Analysis

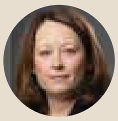
What to expect in tax in 2023

Speed read

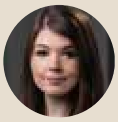
After the turbulence of 2022, the prospects of a quiet year ahead appear limited. The government may not want to impose the rigidity of a roadmap on itself but calls to understand the direction of travel and how to ensure greater stability and certainty in the tax system will continue to grow. In the meantime, large corporates will be busy with the advent of the global minimum tax and in particular navigating different timetables and potentially different rules. Corporates and individuals will be interested to understand the government's policy direction in light of the emerging trend of remote working. Stretched public finances and increased dedicated resources means there is unlikely to be any let up in the attention taxpayers receive from HMRC.

Another bumpy year?

Expect the government to remain in revenue raising mode.



Rhiannon Kinghall Were
Macfarlanes
Rhiannon Kinghall Were is the head of tax policy at Macfarlanes LLP. She was previously the principal tax policy adviser at the CBI, where she was responsible for leading the policy development of domestic tax issues affecting businesses operating in the UK. Email: rhiannon.kinghallwere@macfarlanes.com; tel: 020 7791 4131.



Lucy Urwin
Macfarlanes
Lucy Urwin is a solicitor in corporate tax at Macfarlanes LLP. She advises clients on a wide range of domestic and international tax issues, and she has a particular interest in tax policy and its development. Email: lucy.urwin@macfarlanes.com; tel: 020 7849 2749.

After a year so turbulent that 'permacrisis' was declared the word of the year, many will wish the coming one is far quieter. Dealing with the consequences of Russia's invasion of Ukraine, the aftermath of Brexit, Covid, and the recent political upheaval has only heightened the case for providing greater certainty to businesses and investors.

The last 12 months have been the antithesis of stability with four chancellors, three prime ministers, two fiscal statements, and one (never to be repeated) 'mini-Budget'. In the chancellor's 2022 Autumn Statement, not only was 'stability' mentioned ten times it was officially set as a priority ahead of growth and public services. While there are calls for more stability and certainty every year, this year it feels more pertinent than ever.

Keeping up with the boomerang nature of policy making over the last year has been a challenge for anyone working in tax. The Health and Social Care Levy was repealed before it even came into effect. The rate of corporation tax will rise to 25% in April as originally planned, but only after a momentary flirtation of retaining the lower rate of 19%. The off-payroll worker rules remain on statute despite the short-lived prospect of a reprieve. The unhinged nature of tax policy making has eroded confidence in the UK as a place to do business.

Making sense of the past year

Beyond 'turbulence', it is hard to discern a particular direction of travel in tax policy over the last year (other than perhaps a newfound reliance on fiscal drag). However, looking back in the round one discernible theme of 2022 was the number of well-publicised tax measures introduced in direct response to specific, identifiable real-world events. While revenue shortfalls as a driver of tax policymaking is nothing new, the extent to which measures have been introduced with the express aim of combatting the costs of specific social or economic problems is noteworthy.

It is true that the funds raised from these measures were not formally segregated in the manner of a fully hypothecated tax (i.e. where revenues raised are legally 'earmarked' for a particular purpose, as the Health and Social Care Levy would have been). However there has been a clear trend of at least 'political' hypothecation, with the policy rationale behind a given measure being the need to plug a funding hole that has arisen as result of a particular crisis or event.

A good example is the residential property developer tax (RPDT), sometimes referred to colloquially as the 'cladding tax', which came into force in April 2022. The anticipated £2bn of revenue is specifically intended to help the government recoup at least some of the funds it committed in resolving the various cladding and fire safety issues that came to light as a result of the 2017 Grenfell Tower tragedy. Although not a legally hypothecated fund, the design and underlying rationale of the tax was nonetheless clearly aimed at meeting the costs of addressing this pressing and specific socioeconomic need and may offer the playbook for more taxes in the pipeline (for example, a new building safety levy is under consultation to raise funds to pay for remediation of certain other building defects).

Another example of a politically hypothecated fund is the so-called 'windfall tax' on energy companies. Introduced as the 'energy profits levy' by Rishi Sunak in May 2022, this was expanded by Jeremy Hunt in the Autumn Statement both through a rate rise of 25% to 35% and an expiry date of March 2028 rather than the end of 2025. The net was also widened to electricity generators with a new levy under construction for a temporary 45% tax on their extraordinary returns. Crucially, the introduction of both these temporary levies was prompted specifically by the need to fund the package of measures required to support UK households through a surge in cost of living caused by a multitude of factors, including the war in Ukraine.

An interesting (and perhaps unexpected) second theme that comes through clearly in these well-publicised measures is 'fairness'. For example, the government was clear in stating that the 4% RPDT represents a 'fair contribution' from large developers (although it was in no way intended as a punitive measure or implication of 'responsibility'). This was on the basis that they will benefit from operating in a market improved by the remediation of the relevant defects.

Similarly, the policy rationale behind the windfall tax was to ensure oil and gas companies benefitting from the prolonged period of increased prices 'continue to pay their fair share of tax' in a year in which UK wholesale gas prices reached record highs.

These are apparent symptoms of a business and political environment in which there is increasing pressure to demonstrate corporates do not operate in isolation but contribute equitably to society and acknowledge their obligations to other participants. This was underscored by an explosion in the private sector of conversations and reflections around 'ESG' (environmental, social and governance) issues, from which tax was not immune. 2022 saw the publication of yet more guidance around what good tax behaviour looks like, including the milestone European Business Tax Forum's publication: *Best Practices for Good Tax Governance*. The continued UK (and broader) momentum to implement the global minimum tax under Pillar Two of the OECD BEPS 2.0 initiative also sits comfortably in this context.

Do omissions point the way to future reform?

With themes of ESG and fairness having taken on renewed prominence, it is perhaps surprising that significant new environmental tax measures were notable in 2022 only by their absence. It is true that this was the year when the UK's plastic packaging tax came into force, but this does little to directly mitigate behaviours that continue to foment global warming and is arguably 'small fry' in the broader context of what needs to be done. If anything, any environmental tax announcements last year appeared to take a step backwards: Liz Truss attempted to scrap various green levies on energy bills and Jeremy Hunt announced in the Autumn Statement that electric vehicles would no longer be exempt from excise duty (road tax) from 2025 which is thought may slow the transition towards greener cars. Perhaps the conclusions of the review into net zero anticipated early this year will finally set this agenda on its rightful course?

When public finances are stretched, policy makers may increasingly look at ways to provide more certainty by codifying certain practices

There were other notable omissions too: there has been, for example, no serious proposition for a (politically or otherwise) hypothecated tax in response to the record expenditure on furlough and other business support during the Covid pandemic. Other tax-based responses to Covid were also notable by their omission. The legacy of flexible and remote working practices left by the pandemic has not been matched by any notable concessions or amendments to employment taxation that may save businesses and employees alike some sleepless nights caused by the tax implications of those practices. 2023 might offer some clarification in light of the OTS's review of hybrid and distance working and the OECD may also be tempted to examine the cross-border tax issues that arise from these arrangements.

Looking ahead

What will 2023 deliver? Stability is much called for but an often undervalued component of a well-functioning tax system. However, with the rate of corporation tax set to be at its highest for over a decade (and coupled with a much broader base) some businesses may question whether now is really the time to refrain from further change. But stability does not equal stasis and calls for the former do not require an absolute moratorium on refinements to the fiscal environment. Rather, a stable tax system is one which is clearly principled and, to some extent, predictable. Change can be welcome, if it is anticipated.

This is an appropriate juncture to look back beyond 2022, to another notable time when re-establishing stability was top of the agenda. Published in the wake of the financial crisis, the 2010 Corporate Tax Roadmap was designed to get the UK economy on a path to growth when public finances were tight and at a time when concerns were raised about the lack of direction and frequency of change in the tax system (sound familiar?). Such concerns are arguably as applicable today as 12 years ago, and the document could just as well have been written last year as in 2010.

So, are we likely to see a roadmap? At this stage in the government's term, time is not on its side when it comes to implementing fundamental or structural changes in the tax system. However, there should nonetheless be capacity to set out a strategy and initiate a conversation about tackling the big issues on the horizon. This may mean we start to see work undertaken on how the tax system can tackle climate change and address the challenges presented by hybrid working, however given the multifaceted nature of these issues it is unlikely conclusions will be delivered in 2023. Taking the time to consider the full remit of these policy challenges will be important and plays into the wider debate around the quality of tax policy making. This was a substantial part of the 2010 roadmap to help ensure significant reforms were designed effectively and result in fewer changes further down the line.

This may not be enough to incentivise the government to commit to a roadmap, though. For one thing, a roadmap is not without risk in that it reduces a government's future flexibility (although not so far as restraining the government from taking action against avoidance or reacting to global events). A roadmap also requires an underlying plan, and in light of recent volatility this may still be work in progress. However, the government should not underestimate the value in being explicit about what it is not going to do – this is better than nothing.

Even if a roadmap is not forthcoming, there is much to watch out for in 2023. The state of public finances is likely to mean the government remains in revenue raising mode and therefore we can expect new taxes or levies to be introduced. Speaking of new taxes, momentum behind Pillar Two means we have now reached the critical mass of adopters needed for the rules to be effective, therefore businesses will need to shift into implementation mode to be ready for the UK's new multinational top-up tax (and other variants of the income inclusion rule) that will come into effect for accounting periods beginning on or after 31 December 2023. We can also expect consultation on the introduction of the undertaxed profit rule and qualified domestic minimum top-up tax, and more guidance from the OECD on other aspects of the rules.

In the short-term, giveaways are unlikely. The recent VAT consultation on the treatment of investment management fees has closed the door on zero-rating these fees; however, the government is looking to codify existing practice. When public finances are stretched, policy makers may increasingly look at ways to provide more certainty (for HMRC and taxpayers alike) by codifying certain practices. From a personal tax perspective, the government may find itself under political pressure to undertake a review of the non-dom regime after Jeremy Hunt committed the Treasury to undertake an analysis of the revenue associated with it. 2023 is unlikely to see any let up by HMRC. Extra funding for HMRC and the commitment for more dedicated resources allocated to specific taxpayers will mean tax investigations remain high on the agenda in the corporate and private client world.

On reflection, a year without change would be too much to ask for, and a quiet year might even be optimistic. ■

The political perspective

The government faces the trickiest of balancing acts.

David Gauke
Macfarlanes
David Gauke served as former Treasury minister from 2010 to 2017, including as Chief Secretary to the Treasury from July 2016. More recently, he was Secretary of State for Justice and Lord Chancellor from 2018 to 2019. He is now the head of public policy at Macfarlanes.

After a period of extraordinary tax policy volatility in the autumn of 2022 (when previously announced tax increases were abandoned and tax cuts announced followed in short order by most of the reversed tax increases being reinstated and the recently announced tax cuts abandoned), the government will be hoping for a period of calm in 2023.

Rishi Sunak and Jeremy Hunt came to office because of a loss of political and market confidence and Hunt's emergency statement of 17 October followed by his Autumn Statement of 17 November were designed to reassure the markets of the government's fiscal credibility whilst not overly antagonising Conservative MPs concerned about the rising tax burden.

It is a challenging balancing act. The government raised taxes (principally through fiscal drag but also a big windfall tax and a lower starting point for the additional rate of income tax) and had it done anything less, the markets may have been sceptical that the government could deliver sustainable public finances. Had the government done more on taxes (and less on spending), Conservative MPs would have become much more disgruntled.

> The excitement of September and October 2022 are unlikely to be repeated, but it would be unwise to assume that 2023 will be a quiet year for tax policy

All of this suggests that Sunak and Hunt would be reluctant to re-open big questions of tax policy when there is very little room for manoeuvre either way. The balance could, however, be disturbed by political and economic factors.

It would not take much of a projected slowdown in the economy for the government to be in breach of its already loosened fiscal rules. The government might also struggle to stick to its spending plans even in the near term (pressure on public sector pay, for example, is considerable). A combination of weaker growth (with lower tax receipts) and higher public spending would require taxes to rise if the fiscal rules are to be met.

If, however, the public finances prove to be stronger than expected the calls from Conservative MPs to lower the tax burden (or, at least, not increase it as much) will be voluble as a general election becomes imminent, especially if Labour maintains a strong lead in the opinion polls.

Talking of Labour, it is clear that the Opposition is going to keep up pressure on the taxation of resident non domiciles and carried interest. The government is obviously sceptical that Labour's reforms in these areas will raise large sums and fear that Labour's policies will damage UK competitiveness, but these can be uncomfortable arguments for the Conservatives. It is perfectly possible that the government will want to take action to neutralise Labour's arguments, possibly by setting out its own reforms.

The excitement of September and October 2022 are unlikely to be repeated, but it would be unwise to assume that 2023 will be a quiet year for tax policy. ■

Corporate and international perspective

Brexit and BEPS will continue to dominate the corporate agenda in 2023.

Ashley Greenbank
Macfarlanes
Ashley Greenbank is a partner in the tax group at Macfarlanes LLP. He advises on the full range of corporate tax issues, group tax planning and dispute resolution. He is a CEDR accredited mediator. Email: ashley.greenbank@macfarlanes.com; tel: 020 7849 2512.

Here are a few potential corporate tax developments on which to keep a watchful eye in 2023.

Corporation tax increase

On the purely domestic agenda, after a brief hiatus during the Liz Truss government, the planned increase in the corporation tax rate to 25% will proceed on 1 April 2023 as expected. This is an important milestone, marking the end of an era of falling/relatively low UK corporate tax rates. The chances of a return to sub-20% rates in the near future look slim indeed. The combination of higher rates and the expiry of the super-deduction mean that many businesses will be bearing significantly higher effective tax rates on profits next year.

BEPS 2.0

In the wider world, we can anticipate further progress on at least some aspects of the OECD Inclusive Framework's two 'Pillar' approach to reform the international tax system (commonly referred to as 'BEPS 2.0').

At present, it looks like 2023 will see significant developments on Pillar Two – the global minimum tax. The UK has already produced draft legislation for its implementation of the income inclusion rule (IIR). The Autumn Statement confirmed that the new rules, which will also include a qualifying domestic minimum top-up tax (QDMTT), will apply from 31 December 2023. The EU has also recently announced agreement on a directive which, subject to some exceptions, will require EU member states to implement the IIR with effect from the same date.

This is a challenging timetable for the UK and EU member states. There are some serious practical difficulties, not least because the OECD has only recently published its proposals on the important issues of safe-harbours and the administration of the regime. It remains to be seen how many of the members of the Inclusive Framework will be able to match the timetable. The likelihood must be that many countries will not.

Another important aspect remains the position of the US, where implementation of Pillar Two is stalled. Without further reform, which looks increasingly unlikely in the short term, it is difficult to see how the US GILTI rules could be treated as a qualifying IIR for Pillar Two purposes. That will leave open the question as to how tax paid under the GILTI regime will be treated by other countries as they implement the new regime. HMRC expressed the view (in its summary of consultation responses) that the US GILTI rules should be treated as a controlled foreign company regime allowing US tax paid under those rules to be allocated to other jurisdictions for Pillar Two purposes. However, we await guidance from the OECD on the issue. Perhaps 2023 will deliver.

Faced with all of this, many MNEs will need to consider what steps can be taken to mitigate the impact of the Pillar Two rules (and, in particular, the administrative burden that they will impose) against a shifting background of implementation processes in different jurisdictions moving along different timetables, and emerging legislation and guidance from the OECD and relevant tax authorities. Any time for restructuring or designing reporting procedures is going to be limited. Pillar Two will be at the top of the agenda for larger MNEs in the New Year.

> What about Pillar One? My advice: forget about it until next year. It may never happen

What about Pillar One – the creation of a new taxing right for market jurisdictions? The OECD has published some very detailed papers on aspects of the proposals, but the central proposal is becoming mired in complexity. My advice: forget about it until next year. It may never happen. But if it does not, or even if the implementation of Pillar One becomes materially delayed, digital services taxes (DSTs) will continue to proliferate, existing DSTs will not be repealed, and the threat of retaliation by the US through tariffs and trade sanctions may re-emerge.

EU developments

The CJEU issued a landmark ruling in November 2022 annulling the EU Commission's decision that tax rulings given by Luxembourg to Fiat amounted to unlawful state aid. The CJEU's decision – in short, that the existence of state aid has to be tested by reference to the national tax system concerned and not, as the Commission argued, by reference to an interpretation of the arm's-length principle based on OECD principles – will have significant implications for a host of other state aid tax cases that are in the pipeline. The Apple, Amazon and ENGIE state aid tax cases all are due for hearing before the CJEU and the Commission is investigating several others (including Nike and IKEA).

In light of the defeat, EU Commissioner Margrethe Vestager stated that the Commission will 'continue using all the tools at its disposal' to ensure that fair competition is not distorted by 'illegal' tax breaks. Perhaps 2023 will reveal whether this is merely bluster or whether the Commission has more in its toolbox with which to continue its crusade against what it regards as sweetheart deals between MNEs and tax authorities in certain member states.

The Commission's ambition to shape EU member states' tax systems seems to be undimmed and is likely to continue into 2023. The Unshell Directive has been floundering but may re-emerge in some form later in the year. Proposals like BEFIT (the successor to the common consolidated corporate tax base project) and DEBRA (the debt-equity bias reduction allowance) look likely to remain little more than lofty ambitions.

Brexit revisited

Finally, we have not yet escaped the ramifications of Brexit. As many will recall, the Brexit legislation included, in the EU (Withdrawal) Act 2018, provisions which retained many aspects of EU law as part of UK law. Proposals to repeal this 'retained EU law' are contained in the Retained EU Law (Revocation and Reform) Bill. If it proceeds – and there is some doubt that it will – the Bill will revoke all EU-derived secondary legislation and all retained direct EU legislation with effect from 31 December 2023 unless the government either (i) defers revocation until 23 June 2026 or (ii) introduces legislation to replace or restate it. Perhaps just as important in a tax context, the Bill will abolish the primacy of EU law – and retained general principles of EU law with effect from 31 December 2023. The result is that much EU derived legislation that remains on the statute book after 31 December 2023 will have to be interpreted through a domestic law lens. Over time, it will be increasingly likely that the interpretation of the UK VAT code will differ from that of the EU legislation from which it is derived. ■

Private client perspective

Expect increased scrutiny from HMRC.

Clare Wilson
Macfarlanes
Clare Wilson is a senior knowledge lawyer at Macfarlanes. She has particular experience in cross-border matters, including assisting with the implementation of planning and on related UK tax issues. Email: clare.wilson@macfarlanes.com; tel: 020 7831 9222.

Personal taxes: a possible change in behaviour?

On 17 November last year, Jeremy Hunt was under considerable pressure to deliver an Autumn Statement which went at least some way towards restoring the UK's economic credibility. Although he decided against raising headline rates of personal taxation, a significant amount of revenue will be generated by way of 'fiscal drag', with the income tax personal allowance and higher rate threshold fixed at current levels until April 2028. Furthermore, various thresholds are to be lowered from April 2023: the income tax additional rate threshold will be reduced from £150,000 to £125,140; the dividend allowance will fall from £2,000 to £1,000 (and then to £500 in April 2024); and the CGT annual exempt amount will be lowered from £12,300 to £6,000 (and will drop further to £3,000 in April 2024).

In light of this, taxpayers may wish to consider whether it would be appropriate (or, indeed, practicable) to accelerate income payments (for example, dividend receipts) or disposals to the first quarter of 2023, in order to take advantage of the current, more generous, tax-free allowances. In this context, advisers should also remain alert to the possibility of further reforms or rate increases being announced in the 2023 Spring Budget.

Non-doms

Aside from the introduction of a specific capital gains tax anti-avoidance provision (relating to the exchange of securities in a UK company for securities in a non-UK holding company), no announcements relating to non-doms were made in Jeremy Hunt's 2022 Autumn Statement, perhaps surprisingly given the prior heat on the topic. Mr Hunt has defended the regime, highlighting the existence of similar regimes in other jurisdictions and arguing that he does not want to 'damage the long-term attractiveness of the UK'. However, the Labour Party has proposed scrapping the regime entirely, relying on a claim made in a recent academic publication that doing so would raise at least £3.2bn for the Treasury.

> HMRC wins in a number of recent cases, combined with the additional funding for tax compliance, may well encourage HMRC to choose discovery assessments as a routine method of tax compliance

This policy area is likely to remain contentious in 2023, with the government under political pressure to (at the very least) conduct a review of the regime. If reforms are announced, the government may need to introduce appropriate transitional provisions, to minimise any potential migratory response to the changes.

The future of transparency

A general global trend towards increased transparency and expanded disclosure requirements continued for most of 2022. In the UK, the Trust Registration Service (first introduced in 2017 as a register of the beneficial ownership of trusts) was expanded in scope, with a 1 September 2022 deadline for registering most trusts being brought within the widened scope of the rules. In parallel, a new register of overseas entities was launched on 1 August 2022, requiring such entities which own land in the UK to register with Companies House and provide information about their 'beneficial owners'.

However, in a significant judgment published on 22 November 2022, the CJEU struck down provisions of EU law that give the general public unfettered access to information on the beneficial owners of legal entities: a number of European jurisdictions immediately restricted access to their beneficial ownership registers and we can expect others to follow suit.

The extent to which the ruling will change the direction of travel regarding transparency in the UK remains to be seen. Although there is no immediate legal impact for the UK (since it is no longer a member of the EU or subject to EU law), it does give rise to political difficulties. The decision means that, in some situations, beneficial ownership information will be more publicly available and easily accessible in the UK than in the EU. Furthermore, the UK had previously extracted commitments from the Crown Dependencies and the British Overseas Territories to introduce public beneficial ownership registers by the end of 2023; however, these offshore jurisdictions may now rely on this decision to delay implementation. Practitioners should watch this space for further developments in 2023.

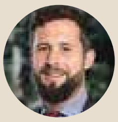
Tax compliance

The 2022 Autumn Statement provided for an additional £79m to be allocated to HMRC over the next five years to tackle tax fraud and to address tax compliance risks among wealthy taxpayers. Accordingly, private clients and their advisers should expect no let-up in the level of scrutiny of their affairs by HMRC during 2023.

Following the Supreme Court's rejection of staleness as a defence to discovery assessments in *HMRC v Tooth* [2021] UKSC 17, HMRC had a number of wins in discovery assessment cases in 2022. Going forwards, these wins, combined with the additional funding for tax compliance, may well encourage HMRC to choose discovery assessments as a routine method of tax compliance. ■

VAT perspective

2023 through the VAT lense.



Chris Mortimer
Macfarlanes
Chris Mortimer is head of the VAT practice at Macfarlanes LLP. He advises a broad range of clients but has a particular focus on financial services, real estate and luxury assets. Email: chris.mortimer@macfarlanes.com; tel: 020 7849 2149.

Jack Slater
Macfarlanes
Jack Slater is a VAT specialist in the Tax & Reward group at Macfarlanes LLP. He advises on all areas of VAT but with an emphasis on financial services and real estate. Email: jack.slater@macfarlanes.com, tel: 020 7849 2592.

Investment management consultation

The long-awaited VAT and investment management consultation was released on 9 December 2022.

The consultation is modest in its objectives and narrow in scope. The consultation seeks to codify in UK legislation existing EU case law principles defining a special investment fund (SIF), the management of which is VAT-exempt, with no discussion of which funds might fall within that definition.

There has long been a debate as to whether certain types of retail products – including certain types of life fund – qualify as SIFs under EU case law principles and the consultation is likely to re-ignite that debate.

The consultation does not address the meaning of 'management' and how it applies in the context of outsourcing, or the issues which arise where management services are used in relation to both SIFs and non-SIFs. In practice these issues give rise to greater uncertainty than the SIF definition. The consultation does, however, ask respondents to identify other amendments which could be made to improve the fund management VAT regime, and it may be that such issues find their way into the consultation via responses to the initial consultation document.

Changes to the default surcharge regime

The new penalty regime for late VAT returns and payments will come into effect from January 2023. Points will be issued for the late filing of VAT returns and once a certain threshold is exceeded subsequent late filings will trigger fixed penalties of £200. Late payments of VAT will be subject to penalties calculated as a percentage of the late-paid VAT, with the amount payable increasing the longer the payment is delayed. Interest will also apply to late payments.

EU VAT in the digital age (VIDA)

On 8 December 2022, the European Commission published its proposals for new ViDA legislation. The proposals cover e-invoicing; transaction-based reporting; increased responsibility for digital platform operators to account for VAT on transactions they facilitate; and the introduction of a single VAT registration to cover all activities carried on by a business in the EU. Any new rules will not take effect in the UK but are likely to have significant impact on UK businesses with activities in the EU.

Cases to watch

Target [2021] ECWA Civ 1043 is due to be heard in the Supreme Court in 2023. The case considers the VAT treatment of outsourced loan administration services where the outsourcer is not involved in the origination of the loans. The case will present an opportunity for the Supreme Court to consider the VAT exemption for 'transactions in money' without being bound by the CJEU case law, which has become increasingly restrictive.

The VAT grouping 'fixed establishment' cases continue at a glacial pace

The VAT grouping 'fixed establishment' cases continue at a glacial pace. Following the recent *HSBC* [2022] UKUT 41 (TCC) judgment of the Upper Tribunal on certain preliminary issues, the case has been remitted to the First-tier Tribunal for a full substantive hearing. This is a case with relevance to many taxpayers, some of whom have significant amounts at stake. The first instance judgment of the FTT will be the first judicial commentary on HMRC's controversial view that for a UK fixed establishment to be capable of bringing an entity within a VAT group, it must make 'external supplies', meaning supplies to other persons or entities (rather than to other establishments of the same entity).

HMRC has been granted permission to appeal to the Upper Tribunal in the case of *Hotel la Tour* [2021] UKFTT 451 (TC). This case concerns the recovery of input VAT related to the sale of a subsidiary where the proceeds were to be used to fund the taxable business activities of retained members of the corporate group. The FTT concluded that the input VAT could be recovered as an overhead cost of the retained group, rather than attributed to the immediate VAT-exempt supply of shares. The UT hearing is scheduled for June 2023. ■

Employment tax perspective

Plus ça change?

Philip Swinburn
Macfarlanes
Philip Swinburn is an employment tax specialist at Macfarlanes LLP. He advises businesses and individuals on a range of employment and personal tax matters, with a particular focus on supporting businesses with internationally mobile individuals. Email: philip.swinburn@macfarlanes.com; 020 7849 2596.

Despite the political upheaval in 2022, the outcome was that from an employment tax perspective at least, the more things seem to change, the more they have really stayed the same. Jeremy Hunt's Autumn Statement confirmed that, from an employment tax perspective at least, we can expect this to be the case for some time.

The Autumn Statement froze the personal allowance and income tax bands, and set a timeline for a reduction in the dividend and savings allowances. With inflation running high, freezing tax bands (and reducing the additional rate threshold) is an effective stealth tax for the government, and we shouldn't be expecting any changes to this approach in 2023. Hunt's statement included a U-turn on Kwasi Kwateng's own IR35 U-turn, putting us back to the rules that have existed since 6 April 2021. This is clearly an area the Treasury consider that there is a 'tax gap', and we can expect to see continued focus from HMRC on 'off-payroll' arrangements in 2023.

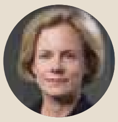
Both employers and employees will be hoping to see something from the Treasury on the tax rules that surround flexible working, especially in light of the recent OTS consultation on the topic. Flexible working arrangements have become more commonplace since Covid, and tax rules have not kept up with the pace of change (especially in light of the recent BEIS announcement that employees will have a right to request flexible working arrangements from day one). Facilitating such arrangements can add complexity for employers and employees. It is worth keeping in mind the following points:

- Ordinary commuting is not tax deductible, but there is uncertainty on the point where an employee's workplace is their home.
- Office equipment can be tax deductible in some circumstances (though the Covid concession on the point has now been removed), but cash allowances and reimbursements generally are not.
- Other costs like broadband or additional utility costs are generally not deductible as they are often not *exclusively* for the purpose of working from home.
- Working from overseas can add huge layers of complexity for employers, potentially giving rise to corporate tax reporting obligations and payroll requirements.

As such, in 2023 we hope to see updates to the employment taxes rules that govern flexible working arrangements, to mitigate the implications for employers who want to remain competitive by attracting and retaining talent with an ever-increasing desire to work flexibly. ■

Real estate perspective

Four key issues to watch.



Kirsten Prichard Jones
Macfarlanes
Kirsten Prichard Jones is a senior counsel at Macfarlanes LLP and advises on the tax treatment of all real estate transactions, including forward fundings and developments, financing and restructuring transactions, corporate acquisitions, offshore holding structures and the formation of real estate joint ventures.
Email: kirsten.prichardjones@macfarlanes.com;
tel: 020 7849 2613.

UK/Luxembourg double tax treaty

There had been an expectation that the long-awaited changes to the UK/Luxembourg double tax treaty would come into force this year; however, as the treaty has not been ratified by Luxembourg, the changes will not take effect until 2024. From a real estate perspective, one of the key changes is removing the exemption from UK tax for Luxembourg companies selling UK property rich vehicles. Unlike the extension in domestic legislation of capital gains tax to non-residents owning UK real estate, this change will not be accompanied by a rebasing of affected companies' assets. This means that the date of the treaty change will be a cliff edge for these companies, many of whom may well look to exit their investments (or perhaps onshore them) prior to the change.

Sovereign immunity

HM Treasury's proposals on sovereign immunity reform will be eagerly awaited. Although the government clearly has sovereigns' UK real estate assets in their sights, it remains to be seen whether they will accept that any property assets should continue to benefit from exemption (for example, passive investment properties, as contrasted with ones involving significant development activity by the sovereign).

REITs are likely to become increasingly popular as holding vehicles for non-UK investors

REITs

REITs are likely to become increasingly popular as holding vehicles for non-UK investors, thanks to the increase in the corporation tax rate. Currently, the difference between the corporation tax rate (19%) and the treaty rate applicable to overseas' shareholders' REIT distributions (commonly 15%) is not always enough to justify the use of a REIT for these investors. However, from April the potential saving will be much more significant. This, combined with HMRC's ongoing relaxation of certain aspects of the regime, in particular for ones owned by 'institutional investors', is likely to make REITs the vehicle of choice for many of these investors. An exception to this may be sovereigns, whose status as 'institutional investors' is under threat as part of the sovereign immunity reform project referred to above. Removal of this status would cause major headaches for existing 'private' REITs that rely on their sovereign shareholders' 'institutional investor' status to satisfy the non-closeness condition, and benefit from the relaxation of the listing requirement.

VAT treatment of remedial works

At the bricks-and-mortar end of the spectrum, HMRC's approach to the VAT treatment of remedial fire safety works will be watched closely. Following the Grenfell tragedy in 2017 HMRC confirmed to various taxpayers and industry groups that these works could be zero-rated provided certain conditions were met, accepting that the defects in the affected buildings effectively meant the properties' construction had not been completed and the works were akin to 'snagging' works. HMRC have now indicated that these clearances do not reflect their policy, which is that zero-rating will not apply other than in very narrow circumstances. Apart from the technical merits of the case for zero-rating, and the potential cost impact on building owners (many of whom cannot recover VAT on their residential assets), this raises interesting questions about the status of HMRC rulings and taxpayers' entitlement to rely on them. ■

Tax disputes perspective

Hit lists and man-marking.

Gideon Sanitt
Macfarlanes
Gideon Sanitt is a partner and head of the tax disputes and investigations team in Macfarlanes LLP. He specialises in complex disputes with HMRC, in all aspects of direct and indirect tax for both private clients and companies. Email: gideon.sanitt@macfarlanes.com; tel: 020 7849 2123.

On 30 November 2022, various HMRC executives, including the Chief Executive Jim Harra, were questioned by the House of Commons Treasury Committee. The session highlights a number of areas that HMRC are focusing on, with tax fraud given some prominence. In recent years, HMRC has been developing their legislative and operational tools for tackling fraud. There are more rules on the statute books (including the failure to prevent the facilitation of tax evasion) and HMRC has access to more resource. With a lot of HMRC's additional funding (including a further £79m at the Autumn Statement) being earmarked towards tackling fraud, 2023 could well see a marked increase in such investigations.

The Treasury Committee session was a hit parade of targets, including cryptocurrency, with HMRC keen to demonstrate its credentials in that area. At the start of the year, HMRC announced the first ever seizure of non-fungible tokens as part of a VAT fraud investigation and, at the same time, sent out 'nudge letters' to cryptocurrency investors, calling on them to review their affairs and raise any uncertainties with HMRC.

Cryptocurrency may be topical, but 2023 is unlikely to see any let up on the traditional targets. HMRC are challenging thousands of 'mini umbrella' companies, which supply temporary workers without paying the tax due. Perhaps more significantly for the future, HMRC's view is that businesses that use temporary workers are responsible for ensuring the legitimacy of their supply chain. These investigations may, therefore, end up prompting enquiries into companies at the top of the chain as to what they knew or should have known. On a related topic, there are a large number of cases – both fraud and civil – waiting in the wings regarding the status of contractors (under IR35) and whether or not they are in fact employees.

Cryptocurrency may be topical, but 2023 is unlikely to see any let up on the traditional targets

There are various industries that have been facing their own challenges concerning 'disguised' remuneration and employment. That includes investment managers, who have been contending with various rules on salaried members, mixed members, disguised investment management fees and miscellaneous income, all of which are essentially seeking to tax amounts received by partners as income and, ideally, as employment income. These enquiries have been slow to develop but are reaching their conclusion. There have been two decisions for Bluecrest in relation to the taxation of remuneration arrangements ([2022] UKUT 200 (TCC)) and the salaried member rules ([2022] UKFTT 204 (TC)). 2023 is likely to see more.

The Treasury Committee did not forget about wealthy individuals, including non-domiciled individuals. While the non-dom regime has, for the moment, been left unscathed by the Autumn Statement, foreign and non-domiciled individuals are facing challenges in court, either in relation to their domicile status or their residence. In a cross-over between cryptocurrency and non-domiciled individuals, there are a number of challenges being pursued by HMRC as to the legal location (the situs) of cryptocurrency assets for tax purposes. More generally, Jim Harra referred the committee to HMRC's approach of 'man marking' the very wealthy in order to keep track of them and how they manage their money. That approach will ensure such individuals continue to receive significant and personal attention in 2023.

There are, however, also areas in which taxpayers are seeking to hold HMRC to account. As noted above, the decision in *Tooth* may embolden HMRC to issue discovery assessments, but that does not mean HMRC is immune to scrutiny over its actions. The tribunal has indicated that it would look at whether actions of HMRC can amount to abuse of process (*Kingdon and others v HMRC* [2022] UKFTT 407 (TC)). The ultimate remedy, however, is judicial review before the High Court and this was a remedy expressly noted by the Supreme Court in *Tooth*. Judicial review is a complex process with strict timing limits, but it can be a powerful (and sometimes the only) remedy. With the sort of judicial encouragement shown in *Tooth*, it is the type of tool that taxpayers may increasingly consider appropriate. ■