# Keeping Up with Tax for Insurance

October 2021

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# Introduction

Welcome to another edition of Keeping Up with Tax for Insurance. I have now been able to settle into a good routine of hybrid working, and it has been great to see a number of clients in person again.

I am delighted that we are able to host our Lloyd's tax training event on 21 October. This will be a hybrid event (we have offered the option of attending either in person or virtually) and we are very much looking forward to starting in person events again. This will be followed by a general Insurance Tax update event in early December, details to be confirmed.

In wider international news, on Friday 8 October, 136 countries of the Inclusive Framework on BEPS ("IF") endorsed the agreement on Pillar 1 and 2. We have produced a Tax Policy Alert which discusses the agreement in more detail, particularly the differences from the July 2021 Statement of the IF. The next important steps are the G20 Finance Ministers meeting on 13 October and the G20 Leaders meeting on 30 October where it is expected that the largest economies on the Globe will provide their final political endorsement of the agreement. However technical work will continue with probably more detailed rules on the Pillars being made public around the end of November.

Back in the UK, the Chancellor has announced that he will deliver the Autumn Budget and Spending Review for 2021 on 27 October 2021. We will be sure to provide our response soon after his announcements.

Since HMRC launched the Profit Diversion Compliance Facility ("PDCF") back in January 2019, HMRC have sent four tranches of 'nudge' letters to selected taxpayers, suggesting that they review their tax arrangements and consider registering for the Facility. HMRC have recently confirmed that they sent out a fifth tranche of 'nudge' letters for the PDCF before the end of September. Please do get in touch if you receive such a letter.

## Webcasts and podcasts

There have been a number of recent webcasts and podcasts which I thought worthwhile to bring to your attention:

- **Tax Readiness: Q3 financial reporting considerations - A** deep dive into relevant tax accounting matters and recent tax developments. Register here
- **Tax Readiness: Elevating Tax in a Hot Deal Market** - A timely discussion on the important role tax plays in the current deals environment including a discussion of opportunities for the tax department to add value as an integral part of the deal process. Register here.
- **Tap into Tax podcast** - Perspectives from our tax technical specialists and our professionals focusing on the evolving tax function for a holistic look at tax. PwC's Business Travelers and Commuters Survey: How global mobility is evolving

A number of previous webcasts are available for replay in our US tax reform hub here, including:

- **Tax Readiness: US tax legislation advances under budget reconciliation -** Watch the replay
- **Tax Readiness: ESG – Bringing your reporting and investment strategy to life -** Watch the replay.
- **Tax Readiness: Crypto Market Insights 2021 – Latest trends -** Watch the replay

In this month's edition, we have included the following articles:

- **Introduction of the Health and Social Care levy**
- **Modernising stamp taxes on shares: where do we stand and what happens next?**
- **UTT – Legislation and HMRC Guidance**
- **Employment tax – FS sector compliance checks and learnings from recent public sector IR35 settlements**
- **Test Claimants in the Franked Investment Income Group Litigation v HMRC [2021] UKSC 31**

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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Andy is PwC's Insurance Tax Market Leader and he specialises in cross border transactions, group restructuring and financing.

# Introduction of the Health and Social Care levy

On 7th September, as part of the Government's plan on health and social care reform, the Prime Minister announced an additional 1.25% National Insurance Contribution ('NIC') rate for both employees' and employer's NIC. The new rate will apply from April 2022, will be mirrored to Class 4 NIC for the self-employed and alongside an increase of 1.25% in the Dividend tax rate, is set to generate £12bn per annum.

The rise will be shown on individuals' payslips included within the 'standard' NIC rates for the 2022/23 tax year and then separated out as a 'Health and Social Care Levy' from the 2023/24 tax year following a system update by HMRC. Following this update, individuals who are in employment or self employment and above the state pension age will also be required to pay the newly termed 'Health and Social Care Levy'.

## Areas to consider

The Health and Social Care Levy Bill has already been introduced to Parliament and passed all stages in the House of Commons in a fast tracked process, and was debated in the House of Lords on 11 October.

Whilst, we are expecting much of the detail of the new Levy to be contained in statutory instruments to be made by HMRC at a later stage. There is much we already know from the Bill, including the following:

- The Bill both introduces a temporary rise of 1.25% to NIC rates for 2022/23 followed by the introduction of a standalone Health and Social Care Levy from 2023/24 which puts the rate rise on a permanent footing;
- The 1.25% increase applies to employees' and employer's Class 1 NIC (applicable to payments of employment income via the payroll), Class 1A NIC (applicable to most benefits in kind reportable on Forms P11D), Class 1B NIC (applicable to the PAYE Settlement Agreement) and Class 4 NIC (on profits from self employment);
- The rate rise also applies to both the main percentage and additional percentage (i.e. the 2% contribution for income above the Upper Earnings Limit/Upper Profits Limit is increased to 3.25% as well as the main rates of 12% – for employee's Class 1 NIC – and 9% for Class 4 NIC – increasing to 13.25% and 10.25% respectively);
- Where reliefs apply meaning that the relevant employer rate is 0% (such as for certain apprentices under 25 years and veterans) that relief will also apply to the Levy;
- The new Levy is to be introduced as a **tax** (rather than a social security contribution) imposed on persons who are liable to NIC, or who would be so chargeable but for attaining State Pension Age, and leans heavily on the social security legislation. We think one of the key consequences of this is that for internationally mobile individuals, the liability to the Health and Social Care Levy should only be imposed on both the employee and the employer, if the employee is within the scope of UK NIC as the liability for the Levy is effectively 'tagged' to the liability to NIC. However, this is a point that we are looking to confirm with HMRC;
- The Bill applies provisions in National Insurance law to the Levy but also contains enabling provisions for HMRC to make amendments in their application. There are a number of areas where would expect HMRC to introduce statutory instruments under this provision particularly concerning the administration and enforcement of the Levy where there is some variation between NIC and taxes or omissions in the underlying NIC rules;
- It is not clear as of yet whether the Government intends to allow the transfer of the Health and Social Care Levy to employees in the same circumstances in which a NIC election would currently be possible. Again, this is a point we are intending to discuss with HMRC; and
- Finally, the Bill in its current form does not contain any anti-forestalling provisions.

## Next steps for Insurers

Insurers may wish to consider the following questions:

- Do you understand the cost implications of the Health and Social Care Levy on your organisation? This should include both the direct (payroll) costs and the costs of potential price increases from your labour supply chain where contracts enable the costs to be passed up the chain.
- In circumstances where reward packages may be being revisited in light of the shift to home or hybrid working, is the Health and Social Care Levy being factored into the costing and decision making process?
- Does the introduction of the Health and Social Care Levy increase the attractiveness of forms of remuneration where there is no employment income tax or NIC for your organisation? Examples include, but are not limited to, salary sacrifice for contributions to registered pension schemes, salary sacrifice for Ultra Low Emission Vehicles (e.g. electric cars), tax advantaged share schemes or growth/hurdle shares.
- Have you reviewed where changes may need to be made to company documentation or policies? For example, will changes need to be made to Flexible Benefits employee communications and should the additional savings on pension salary sacrifice be shared with employees?
- Given the increased costs of employment, is it worth taking a closer look at the Apprenticeship Levy and whether some of the funds can be more readily accessed to support the acquisition of new skills and capabilities in the organisation?
- Has the impact of the Levy been communicated to all those in the organisation for whom this is a factor in decision making? For example, do Employee Relations staff understand the impact on termination negotiations – particularly those close to the end of the tax year?
- Are there any ongoing disclosures/settlements with HMRC which include 'voluntary restitution' items that may be more beneficial to conclude before the end of the tax year?

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The new Levy is to be introduced as a tax (rather than a social security contribution) imposed on persons who are liable to NIC

# Modernising stamp taxes on shares: where do we stand and what happens next?

As part of 'Legislation Day' on 20 July 2021, HMRC released the outcome of a Call for Evidence on modernising the UK stamp tax regime that applies to share transactions. In this article, we set out the main areas of interest for asset and wealth managers in the responses received and the next steps in the reform process.

## A brief recap

Reform of the UK's stamp tax regime for taxing share transactions has long been called for. The current regime of parallel stamp tax systems (i.e. Stamp Duty and Stamp Duty Reserve Tax – SDRT), with differing rules and exemptions, and featuring a combination of paper-based and electronic claims and reporting, has long been seen as in need of modernisation. This view was supported by the conclusions of a report released by the Office For Tax Simplification in 2017.

Following a 2018 consultation into reform of specific aspects of the regime, the government acknowledged that narrow changes to the regime could, in isolation, have negative impacts on certain sectors. For this reason a Call for Evidence was launched by the government in 2020 asking more fundamental questions about a new framework for stamp taxes on shares. The outcome of this Call for Evidence was released on 20 July 2021.

## The responses

There are three main areas covered by the responses that are likely to be relevant to asset and wealth managers.

**Creation of a single UK stamp tax for shares –** There was broad support for replacing the current dual systems with a single stamp tax on shares. This would be a fundamental change to the way the regime has operated for the past 35 years. Whilst conceptually logical, this would give rise to a number of questions.

In particular, a number of relief and exemptions (such as intra-group relief) exist only in the Stamp Duty code and not the SDRT code. For asset management groups in particular, the ability to execute a 'letter of direction' in appropriate circumstances to cancel the SDRT charge that would otherwise arise on fund transitions and mergers would need to be replicated in some form if such transactions are to remain non-taxable.

1

**A new payment and reporting mechanism –** The majority of respondents took the view that the legacy, paper-based reporting and collection mechanism for Stamp Duty needed to be modernised. A digital, self-assessed model for reporting and payment of the tax was the strong recommendation from the responses, with a clear message that the current model for collecting and reporting dematerialised transactions through the UK's settlement system (CREST) should not be disturbed.

For asset and wealth managers, the vast majority of portfolio trading and investing in the UK market is performed through CREST, with stamp tax obligations dealt with by the banks or brokers involved. Given the effectiveness and efficiency of this model we can expect this to continue, but we need to see how the payment and reporting model for other transaction types evolves to understand whether obligations may fall on asset and wealth managers (and indeed whether a reformed payment and reporting process could impose any other obligations in such groups).

2

**Removal of physical stamping of documents –** Another key theme from the responses was that the requirement to obtain physical stamping of documents from HMRC was outdated. This had already been addressed by HMRC – in June it was confirmed that the 'temporary' process introduced in the context of COVID-19, allowing electronic submission of documents and confirmation from HMRC by letter rather than by affixing a physical stamp to the document, will become permanent.

This means that where asset and wealth management groups are seeking HMRC adjudication of transfer documents (for example, in the case of group reorganisations requiring a group relief claim), such groups should familiarise themselves with these new procedures and ensure these are followed to ensure efficiency and compliance.

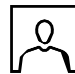
3

## What happens next?

Following the responses received, the government intends to the following:

- Further explore the feasibility and implications of the priority areas identified by the respondents to the Call for Evidence, including evaluating the benefits and risks involved with reform.
- Establish a Working Group to inform the development of policy proposals and frame future consultation documents.

The government recognises that major reform of the UK's stamp taxes regime will be a significant undertaking. For this reason we can expect that it will be some time before further changes are decided upon and, ultimately, implemented.



## Next steps for Insurers

As noted above, there will likely be some time before we see any further reform of the current regime. The government's response to the Call for Evidence signals that any major changes to the UK's stamp taxes regime will be very carefully considered and will be consulted upon. For this reason, to some extent this is an area for asset and wealth managers to maintain a watching brief. We will revisit this topic in future articles as more clarity on potential changes emerges during the consultation process.

That said, given the changes to physical stamping noted above asset and wealth management groups seeking HMRC adjudication of transfer documents should familiarise themselves with the new procedures to ensure these are followed.

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# UTT – Legislation and HMRC Guidance

## In brief

Over the summer HMRC draft legislation and guidance on the Uncertain Tax Treatment ('UTT') rules which include some significant changes to the previous two rounds of consultation was published. These rules now mean that from April 2022, large businesses (corporates, partnerships and UK branches of overseas entities) will be required to send a specific notification to HMRC if their tax return contains an Uncertain Tax Treatment ('UTT'). HMRC see the measures as a tool to help close the legal interpretation tax gap created where HMRC and a taxpayer take a different view of what the law means, a gap estimated to be £5.8bn during the 2019/2020 tax year. It will also effectively provide HMRC with an early warning system that is expected to see HMRC enquire into more tax returns and filed positions in a more targeted way. This article sets out some observations in respect of key issues and challenges as well as actions groups should be taking now to prepare for complying with these rules.

## In detail

**Key points reflected in the draft legislation and guidance**

The main points to be clarified covered:

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| **Date of enactment** | This is now expected to be 1st of April 2022; |
| **Reporting triggers** | These have now been reduced from 7 to 3 (more on this below); |
| **Taxes in scope** | These have been reduced to cover Corporation Tax, VAT, and Income Tax (PAYE and NICs); |
| **Reporting threshold** | This has been confirmed at £5m, which it is important to note represents a relative amount being the difference between the uncertain amount representing the position taken and the alternative position that could have been taken; |
| **Exemptions** | Exemptions from reporting, both general and specific, have been clarified; |
| **Notification process** | Clarification has been provided in respect of how the notification process will work as well as the information that needs to be reported; and |
| **Penalties** | The position regarding penalties has been confirmed in that failure to provide a notification where required will result in a penalty of £5,000, increasing to £25,000 for a second failure in respect of a relevant tax and to £50,000 for a third failure in a three year period from when the first penalty arose. |

We now look at some specific aspects of the draft legislation and guidance in more detail.

## Reporting criteria/triggers

**There are now only three triggers in respect of identifying a UTT but some challenges remain:**

### Trigger 1

**Tax Provisions: if a provision has been recognised in the accounts to reflect the probability that a different tax treatment will be applied to the transaction.**

It has been clarified that provisions that are raised that are not 'in accordance with GAAP' are not notifiable per this trigger but may be under trigger 3. A key point to consider is that this trigger may result in a greater number of instances of reports being made than HMRC envisages (especially as the carve-out for transfer pricing cases does not apply to this trigger – see below). The guidance does not comment on provisions held centrally, i.e. in an entity other than the reporting company/ partnership nor does it provide clarification as to whether provisions in respect of deferred tax need to be reported. The latter are more driven by tax versus accounting differences rather than uncertainty in respect of the application of tax law.
A final point to consider is that the introduction of the UTT rules is likely to result in close internal scrutiny of tax related provisions as well as an increased level of review from external auditors.

### Trigger 2

**HMRC's known position: if the tax treatment applied relies on an interpretation or application of the law that is not in accordance with the way it is known that HMRC would apply or interpret the law.**

Clarification is provided as to what the sources of 'HMRC's known position' that can be relied upon are and include HMRC manuals, statements of practice, public notices, publications which set out HMRC's view of tax compliance risk in relation to certain transactions, Revenue and Customs Briefs as well as correspondence between taxpayers and HMRC in respect of transactions covering statutory and non statutory clearances and advice provided by HMRC on specific transactions (e.g. discussions with an HMRC CCM or Tax Specialist). More challenging though are the instances where HMRC state that where a tribunal or court decision is contrary to HMRC's known position but where it intends to appeal, that the position taken by HMRC remains its known position. This potentially creates the need for taxpayers to monitor cases and ascertain HMRC's intention in terms of launching appeals. Another complication arises when there may be a contradiction between 'published guidance' and a taxpayer's 'dealings with HMRC'. Finally, a belief that HMRC's guidance is wrong will not mean that notification is not required.

### Trigger 3

**Substantial possibility: if a tribunal or court were to consider the tax treatment applied, there is a substantial possibility that the treatment would be found to be incorrect in one or more material respects.**

The purpose of this trigger is to catch the transactions HMRC are least likely to know about. The guidance provides some factors that would indicate this test has been met but it remains very subjective. The concept is explained in terms of factors external to a court (for example, the fact that different advisors have wrecommended different tax treatments, or the outcome of the business' own risk management processes) which are not related to a court's decision making process. Further guidance to provide more clarification on the application of the trigger would be useful e.g. examples of previous cases where HMRC believes that this criterion would or would not have been met.

## Exemptions from reporting

The following outlines the current exemptions – general and specific:

### General exemptions

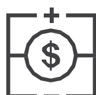
- Anything disclosable under a different legislative requirement (e.g. Banking Code of Practice ('The Code'), DOTAS, EUMDR, VADR, DASVOIT) will not need to be notified.
- If HMRC is already aware of the uncertainty, and how the business plans to treat it for tax purposes, the business will not need to notify, unless the tax treatment is contrary to that which HMRC's may have recommended.

  It will be very important in situations where a taxpayer will seek to rely on this exemption in any reporting or discussions with HMRC in respect of a potential reportable transaction to ensure that the discussion or notification includes all the information that would otherwise be provided via a UTT notification. It should be made clear in such discussions that they are to otherwise satisfy the requirement to notify under the UTT rules and that the conclusion is documented. HMRC reiterates this point in the guidance.

### Specific exemptions

The key specific exemption relates to transfer pricing. This exemption only applies in relation to trigger 3 and where the uncertainty is in respect of the choice or application of a transfer pricing method. If trigger 1 or 2 is met then reporting is required. This exemption is therefore much more narrowly defined than originally expected and could give rise to a large number of disclosures being made in respect of transfer pricing provisions, especially given such provisions are common reflecting the inherent subjectivity of transfer pricing.

### Other specific exemptions include:



- **Certain group transactions:** Uncertain amounts of Corporation Tax, where the overall tax advantage (taking into account the group position) is below the £5m threshold;
- **Profits attributable to non-UK resident companies:** The requirement to notify for uncertain amounts representing profits that are attributable to UK PE's of non-UK resident companies, but only in relation to trigger 3. If trigger 1 or 2 is met then reporting is required; and
- **Collective investment schemes ('CISs')** and partnerships established as CISs are exempt.

The business will not need to notify, unless the tax treatment is contrary to that which HMRC's may have recommended.

## Application of the threshold test

The threshold remains at £5m and needs to be tested against the three triggers.

Guidance is given as to what constitutes a tax advantage as well as the 'expected' amount with some examples across the different heads of tax. It is the delta between the tax advantage and the expected amount that represents the threshold to be assessed. It is important to note that an assessment has to be made against all three reporting criteria/ triggers as the expected amount can differ across the three and they do overlap.

Another area which is elaborated on in the guidance is the aggregation of related transactions. When assessing if the threshold test is met, amounts which are related to the uncertain amount must be aggregated for the purposes of the test. The primary aim of this aggregating guidance is to ensure that qualifying businesses involved in high volumes of low value, but related, transactions fall within the scope of the UTT rules. There remains uncertainty in respect to the definition of related amounts or transactions.

The guidance remains unclear in respect of VAT and whether the threshold that should be looked at is the gross or net amount of tax. This will be of interest to businesses as, if HMRC pursue a gross amount of tax approach, this threshold may be breached more easily in relation to VAT – particularly when the need to aggregate related transactions is also taken into account.

## Penalties and reasonable excuse

A penalty will not be levied where there was a failure to report if there was a reasonable excuse for not doing so and the failure is put right without unreasonable delay. The guidance states that there is no statutory definition of reasonable excuse and that it will need to be considered in light of all the circumstances of a particular case.

The following are explicitly stated as not representing a reasonable excuse: pressure or work, lack of information or reminders from HMRC, ignorance of basic law, insufficiency of funds or reliance on another person.

Though not explicitly stated in the guidance, taxpayers should ensure that they can demonstrate that they have taken reasonable care in dealing with these rules in that they have appropriate governance in place such that potentially reportable items can be identified and assessed, procedures are in place to capture and report transactions where required and appropriate protocols are in place for communicating with HMRC.

HMRC states that it does not expect it is necessary that legal advice should be obtained in order to comply with the UTT regime but expects a level of governance proportionate to the tax risk and level of uncertainty to be in place.

## The Takeaway

The UTT rules are just one of a growing number of regimes that are now in place. Collectively these highlight the need for taxpayers in particular to have appropriate processes in place that address the identification, assessment and escalation of key tax risks internally and in certain cases disclosure and discussion with tax authorities.

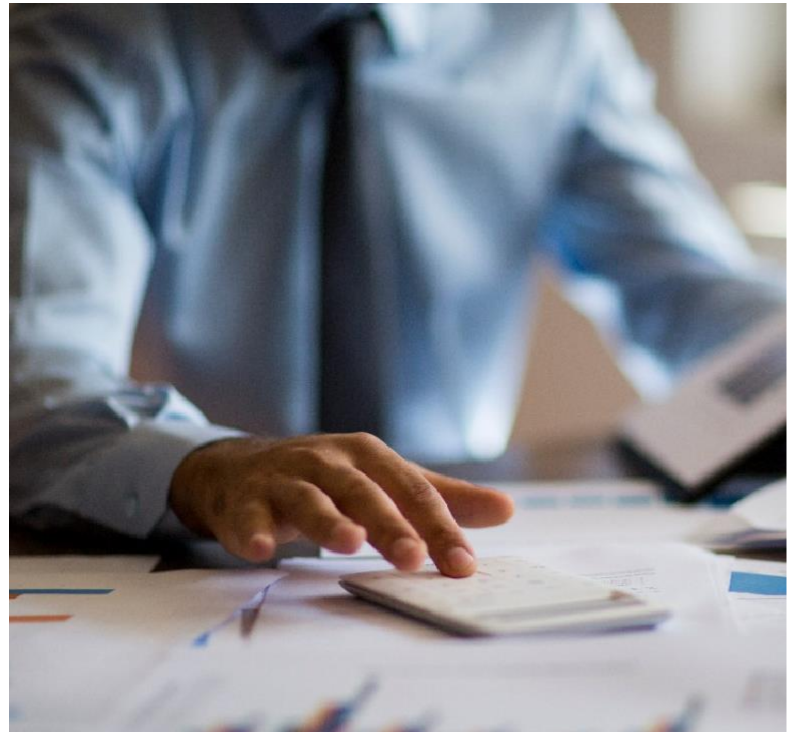
Key steps taxpayers should be taking at this point, especially given these rules will impact returns being prepared in respect of 2021, include:

1. Revisit recent transactions, consider planned transactions and assess prior year transactions that continue to impact the current year to identify whether any of the three triggers could apply;

2. If reporting is envisaged then prepare for HMRC enquiry by examining whether existing documentation is sufficient to support the planned tax treatment or whether the evidence file or documentation can be enhanced with additional supporting facts and evidence;

3. Include the new obligation to notify into existing compliance processes e.g. update the Senior Accounting Officer framework to make this obligation an additional areas to be considered alongside the CT, IT (including PAYE) and VAT return preparation and signed off by an appropriately experienced senior member of the compliance team; and

4. Review current approach to tax provisioning and related provisions in anticipation of the new rules.



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# Complying with employment tax requirements

## FS sector compliance checks and learnings from recent public sector IR35 settlements

### In Brief

HMRC have recently started to undertake checks of IR35 compliance focused on the Financial Services ('FS') sector. FS is specifically being targeted (alongside Oil and Gas) as HMRC are of the view that there is a higher proportion of the workforce in Financial Services which is paid off-payroll compared to other industries. We do not believe that they have identified specific risks inherent in the approach taken by the industry.

Unusually, we have been told that some of these checks will be carried out in relation to the current tax year and so businesses in the sector may be approached before the end of 2021/22 for a partial year review.

The intervention is being described as being part of HMRC's programme of support around the IR35 changes with the approach following that described in their briefing 'Supporting organisations to comply with changes to the off payroll working rules (IR35)'.

Under this compliance check, HMRC have stated that they will work with organisations to test whether their systems and processes are 'suitable' and will work with businesses to make corrections where appropriate. In the event that a tax or NIC liability arises, HMRC have stated that they may impose a penalty, although have reiterated their previous commitment that no penalties will be due for IR35 errors in 2021/22 unless there is evidence of deliberate non-compliance.

With these compliance checks now underway, this article considers what learnings can be taken for Financial Services institutions from the public sector, who were subject to IR35 reform four years ahead of the private sector, and where there have been some sizeable settlements with HMRC (including one with a department of central government for £88m).

### In Detail

For FS institutions who are only 6 months into the new IR35 regime, some comfort may have been taken from HMRC's published statements that they intend to 'take a light touch approach to penalties' and that 'customers will not have to pay penalties for inaccuracies for the first 12 months unless there is evidence of deliberate non-compliance'.

The recent public sector activity by HMRC into IR35, however, reminds us that this commitment only relates to the penalty position and HMRC will likely pursue and seek settlements in relation to any underlying PAYE and NIC liabilities relating to IR35. Furthermore, if the errors stem from a system or control deficiency, the commitment around penalties in year one may be of little value if the same errors are consequently delivered in years two and beyond.

Another area that has gained attention in relation to these public sector settlements with HMRC is the use by some public sector bodies of HMRC's Check Employment Status for Tax ('CEST') tool. Our experience is that for those FS institutions which continue to allow Personal Service Companies ('PSCs') or similar in their supply chain, CEST is by far the most popular assessment platform, on the basis that HMRC will 'stand by the result provided the information is accurate and it is used in accordance with their guidance'. A question may therefore be asked as to whether the CEST tool has any value for FS institutions in risk mitigation if users of the platform have still had to enter into substantial settlements.

In this regard, it should first be noted that CEST, and any other assessment platform, can only ever be an approximation of the law. Employment status case law itself does not impose a scoring system or a decision tree as the technology may demand, but rather requires a qualitative assessment of facts based on the details of the particular case. As a result, there may be some cases (e.g. high value or business critical contractors) where a professional opinion grounded in the case law may be justified.

For other populations, where organisations are prepared to lean on HMRC's interpretation of the case law, use of CEST may still be worthwhile. However, its use cannot be divorced from the need to gather and interpret the facts correctly and input the data into CEST following HMRC's guidance. An example, which has manifested itself in some of the public sector cases is the significance of 'substitution' clauses which may be present in contracts between the PSC and agency but not between the agency and end user or where there are substantially similar populations which do not have the same clause.

For those FS institutions who have prohibited PSCs, the learnings from the public sector approach can be more carefully targeted towards exceptions to the general policy. In this regard, it is worth noting that HMRC in their August Employer Bulletin raised concerns around contrived arrangements designed to avoid IR35 or engagements that would, in substance, fall within IR35 being mislabelled 'Statements of Work' or 'Managed Services'.

Additionally, the growth of umbrella companies as an alternative to PSCs have become an increasing area of focus both for HMRC and Parliamentarians as evidence has begun to emerge of sub-sections of that market engaging in conduct which results in the exploitation of workers or avoidance of tax.

Indeed, a few months ago, HMRC discovered evidence of large scale mini-umbrella company fraud in the supply chains of some listed companies, where more than 40,000 companies were set up with a view towards exploiting the employment allowance and VAT flat rate scheme.

HMRC have already laid out their expectations of the level of due diligence required of end users to secure their labour supply chains and we expect this responsibility to grow as regulation of umbrella companies is taken on by a new Single Enforcement Body.

## The Takeaway

The evidence from the public sector IR35 settlements is that it is reasonable for FS institutions to expect HMRC to take a robust approach to testing the adequacy of IR35 related processes and controls. This approach is likely to be in point whether businesses use CEST or some other status assessment platform.

In addition, our experience is that the growing awareness of non-compliance and exploitative practices amongst certain umbrella companies has led to end user FS institutions looking at the proactive steps they can take to drive the right conduct in their supply chain in order to manage their risks and meet their ESG obligations. Many of these steps are shared with the expectations of HMRC and other public stakeholders.

Given the above, now is the optimal time to:

1. Review whether your contingent workforce policy and processes are adequate to prevent risk of later HMRC discovery;
2. Ensure that your agreements with your counterparties adequately detail each party's responsibilities under IR35 and other disguised employment anti-avoidance, addresses supplier conduct and gives you the appropriate rights of redress and audit; and
3. Update your tax governance processes and documentation to ensure compliance with regimes such as CCO and SAO where relevant.

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# Test Claimants in the Franked Investment Income Group Litigation v HMRC [2021] UKSC 31

The Supreme Court gave judgment on 23 July 2021, for the third time, in the never-ending **Franked Investment Income** ('FII') group litigation, commenced in 2003. This concerns the incompatibility with Articles 49 and 63 TFEU, of the UK's imputation system of taxation of UK-resident companies on their foreign dividends received prior to 1 July 2009 (as contrasted with the blanket exemption of domestic dividends), and the remedies for that incompatibility.

The **FII** Group Litigation Order ('GLO') is one of three High Court GLOs regarding the UK's pre-July 2009 dividend taxation regime's incompatibility with EU law; it concerns the taxation of foreign dividends from participations conferring at least 10% of the voting power ('non-portfolio' holdings), and the main test claimant is the British and American Tobacco plc group. The other two current GLOs relating to corporate dividend taxation are:

a. the **CFC and Dividend GLO** (concerning foreign dividends from 'portfolio' holdings, where the UK company holds less than 10% of the voting power), in which the test claimant is the Prudential Assurance group; and

b. the **Foreign Income Dividends GLO** (concerning the 'FIDs' regime introduced in 1994).

Between them, these issues have now been the subject of well over a dozen Tax Tribunal and High Court decisions, several Court of Appeal judgments, four UK Supreme Court judgments and three judgments of the CJEU on preliminary references (Case C-446/04 **FII** of 12 December 2006, C-35/11 **FII** of 13 November 2012, and C-362/12 **FII** of 12 December 2013). Moreover, those numbers do not even include the earlier **ACT Group Litigation**, which itself spawned multiple judgments at all levels up to and including the House of Lords (the Supreme Court's predecessor court) and the CJEU (Cases C-397/98 and C-410/98 **Metallgesellschaft Ltd v IRC** and **Hoechst AG v IRC** of 8 March 2001). Each UK judgment typically runs to up to 100 pages – sometimes more.

The volume of litigation is explained first by the fact that the amounts of tax at stake are huge – thought to run to £tens of billions going all the way back to 1973 – and second by the fact that the entire UK system of taxation of UK companies' foreign dividends pre-July 2009 is under challenge.

The latest instalment from the Supreme Court (a mere 76 pages) holds, inter alia:

- in favour of HMRC, that where advance corporation tax ('ACT'), levied contrary to EU law, was offset against mainstream corporation tax, requiring reimbursement on grounds of 'premature levy' (see Case C-397/98 **Metallgesellschaft**, para 88), the prematurity falls to be compensated only on a 'simple' basis of interest, not a 'compound' basis;
- in favour of the claimants, that where, under UK law, surplus management expenses were mandatorily offset against foreign dividends on which EU law would otherwise have required double tax relief credits ('DTR credits') to be granted for foreign tax, and UK law did not permit the DTR credits to be carried forward (with the result that they would be wasted), as contrasted with the treatment of UK dividends which were simply exempt, this contravened Arts.49 and 63 TFEU for the reason in Case C-436/08 **Haribo** at paras 157-159. In these circumstances the remedy required by EU law is:
  i. the reimbursement (on the basis of Case 199/82 **San Giorgio**) of tax actually paid in later years as a result of the inability to carry forward the unused DTR credits; and
  ii. to the extent that the inability to carry forward the unused DTR credits did not result in actual payment of tax, the unused DTR credits must be regarded as remaining available;

- in favour of the claimants, that the shareholder credits available to individual shareholders on payment to them of dividends did **not** fall to be set off against, so as to reduce, the amount of unlawfully charged ACT falling to be reimbursed by HMRC;
- in favour of the claimants, that the partial credit available to a US corporate shareholder under the UK/US Treaty, on payment to it of dividends by the UK company sourced from foreign dividends, did **not** fall to be set off against, so as to reduce, the amount of unlawfully charged ACT falling to be reimbursed by HMRC; and
- in favour of the claimants, that in relation to third country 'non-portfolio' (>10% participation) dividends paid after 30 March 2001, when the UK DTR rules were very significantly amended, the Art.64 TFEU 'standstill' defence (for restrictions existing on 31 December 1993 in respect of movements of capital involving 'direct investment') ceased to apply. Applying Case C-302/97 **Konle v Austria**, paras 52-53, and Case C-446/04 **FII**, paras 190-192 and 196, the standstill could only apply if the legislation had remained unchanged or had been amended to reduce the restrictions. Here, there had been material changes which did not reduce the restrictions. On the contrary, they could result in a significantly increased tax burden.

Unfortunately, this is still not the end of the litigation regarding the UK's pre-July 2009 dividend taxation's incompatibility with EU law. In its previous judgment in November 2020, the Supreme Court remitted to the High Court certain important issues regarding the statute of limitations; these are still to be heard. And in June 2021, a number of important outstanding issues were heard by the First-tier Tribunal, on which the Tribunal's decision is awaited; doubtless, these issues will be appealed through the various levels of appeal, so it is likely that this litigation will in due course pass the 20-year mark before it is finally resolved.

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