC indicate that, when seeking to determine if hallmark E3 is satisfied, it is necessary to consider it from the point of view of a hypothetical informed observer. More specifically, based on all the facts and circumstances, would a reasonable person consider that, on the balance of probabilities, the expected EBIT of the transferor should decrease by at least 50% in the following three years? This test may be difficult to apply in practice for transactions that were implemented during the transition period.

- HMRC accept that intermediaries who are service providers may not know all details of an arrangement and are not required to do additional due diligence beyond that necessary to perform their services. This could result in disclosure obligations transferring to other intermediaries or taxpayers. However it should also mean – for example – that where an insurer insures a risk associated with a reportable arrangement, that insurer should not be an intermediary unless it would be aware in the ordinary course of its business that the arrangement was reportable.

- Disclosure in the UK and the EU – Whilst HMRC's approach, as reflected in the UK draft guidance is generally pragmatic and helpful, arrangements may still be disclosable in the EU even if not in the UK.

Matters on which further clarification is still awaited:

- Hallmark E3 and Brexit – HMRC does not consider that it would be appropriate to carve out Brexit-related reorganisations from the legislation and the draft guidance does not shed any further light here. However, HMRC will explore whether steps can be taken to minimise over-reporting of benign transactions through further guidance. Guidance will also address sector specific issues such as the application of the EBIT test to financial sector entities and funds.

- Penalties – The draft guidance currently only sets out the circumstances in which a person may be liable for a penalty. Further guidance on penalties is to follow.

What we are seeing the industry do to prepare

- We are seeing clear trends emerging on implementation preparation. Firstly, insurers and brokers have sometimes been slower to move than other parts of the Financial Services sector. While in general the risk of a reportable transaction from most insurance business is low, best practice often still requires changes in governance and compliance. The effects of COVID-19 means many are struggling to make the required changes in time for 1 July.

- When taxpayers turn their minds to EU MDR, this generally involves first conducting an Impact Assessment on how the technical aspects of the legislation apply to different parts of the business, the level of analysis needed over transactions and structures, and determining the intermediary responsible for any reporting. We note that insurance premium tax is a covered tax for EU MDR purposes even though VAT is generally not; care should be taken that this forms part of any risk assessment.

- For insurers and brokers who have BAU transactions at risk (e.g. tax risk insurance, offshore life bonds), positions are being documented and opinions sought to ensure that where arrangements are considered not reportable, sufficient evidence is available for the position to be adopted going forward.

- We are seeing groups considering areas such as training for deals and compliance teams, putting in place central Tax oversight processes, and considering the role technology may play in ongoing analysis and reporting. There are a variety of different approaches being adopted in terms of ownership of the issue on an ongoing basis (i.e. does it rest with Tax, with Compliance/Regulatory, or somewhere in between?).

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COVID-19: Coronavirus Job Retention Scheme - Updated HMRC guidance

As discussed in our previous edition, the Coronavirus Job Retention Scheme (CJRS) was launched on 20 March with the objective of supporting employers whose operations have been impacted by coronavirus, to retain their employees and protect the UK economy.

Since the last issue of KUWT for Insurance, there have been a number of developments on the scheme, including a Treasury Direction (instructing HMRC on the parameters of the scheme), updated and more extensive guidance to employees and employers and an announcement that the scheme was to be extended by one month to 30 June and may be extended for longer if required.

Additionally, on 12 May the Chancellor announced the scheme would be extended further to October 2020, though with employers potentially expected to contribute in the later months of this scheme. We expect more detailed guidance on this in due course.

Monday 20th April also saw the CJRS portal go live and on the first day alone, approximately 185,000 claims were made, representing more than 1m employees. Of these, over 6,500 claims received call back referrals and at the date of writing, the first employer claimants have started to receive payment of the CJRS grant monies.

Recap on the scheme

As a reminder, under CJRS:

- Employers are able to apply to HMRC for a grant to cover part of the wage costs of employees that have been placed into “furlough” (employees that have been given a leave of absence for reasons associated with the Coronavirus pandemic);
- The grant is the lower of 80% of the employee’s regular wage in their salary reference period or £2,500 per employee per month;
- The grant also includes the associated Employer NIC and minimum auto-enrolment pension contributions;
- Employers can top up the remaining 20% earnings if they choose, but there is no obligation to do so. They must, however, ensure that they pay the subsidised wages to the furloughed employee;
- The furlough period must be for a minimum of 21 consecutive calendar days and during this period the employee cannot do any work for the employer;
- The scheme is available for any employer with a PAYE scheme that was created and started on or before 19 March 2020, has enrolled for PAYE online and has a UK bank account;
- To be eligible employees must be employed by the employer, paid during 2019/20 and included in a Full Payment Submission (“FPS”) on or before 19 March 2020 without a leavers flag;
- Leavers on or after 28 February and included on an FPS on or before this date, may also be eligible for the scheme if they are subsequently rehired and placed on furlough;
- The scheme is also extended to other individuals who are not employees but treated as such for tax purposes, including directors, agency workers and salaried members of LLPs.

Observations from the updated guidance

The updated guidance and Treasury Direction provides much welcomed clarity to employers about the operation of the scheme. Key questions such as the interaction between the scheme and TUPE transfers/payroll transfers and the interaction with annual holiday entitlement are now addressed in the guidance and there are a number of detailed examples on how to calculate the claim.

However, it is equally apparent that the scheme may be more complex than many organisations will have anticipated. There are also a number of cases where the Treasury Direction and HMRC guidance don’t mirror one another and clients will need to decide how to deal with these mismatches.

One example of an area of complexity is the definition of a fixed pay (formerly salaried) employee. This is significant because the value of the grant is set by reference to the regular wage the employee receives in a salary reference period which varies depending on whether the employee is a variable or fixed pay employee. Here, the definition in the is highly restrictive, drawing heavily on the National Minimum Wage definition of a salaried worker. It is likely that based on this definition, the majority of employees who receive a monthly salary will still be regarded as variable pay employees, though it should be noted that the guidance appears to take a more expansive interpretation.

Other areas of complexity include the interaction with periods on Statutory Sick Pay and unpaid leaves of absence, calculation of the reference salary for new starters during the reference period and those on statutory benefit leave and determination of the pay elements that count as regular wage.

COVID-19: Coronavirus Job Retention Scheme - Updated HMRC guidance (cont.)

Holiday leave

It has now been confirmed that employees can take holiday during furlough. Employees should receive 100% of their "normal rate of pay" for holiday, so employers may be required to top up their pay by the amount covered by the grant. Employers will need to decide their approach to requiring employees to take holiday or to changing holiday arrangements (subject to the minimum requirements of the Working Time Regulations).

If a furloughed employee usually works bank holidays the employer can agree that this is included in the grant payment. If bank holidays are usually taken as leave the employer is required to either top up the employee's pay, or give a day of holiday in lieu.

The revised guidance also says "During this unprecedented time, we are keeping the policy on holiday pay during furlough under review" and therefore should be monitored for any updates regularly.

What should organisations consider?
Making the decision whether to access the CJRS

Before applying for the scheme, organisations should understand the costs and benefits of accessing the CJRS grant versus any other options that may be available. This includes the reputational and stakeholder impact of making a claim. Once decisions have been made, these need to be communicated clearly with employees to implement the furlough agreement.

Agreeing to furlough employees

Employers must discuss the terms of furlough with their staff and make any changes to their employment contract by agreement. In some cases employers may need to seek legal advice on the process as the CJRS scheme does not infer an automatic right for an employer to furlough workers or reduce their pay without agreement. HMRC's position is that employers must confirm in writing to their employees that they have been furloughed saying "if this is done in a way that is consistent with employment law, that consent is valid for CJRS. There needs to be a written record, but the employee does not have to provide a written response". Employers must ensure their communications with employees meet this test as a minimum.

Making payments to employees

HMRC have provided detailed instructions regarding the calculation of pay and the subsequent grant claim. Given the need to ensure accuracy, these instructions should be considered carefully by employers when completing calculations. The latest guidance provides welcome clarity on a number of areas including how pay is to be apportioned across a number of scenarios. HMRC have emphasised that it is "the claimant's responsibility to ensure that the information provided in the application is accurate". Moreover, HMRC state expressly that "payments may be withheld or need to be repaid in full to HMRC if the claim is based on dishonest or inaccurate information or found to be fraudulent".

It is explicit in the latest guidance that the grant paid to an employer to cover an employee's subsidised pay must be paid to the worker and that no part of the grant should be netted off against fees or for the provision of employee benefits or a salary sacrifice scheme.

This guidance that was updated on 23 April 2020 can be found here.

Record keeping

The requirement to retain all records extends to records of calculations and the amount claimed for each furloughed employee and the period for which each employee is furloughed.

Next steps for insurers

Now that HMRC's online portal is up and running an application to receive a grant can be submitted for any employee that has been furloughed and meets the above criteria. It is important to ensure that there is a written record for any employee furloughed and any records of calculations are maintained. There are still some points that HMRC haven't commented on including the application of State Aid rules, which is anticipated to be received in the coming weeks.

More generally, employers should consider carefully:

- whether furloughing staff is the right strategy for your business or whether there are alternative ways of maintaining liquidity over the current crisis, having regard to cost, employee engagement and reputation (for example if claims handlers are busy, could staff from quieter areas be redeployed?),
- whether pay should be "topped up" during the furloughed period,
- who are you going to furlough, for how long and how can you implement the arrangements appropriately, both in meeting the requirement of the scheme and ensuring that the selection of staff for furlough and contract variation is lawful; and
- where redundancies were expected by employees, do you need to reassess and communicate quickly to reassure staff?

Please contact Sam Moore (07483 440171) or Karen Toora (07843 331224) for more information on the CJRS.

Cross border tax reliefs - an update on latest case law

In brief
ExxonMobil have lost at the First-Tier Tribunal in relation to an attempt to surrender a Danish subsidiary's pre 2006 losses to UK companies in the same group.
The UK group relief rules did not provide for EU/EEA losses to be utilised in the UK at the time. However, ExxonMobil argued that their claim was in line with the principle set forth in *Marks & Spencer (C-446/03)* - i.e. that losses can potentially be the subject of a cross border group relief claim provided that they are "definitive losses".
The Tribunal rejected the taxpayer's claim for several reasons and held that there were no "definitive losses". It indicated that for pre-2006 periods the time to determine whether a loss is definitive is at the time of the claim, and not at the end of the relevant accounting period (as is the case for post 2006 periods).

In detail
The recent case of *Esso Exploration and Production UK Limited et al v Commissioners for HMRC* [2020] UKFTT 0139 (TC) (the "Esso" case) has continued the long line of decisions in relation to cross-border group relief that began in 2005.

In *Marks & Spencer* the CJEU held that the UK's group relief rules in force at the time were contrary to the EU's Freedom of Establishment. This was on the basis that they precluded the UK resident parent from utilising losses of its subsidiary resident in another EU member state where the possibilities of utilising those losses in the non-UK resident subsidiary's state of residence had been exhausted.

As a result of this case and subsequent changes the UK made to the group relief rules in 2006, cross-border group relief from EU-related companies is now available in limited circumstances.

In the *Esso* case, the UK taxpayer companies wished to claim relief for trading losses incurred by a Danish tax resident group member. The group was US headed and the Danish company was part of a separate sub-group to the UK taxpayers. There was no common EU intermediate holding company between the UK and Danish companies.

The key point addressed by the Tribunal was whether the losses could be considered as final applying the principles set out in *Holmen* (CJEU C-608/17). That case concerned the losses of a subsidiary being claimed by a parent company, and the CJEU held that the losses were not definitive unless the intermediate parent company was resident in the same jurisdiction as the subsidiary. This was because to otherwise allow cross border loss relief would essentially give the taxpayer the choice of where to claim the relief (in the ultimate parent or in the intermediate parent), and this would not be consistent with the *Marks & Spencer* doctrine. In *Esso*, the Tribunal noted that the intermediate parent companies were not all resident in the same jurisdiction as the loss making Danish subsidiary, and therefore decided that the losses could not be definitive.

In addition to the issue above, the tribunal also considered:

- Whether there was an infringement of the EU freedom of establishment law**.** The Tribunal found that this was not the case. In particular, the UK had no taxing rights or other powers over either the Danish company or its parent. Therefore, it was not the case that UK legislation infringed their freedom of establishment and EU law was not directly engaged. The taxpayer had also claimed that EU law could be engaged indirectly by virtue of the non-discrimination article in the UK/US Double Tax Treaty. This was on the basis of an argument that the UK resident with its US ultimate parent was disadvantaged compared to where it instead had a UK parent. However, the tribunal found that there was no discrimination; and

- What factors can make a loss definitive. The tribunal found that Danish restrictions meaning that losses were time barred did not make them "definitive losses", and losses which could not be used following a business transfer by virtue of Danish rules were also not definitive. This leaves an interesting question open as to when exactly a loss is considered definitive.

The key message from the Court in this case is that cross-border losses cannot be claimed unless the intermediate parent company is in the same jurisdiction as the subsidiary. However, the case is also helpful for taxpayers with losses from pre-2006 periods who can make claims for losses which have become definitive since 2006. Therefore, if the loss making entity has losses that have since become definitive (e.g. due to the entity being liquidated) it may still be possible to claim for cross-border group relief. If you have claimed, or wish to consider claiming for cross-border group relief, please contact us if you wish to discuss the impact of the above case and other rulings on this topic.

Cross border tax reliefs - an update on latest case law

Next steps for insurers

Where insurers have made claims for historic cross border group relief claims, we recommend these are assessed in light of these most recent cases. The cases may also open an additional avenue for claims to be made for pre 2006 periods (e.g. where overseas subsidiaries have subsequently been liquidated) though the facts would need to be carefully assessed in each case. For post 2006 periods, insurers will need to assess the impact of the UK statutory rules which as noted above tend to be more restrictive on when a loss is considered final and therefore available for relief in the UK.

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