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Legal developments and practical impact

What are likely going to be the most important tax law cases in 2017 and why?

IA: A case of particular interest is *Littlewoods Ltd and others v Revenue and Customs Commissioners* [2015] EWCA Civ 515, [2015] All ER (D) 225 (May) which will be heard by the Supreme Court in 2017. Broadly, the issue in the case is whether, when overpaid VAT is refunded by HMRC, it must be accompanied by compound interest or whether the payment of statutory simple interest suffices. The case is of interest not only because of the vast sums involved (over £1bn) but also because it will set an important precedent which will impact on a number of other cases.

DS: The *Littlewoods* case concerning compound interest on repayment of tax levied in breach of EU law will be heard by the Supreme Court. A very large number of claims against the Revenue are dependent on the outcome of this case.

*R (on the application of De Silva) v R & C Comrs* [2016] EWCA Civ 40, [2016] All ER (D) 41 (Feb) will be heard in the Supreme Court. This concerns the question whether a carry-back claim for loss relief can be the subject of an enquiry into a tax return under section 9A of the Taxes Management Act 1970 (TMA 1970). The Court of Appeal held that this was possible, notwithstanding that the Supreme Court in *Cotter* held (apparently) that a claim of this type was not included in a return and therefore could not be the subject of an enquiry under TMA 1970, s 9A. Though it sounds obscure, the point is important because, if the appeal is successful, it is likely to knock out some 90% of outstanding accelerated payment notices (APNs). That is because these notices will have been issued to deny carry back claims. If the tax is uncollectable, because no effective enquiry was opened to challenge them, then a pre-condition for the issue of the APN will not have been fulfilled, namely, that a ‘tax advantage’ arises from particular arrangements. In that case the APNs will be uniformly invalid.

*R (on the application of Rowe) v R & C Comrs* [2015] EWHC 2293 (Admin), [2015] All ER (D) 12 (Aug), which will be heard in the Court of Appeal in July 2017, is also concerned with APNs. This is an attack on the validity of APNs more generally, rather than on more specific technical grounds. The High Court has in a number of cases robustly upheld APNs, on the grounds that tax avoiders got what was coming to them. However, the judicial climate in relation to the exercise of executive powers is changing.

*BPP Holdings* [2016] All ER (D) 16 (Mar), [2016] All ER (D) 16 (Mar) is also likely to reach the Supreme Court, in which HMRC challenges the application of procedural rules to themselves.

AN: The case involving Rangers Football Club and payments to employees using employee benefit trusts will be heard in the Supreme Court in 2017. Following HMRC’s successful appeal in the Court of Session in November 2015, in *Advocate General for Scotland v Murray Holding and Others* [2015] CSIH 77, BDO as liquidators for the company, have been granted leave to appeal to the Supreme Court. This has been a high profile case as it has passed through the Tax Tribunals and the Court of Session, not least because it relates to payments to professional footballers in one of Europe’s best supported clubs.
The Court of Session held in favour of HMRC that payments directed through employee benefit trusts to footballers and executives at the club were ‘a mere redirection of emoluments and earnings’ and so were subject to income tax.

The case is important, first of all, in that large numbers of tax arrangements and schemes have been implemented over the years on the same or similar basis as the Rangers EBT planning. So promoters and users of these types of arrangements will be anxious to see which way the Supreme Court will go. The risk for taxpayers is that if the Supreme Court find for HMRC, many businesses and individuals could end up paying income tax and national insurance contributions on large sums which they had previously thought would not be taxed, and also could be liable for substantial interest and penalties as well. So they could be in a far worse position than if they had simply paid tax on their income at the time, and not entered into the schemes. HMRC will be buoyed by their success in the Court of Session, but will also be concerned that their recent run of success in the Tax Tribunals and courts against tax avoidance schemes may come to an end in the Supreme Court. They won’t want what’s been a good winning streak for them to come to an end.

The case is also important as a bellwether for how the higher courts are viewing tax planning arrangements in general. There are likely to be arguments on general principles of interpreting case law which could apply to several other cases involving different tax planning and avoidance schemes. The tax schemes industry, currently on the ropes after several heavy blows over the last few years from the Tax Tribunals and courts, could suffer a knockout if the Supreme Court find for HMRC.

The case of Littlewoods is centred on a claim by Littlewoods that it should be paid compound interest rather than simple interest, on a refund of overpaid VAT relating to the years between 1973 and 2004. Littlewoods are claiming approximately £1bn. The Court of Appeal found in favour of Littlewoods in May 2015, and HMRC have been granted leave to appeal to the Supreme Court.

The amount at stake, approximately £1bn, makes this an important case in its own right, and could make a significant dent in the exchequer’s coffers if the Supreme Court follows the Court of Appeal in finding in favour of Littlewoods. There will be several other businesses looking closely at the result, and seeing if their similar claims for compound interest will be successful. On the other side, HMRC and the Treasury will be concerned that if they lose, material amounts may have to be paid out of public revenue on multiple claims on the same issue.

The case is also interesting in that Littlewoods’ arguments to date have relied to a significant extent on principles of EU law. As such, there is something of a fin de siècle feel to it in light of Brexit.

DB: 2017 will see the Supreme Court consider the compound interest claims brought by Littlewoods, which may lead to a large number of following cases coming back to life. The Investment Trust litigation is also to be heard by the Supreme Court and will consider the ability of end customers, which have borne the burden of indirect taxes, to leapfrog the taxpayer to sue HMRC directly for restitution, with the favourable time limits and potential interest rights attached. The big EU Group Litigation Orders (GLOs), Franked Investment Income (FII), Dividend and Stamp Taxes will continue to progress, though past experience suggests finality in these cases is still some way off.

On 13 April 2016, the Supreme Court dismissed the last attempt to appeal the Eclipse 35 [2016] UKSC 24, [2016] All ER (D) 69 (May) decisions of the lower courts. The decision that the partnership was a non-trading film business is therefore final. However, there is still a substantial dispute with HMRC on the unexpected consequences of the decision—that a tax charge under section 609 of Income Tax (Trading and Other Income) Act 2005 may arise against which it is not possible to deduct loan interest. Eclipse 35 (and indeed many other similar schemes) was dependent on an interest deduction to set against the very substantial income tax liability on the fixed income streams generated by the film licence income. That investors not only lose the intended benefit of the scheme (a point now undisputable), but may also be subject to additional taxes, both past and future, which could amount to many multiples of their initial risk capital represents a potential windfall for HMRC and a crippling cost to the taxpayers involved. HMRC has recently equivocated on its approach to this so-called ‘dry tax’, recently sending precursor follower notice letters to taxpayers indicating they would be charging the dry tax, only to then indicate they would not be doing so. 2017 should therefore see more clarity on HMRC’s position on dry tax, including potential large-scale disputes, both on the technical basis for the tax and on the public law issues arising from the follower notices and linked partner payment notices, if HMRC choose to issue them. This might come first in the decision on an appeal in a Matrix scheme in which similar issues are thought to arise.

What are likely to be the most significant legislative and regulatory developments in tax and why?
**DS:** The government has announced that with effect from 1 April 2017 it will introduce general restrictions on interest deductions for companies. This would raise the costs of raising finance for companies, and fundamentally alter current finance models. This is to implement Action 4 of the Base Erosion and Profit Shifting (BEPS) action plan. The impact of this measure would, however, be moderated by the declared intention of simplifying the worldwide debt cap legislation, if and when general restrictions on corporate interest deductions are introduced. Such restrictions would also produce a further departure of tax accounts from commercial accounts, further obscuring the relationship between the two.

**AN:** In August 2016, the government published a consultation document entitled Strengthening Tax Avoidance Sanctions and Deterrents. In this, the Financial Secretary to the Treasury said that the new measures are intended to tackle a ‘shrinking but persistent minority’ of people who ‘seek to exploit tax laws in a way Parliament never intended and secure for themselves or their clients an unfair financial advantage’. This is the latest step in the government’s war on tax avoidance, and in the recent Autumn Statement the Chancellor has confirmed that legislation will be introduced from April 2017.

The government has been concerned that while taxpayers using tax avoidance schemes are being caught by court decisions in favour of HMRC, the professionals who devise and market the schemes can often walk away with no penalty and with their fees intact. So the government is looking to bring in financial sanctions for those who design, market or facilitate the use of tax avoidance arrangements which are subsequently defeated. This could include independent financial advisers, accountants, lawyers, company formation agents, banks, and trustees. The aim is to clamp down on tax avoidance by including in the net of financial penalties those who benefit financially from developing, marketing or selling the products.

Depending on how the legislation is drafted, this could have a significant impact on those providing tax advice, in the accounting and legal professions. If the net is spread too widely, it could have a detrimental effect on taxpayers in general, rather than just the intended target of those using aggressive tax avoidance schemes.

**IA:** The most significant legislative change in 2017 is likely to be the introduction of new rules relating to non-UK domiciled individuals. As the law presently stands individuals are deemed to be UK domiciled for inheritance tax purposes if they have been resident in the UK for a certain period, and this principle will be extended to other taxes. This is of critical importance for non-UK domiciled individuals—they need to consider whether to remain resident in the UK, and if so what mitigation steps they might take, and such issues are likely to keep tax advisers busy.

**DB:** The BEPS project will continue to be implemented internationally. In particular, Directive EU 2016/881 requires implementation in Member States by 5 June 2017. This measure deals with mandatory automatic exchange of information and country-by-country reporting.

The European Commission will have been buoyed by Advocate General Wathelet’s opinion in the decision of C-20/15 P: *Commission v World Duty Free Group and others* in July 2016. 2017 will therefore see no let-up in the Commission’s challenges against Apple Inc’s and others’ arrangements which the Commission considers to be unlawful state aid.

Expect further measures to attract multinational businesses to the UK through corporation tax rate reductions and, alas, more changes to the complex relief systems. Despite the sustained calls for tax simplification from professional bodies and taxpayers alike, the government appears unwilling or unable to make any real headway on this front. The wider economic and political upheaval is likely to draw political focus ever further from this objective in 2017.

**How is Brexit likely to affect these?**

**IA:** One cannot yet know the precise consequences of Brexit. However, in the past, EU law has often been relied upon in challenging the domestic tax regime—Brexit is likely to reduce if not eliminate this, although it, of course, depends on the extent of Brexit as ultimately negotiated. Further, at present there is a mechanism by which questions of EU law can be referred to the Court of Justice of the European Union (CJEU) for resolution. Taxpayers who are involved in litigation which raises points of EU law, or those who will be involved in such litigation, are in a state of uncertainty as to what the procedure will be going forward for enforcing pre-existing EU law rights.

**DS:** To deny tax deductions for interest on corporate debt would be perceived as an anti-business measure. It is difficult for a pro-Brexit government also to be pro-business, given that Brexit will reduce gross national product by £122bn over the next five years, according to the Office for Budget Responsibility and the Institute for Fiscal Studies. In any case, the onset of the Trump presidency is likely to be the death knell of BEPS, quite apart from the UK government’s need to
attract foreign investment into the UK. Accordingly, the decision on whether or not this proposal is carried through will be an important indication of the future direction which the government intends to take.

It is also likely that the government is planning to introduce retrospective legislation to cancel the effect of tax repayment claims based on EU law, once the UK is (on one view) free from the tyranny of the Luxembourg court. So such claims need to be made as soon as possible, to stand a chance of surviving retrospective legislation.

AN: The main area of UK taxes which is linked to and dependent on EU law is VAT, as that is derived from EU Directives. So as we saw with the Littlewoods case, the UK courts will often interpret the application of VAT in the UK in the light of CJEU decisions, and EU legal principles. Following Brexit, that will presumably end. I wouldn’t expect there to be a major rewrite of UK VAT legislation post-Brexit, but there will be an impact on UK jurisprudence around VAT, as cases will no longer be referred to the CJEU. It will be interesting to see post-Brexit, how much judges will still follow cases which had been decided in the UK pre-Brexit, and which followed EU decisions and legal principles. Or will they throw out the EU rule book as it were?

A more general consequence of Brexit on UK taxes could be if, as the Chancellor signalled in his Autumn Statement, there is a significant cost to the UK economy as a result of leaving the EU. The Chancellor referred to forecasts suggesting that there could be a £59bn hole in the public finances as a result of Brexit. That may lead the Treasury to look at ways of recovering some of that through the tax take. Indications at this stage are that increases in corporation tax are not likely, and if anything the rate of corporation tax will decrease in the next few years, as part of global competition in attracting businesses to the UK. Indeed Brexit, and a risk of being outside of the single market, may keep driving headline rates of corporation tax down in the near future. But perceived softer targets in the UK tax regime may see increases in the next few years, if concerns over a ‘Brexit deficit’ turn out to be well founded.

**PSL practical point:** Legislation will be introduced next year to tighten up on income tax and national insurance where workers are contracted with public sector bodies, but aren’t on the payroll. This would include the situation where workers operate through their own personal services company.

From April 2017, the responsibility for making sure that income tax and national insurance is being applied correctly in ‘off-payroll’ circumstances will shift from the worker (and his or her personal service company, or similar type of arrangement) to the public sector entity using their services. This will put an extra compliance burden on the public sector, and a risk of financial penalty if non-compliant, and so may make it keener to move away from using off payroll workers—which is what the government wants. This will affect government departments, NHS trusts and other bodies, and local authorities among others, and so could have a wide impact across the country.

DB: Despite there being no doubt that Brexit will have an effect on the UK tax system, even if that is through a raft of new legislation aimed at maintaining the status quo, it is unlikely we will see any of those measures or effects for some time to come—particularly if the government’s stance on keeping its cards close to its chest continues.

The examples cited above are unlikely to be affected materially by Brexit. While country-by-country reporting is being introduced via an EU Directive, the BEPS project enjoys a high level of domestic and international political agreement and implementation is required before the two-year Article 50 period has expired in any event.

The anti-avoidance measures taken by HMRC are largely aimed at historic planning and are generally a product of domestic legislation. The effect is more likely to be felt indirectly—the increased pressure on HMRC to maximise the tax take to assist in balancing the UK’s rather parlous finances is likely to lead to the continuation of sustained attacks on historic avoidance and the promoters/facilitators of the same. The long rumbling EU GLOs, Littlewoods and the Investment Trust litigation deal with largely historic issues and long since repealed legislation.

The government’s drive to bring in multinational companies to the UK through tax incentives is apparently having some traction regardless of Brexit fears—McDonald’s, for example—a trend which is likely to continue in 2017. But this may be countered by others leaving—the press recently reported certain UK banks’ intentions to move some operations to Paris. This may be the thin end of the wedge, but we are unlikely to know until 2018 or later as businesses hold off making significant decisions until greater clarity emerges on the UK’s Brexit stance and any tax measures which may be introduced to address some of the issues caused.

**Client and business developments**
How do you think the practice of tax law is going to develop in 2017?

IA: A general trend apparent in the practice of tax law has been a shift away from practitioners advising on ‘schemes’ (essentially structures for mass implementation, often with little or no involvement from the scheme participants, which are designed to reduce the tax burden of the participants). Instead, recent years have involved a lot of litigation in relation to the efficacy of such tax schemes, and often HMRC is successful in such cases. The consequence for tax practice is two-fold. First, in the future practitioners are less likely to be asked to advise on the efficacy of schemes. Such a change is already apparent, but it is likely to continue further. Instead, it seems that there will be a greater focus on advising on the tax consequences of past transactions or providing bespoke advice in relation to individual transactions (as distinct from mass schemes). Second, tax lawyers will be spending an increasing amount of time litigating about the efficacy of schemes that have been implemented. There are already a number of such cases but there are likely to be more in 2017, and some of the existing cases will presumably involve one or more appeals.

A regulatory development, not specifically related to tax but with impacts for those working in the tax field, is the introduction of the Common Reporting Standard (CRS). In various circumstances offshore structures are used as part of tax planning, but there are concerns about the extent to which information will need to be reported in relation to the structures and about the security and safekeeping of the information. For example, a concern among some individuals is that the CRS will result in information about their wealth being disclosed to states where the data might be leaked thereby potentially exposing the individuals or their families to danger. Some tax practitioners are already advising in relation to the CRS and this is likely to increase in 2017.

DS: As tax legislation increasingly takes the form of general enabling provisions for HMRC, the shift of tax disputes from technical tax matters to judicial review of the exercise of executive powers will continue. It is significant in this regard that the Finance Act 2016 has introduced measures to do away with the procedural safeguards for the issue of General Anti-Abuse Rule counteraction notices.

AN: It’s likely that tax lawyers may become more cautious when advising on tax issues which aren’t straightforward, and where there is the potential for clients to obtain a tax advantage from arrangements. The increasing anti-avoidance measures being introduced by the government will put pressure on tax advisers, who may be uncertain where HMRC will draw the line between acceptable tax planning and advice, and what it might consider to have avoidance motives. We have come a long way from the well-known 1936 case of the Duke of Westminster [1936] AC 1, where the court said:

‘Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be.’

While arguably the tax avoidance industry with its plethora of schemes needed reigning in, the widening of the scope of Disclosure of Tax Avoidance Schemes, and the new ‘enablers of tax avoidance’ legislation to be introduced in 2017 may make some tax lawyers think carefully before taking on certain instructions, or the extent to which they might advise on certain matters.

What do you think the key challenges are going to be?

IA: In terms of challenges, the greatest challenge is likely to be one of responding to the changes in the tax law environment. Recent years have seen the introduction of measures to crack down on measures used by non-UK domiciled individuals to reduce their tax burden. Further changes to the regime are due in 2017. Moreover, there is a state of uncertainty created by Brexit. How will pre-existing EU law rights be enforced? In practical terms, will Brexit change the chances of success in relying upon EU law rights? Tax lawyers are, of course, used to regular changes in the tax system. Nonetheless, responding to the range of changes and the state of uncertainty will be a challenge, albeit one tax practitioners will be adept at dealing with.

DS: The ‘Making Tax Digital’ programme would fundamentally alter tax compliance for smaller businesses in an adverse way, by requiring payment of tax earlier and increased record-keeping and reporting requirements.

AN: The continuing clampdown by the government on tax avoidance will present challenges. While it’s arguably a small minority of practitioners now, if any, who are actively promoting tax avoidance schemes, the changes to be introduced in
2017 around ‘enablers’ of tax avoidance could affect how far tax lawyers are prepared to go in advising clients, in terms of efficiently managing their tax affairs. Practitioners will be concerned if the legislation is drafted so widely as to catch innocent tax planning. The risk is that professionals may be more concerned about advising on how tax rules should be interpreted, if that could be seen as somehow enabling tax avoidance. That could leave taxpayers without the level of advice they need to steer through ever increasingly complex tax legislation, for their day-to-day business and personal matters, even if they have no intention of entering into tax avoidance arrangements.

Linked to this area of anti-avoidance, I think we will see an increasing number of APNs issued by HMRC, to users of schemes where the courts have not yet reached a final decision on the arrangements in question. As well as clients having to address the actual payment, APNs will be increasingly relevant on company share acquisitions where the target company has been issued with APNs, and where buyers will want to take that into account in negotiations on the sale contract and maybe in setting the purchase price.

*Interviewed by Lucy Trevelyan. The views expressed by our Legal Analysis interviewees are not necessarily those of the proprietor*