Business restructuring as a result of regulatory change arising from EU Exit

In July 2018 a working group was organised jointly by HM Revenue & Customs (HMRC), HM Treasury and a number of representative bodies for firms operating in the financial services industry. The purpose of the working group was to discuss tax issues arising in connection with business restructuring in response to EU Exit. Sub-groups were established for Asset Management, Banking, Insurance and VAT.

The document has been prepared by HMRC to summarise the outcome of meetings of the working group and its sub-groups, and related discussions. As a record of discussions this document is not HMRC guidance, but it will be made available to HMRC's Customer Compliance Managers (CCMs).

The UK financial services sector in particular is facing a period of major regulatory change resulting from EU Exit. HMRC has worked with customers, industry bodies and advisers to understand the challenges that are being faced. HMRC would like to express its thanks to those that have engaged in this process.

It is apparent that there is a wide range of plans driven by the variation in customers' existing structures and their anticipated location as well as current and future business models. Given this variety and the fact-specific nature of the tax analysis arising from restructuring plans, HMRC is constrained from providing detailed and comprehensive guidance.

Some common themes have emerged from this engagement between HMRC and the sector. HMRC's views on certain of those issues are outlined below, including references to existing guidance on specific points. In response to points raised, HMRC may continue to update sections of technical guidance in a number of areas and publish these in due course.

HMRC is also willing to comment on, but not to endorse, representative bodies' own communications to their members on this topic.

HMRC approach to ensuring tax compliance

It is the role of HMRC to apply the law as it stands and to treat all taxpayers equally and consistently. HMRC acknowledges that the circumstances of EU Exit are exceptional, but regards businesses' restructuring proposals no differently to any other corporate event or business change. HMRC will, therefore, approach examination of returns using its usual risk-based approach.

- It is the responsibility of customers to undertake appropriate and proportionate analysis of any restructuring and reflect these conclusions in the tax returns they submit, taking whatever level of external advice is considered appropriate according to their precise circumstances. Although customers are required to take and be able to evidence reasonable care in managing their tax affairs, HMRC does not consider this this will always mean the need to take external advice. As always, customers should ensure that any professional advisers are appropriately qualified.
- Many customers are presenting and implementing plans that continue to evolve. The regulatory and business environment will continue to develop after EU Exit and customers will respond accordingly. In this context there is added relevance to ensuring that contemporaneous records are kept of analysis performed and decisions made.
- Corporate restructuring being undertaken by customers is in a wide variety of forms including the use of Part VII Financial Services and Markets Act, the EU Merger Directive and *societates europaeae.* In certain circumstances the restructuring will involve the (sometimes court approved) dissolution of a transferor entity. Customers should always ensure that they have made appropriate arrangements to file tax returns and settle tax liabilities.
- Where a UK company undertakes a cross-border merger under the EU Merger Directive (2009/133/EC) the UK company will dissolve without entering liquidation. In these circumstances it is HMRC's view that the successor company - via its UK permanent establishment - will take the place of the dissolved company for the purposes of all tax liabilities and obligations (including outstanding payments, current and future enquiries, and provision of information to determine pre-dissolution liabilities). This is in line with the principles set out in the Directive. In cases of uncertainty customers should contact HMRC at the earliest opportunity.

Intangibles and Capital Gains regimes

Part 8 of CTA09 applies to a company's Intangible Fixed Assets (IFAs) and has priority over other parts of the Taxes Acts including Corporation Tax on Capital Gains (see s906 CTA09). It applies to all IFAs created on or after 1 April 2002 and to IFAs acquired from unrelated parties on or after 1 April 2002 (see s882 CTA09). Goodwill is treated as an IFA for the purpose of Part 8. The IFA regime taxes transactions according to their accounting treatment but with supporting statutory provisions that may adjust the accounting measure of profit.

IFAs include intellectual property, as set out in section 712 CTA09, goodwill and intangible assets that meet the accounting definition of an intangible asset. Determination of whether the intangibles regime applies will only be possible after a detailed examination by customers of the regulatory, legal and factual analysis of any restructuring being undertaken. It is not possible for HMRC to set out an exhaustive list of what will and will not fall within the intangibles regime. It is HMRC's position that the regime can include legal, contractual and permission rights provided they meet the accounting definition. In particular, the rights granted under an investment management agreement are capable of being within the regime. Customers should also consider whether the IFA regime applies to any realisation of brand or trade name, and ownership or access to IT systems or knowhow. Guidance on asset identification can be found in the HMRC Corporate Intangibles Research and Development Manual at CIRD49010.

Adjustments to the accounting treatment

When an intangible is realised the amount brought into account for tax is generally determined by reference to the proceeds recognised for accounting purposes. A realisation is defined at s734 CTA09. It includes transactions that result in either an asset ceasing to be recognised for accounting purposes (s734(1)(a)) or a reduction in accounting value (s734(1)(b)), including part realisations (s734(4)). A realisation can apply to an intangible fixed asset whether or not it is recognised in the balance sheet.

If there is a transfer (see below for further comment on transfers) between related parties the market value of the asset must be used, as at s845 CTA09. This is considered to be the 'price that the asset might reasonably be expected to fetch on sale in the open market'. A willing buyer and seller are hypothesised. Further information can be found in the HMRC Capital Gains Manual at CG16330.

The transfer pricing legislation within Part 4 TIOPA 2010 also applies to Part 8 transactions. These rules require the arm's length price of the transaction to be used. HMRC's guidance in the International Manual at INTM440140 has more information on this. Chapter VI of the OECD Transfer Pricing Guidelines states that both parties to the transaction must be considered and gives guidance on location of intangibles.

In an instance where the market value differs from the arm's length price, s846 CTA09 determines that the higher amount is recognised for tax.

The accounts basis is also adjusted where there is a non-cash receipt – for example, where an asset is exchanged for an equity interest – and the cash value of the consideration has to be reflected. Various provisions allow transfers on a tax-neutral basis to take place, including intra-group transfers, company re-constructions and transactions governed by the EU Mergers Directive provided the asset is a chargeable asset in relation to both the transferor and transferee.

Consideration of whether there is a transfer

The market value rules and the tax-neutral transfer rules only apply to transfers of IFAs. Therefore if, for example, an existing investment management contract is cancelled and renegotiated between the client and the group's newly authorised EU entity, customers will need to determine whether there has been a transfer of the underlying asset(s). Whether or not there is a transfer of the rights granted under a contract will dependent on what, if anything, has changed. The termination could still be a realisation of an IFA for the purposes of Part 8 and so the arm's length price would apply to determine the proceeds of realisation. A novation of a contract may or may not be treated as a transfer depending on the facts.

Other receipts in respect of an IFA

In situations where there is no transfer or realisation of assets, customers would need to consider the application of the arm's length principle and whether this would result in any form of compensation or referral fee etc. due to the UK entity as a result of the proposed restructuring.

There are a number of statutory provisions to deal with licensing type arrangements.

Considerations applicable to IFA transactions

An approach to considering the amount to be included in a customer's tax return might be:

- Identify the assets that have moved or ceased to exist as part of the reorganisation.
- Ask whether on commercial terms consideration would have been received, either in the form of cash or for example an equity interest in the new entity that has inherited the economic benefits of the identifiable asset.
- Consider what else would need to move to support the change in the business model or structure.
- If assets have not moved but access is still required, consider what licensing arrangements should exist. These may be informal, especially within a group.
- Consider if the change amounts to a transfer of all or part of the business. A key consideration here is whether this is an asset transfer or a business acquisition or combination where purchased goodwill would be recognised for accounting purposes.
- A movement of business assets, customer relationships or staff could be indicators of a transfer of all or part of a business. If not a business transfer, consider what economic assets have moved.
- Consider the value of the assets, after identifying the relevant statutory provisions. The basis of valuation may need to consider arms-length price, market value (s845 CTA09), fair value (s716-717 CTA09) or just and reasonable apportionment (s856 CTA09).

A targeted anti-avoidance rule can disregard tax-avoidance arrangements.

Valuation matters

HMRC anticipates that customers could take a variety of approaches in valuing IFAs for the purposes of inclusion in their tax returns, with the need to determine the higher of market value or arm's length price influencing this process. The approach adopted will be appropriate for the relevant statutory basis being applied and will depend on the precise facts and circumstances of the asset under consideration and the restructuring undertaken. As is not uncommon in the valuation of intangible assets, there will be complex and subjective issues to consider.

By way of clarification, HMRC considers that:

- In circumstances where there has been a transfer of an intangible and it is necessary to calculate market value:
    - It should be assumed that a hypothetical third party purchaser has the wherewithal to undertake the business being sold or contracts transferred and that the purchaser would not be required to sub-delegate functions to the vendor.
    - That the valuation should reflect that the buyer is likely to need to deploy resources to exploit the asset.
    - That although it is reasonable to factor into a valuation expected client responses to a change in the parties to a contract, any assumptions adopted must be evidence-based and it should not automatically be assumed that a straight-line diminution in value will appropriately reflect the likely value.
- Of particular relevance when an arm's length price is necessary, customers should consider whether a third party would pay an upfront introductory fee or other lump sum at the inception of a relationship or whether the relationship is closer to a licencing arrangement that can be reflected in an annual fee or royalty.
- Customers should also bear in mind that:
    - In HMRC's view, the value of an asset is not necessarily reduced or eliminated because the existing owner cannot continue to operate in the same way as before due to regulatory changes.
    - HMRC recognises that there will be situations where value drivers within a business (e.g. staff knowledge and expertise) will remain in the UK such that valuable business assets, including business goodwill, remain in the UK. Customers need to make their own judgement on this and retain appropriate contemporaneous evidence to support their reasoning and, if evidence can be provided to show that valuable business assets are retained in the UK, HMRC will only require valuations of assets not retained.

Part disposal and goodwill

Goodwill cannot be transferred without disposing of all or part of the business. If part of a business is sold (instead of simply some business assets), then the goodwill associated with that part of the business can also be sold. A sale of assets may constitute a sale of all or part of the business depending on whether the parts can operate together as a business. A detailed understanding of the fact pattern is critical.

If there is a goodwill transfer to an overseas group company it will be a connected person transaction. For businesses operating since before 2002, the disposal will fall within the capital gains regime. Section 18 TCGA92 treats this as occurring at market value in accordance with s272 TCGA92. Sections 845 and 846 CTA09 will apply to goodwill within Part 8 CTA09.

Further guidance

Further guidance on a range of issues can be found in HMRC's practice note on apportioning the price paid for a business transferred as a going concern.

Exemptions for Insurance Contracts

Both Part 8 CTA09 (at s806) and TCGA92 (at s204 and s210) contain exclusions for contracts of insurance. That is to say, the disposal of a contract of insurance is excluded from the IFA rules in Part 8 CTA09, and gains on contracts of insurance are not considered to be chargeable gains for the purposes of TCGA92.

Part 8 additionally excludes at s806(3)(ca) "assets so far as they are derived from, or are referable to, contracts or policies of insurance or capital redemption policies".

It is HMRC's view that this exemption relates narrowly and specifically to the direct rights and obligations within the contracts of insurance. The exemption does not, for example, extend to any 'renewal rights' or other customer intangibles that may be derived from customer relationships. In particular, goodwill does not fall within this exemption as it is referable to the business as a whole rather than individual contracts.

Upstream mergers where there are multiple shareholders – application of TCGA, IFA, loan relationship and derivatives rules.

The UK has implemented the Merger Directive (2009/133/EC).

For capital gains purposes S140E TCGA92 provides for tax neutrality, in the context of a cross border merger of companies on an intragroup basis, for assets that were within the charge to UK tax prior to the transaction and remain within the charge to tax after the transaction.

One of the conditions of obtaining this relief is that the scheme of reconstruction provisions contained within s139 TCGA92 do not apply to the transaction. Under certain scenarios where a subsidiary merges with a parent, if relief under s140E TCGA92 is obtained, s24 (re negligible value claims) and s122 (re capital distributions) are not applied.

In a scenario where a company with two or more shareholders merges upstream into one of its shareholders, the "equal entitlement to new shares" condition in Sch 5AA TCGA92 cannot be met. For example, where two companies (X and Y) are shareholders in a third (Z) and the merger is effected by Z being subsumed into X while X issues shares to Y to replace its share in Z, X will not be issuing any new shares (to itself). In these circumstances s140E(2)(d) TCGA92 will act to ensure that s140E continues to apply where the issue of shares to a party is not possible under the applicable domestic law.

The Merger Directive also applies in a similar way in other parts of the Corporation Tax Acts, such as to loan relationships, derivative contracts and intangible fixed assets (Parts 5 to 8, CTA09).

Calculation of Double Tax Credit where relief under Merger Directive applies

Where there has been a transfer of an intangible fixed asset or a chargeable asset from an overseas permanent establishment of a UK company to an overseas EU based company, s116 TIOPA10 or s122 TIOPA10 may allow double tax relief to be claimed as though the Merger Directive (2009/133/EC) did not apply.

In circumstances where existing tax neutrality provisions exist (or are introduced) in the importing state this may cause additional complexity. Customers should consider the guidance at CG45715 in the first instance, and if there remains any uncertainty they should contact HMRC.

Application of s25 TCGA92 on a transfer of staff between branches

For the purposes of TCGA92 goodwill created pre-2002 is treated as a single asset of the business. Where a number of staff are transferred from a UK branch to a non-UK branch of the same company, consideration should be given as to whether this represents a transfer of a part of the business that could be considered capable of functioning as a separate operation. If this is the case, s25 TCGA92 would then apply and deem a part-disposal of the goodwill of the business at market value.

Whether the staff transferring are capable of separate operation as a business is a question of fact. The relative size of the number of staff transferring in comparison to the exporting and importing branches is an indicative, though not determinative factor – all factors must be taken into account to determine whether what is transferring is capable in principle of separate existence.

Transfer pricing

It will be necessary to update transfer pricing policies to reflect revised business models in instances where there is a movement of functions, assets or risks to an EU member state.

Advance Pricing Agreements (APAs)

APAs assist businesses in determining the correct arm's length outcome for complex transfer pricing issues and provide certainty on those issues for a finite period of time.

HMRC policy on APAs can be found within this Statement of Practice. Customers should note paragraph 16 where it is explained that APA requests are more likely to be accepted by HMRC in cases where the facts and features are 'complex', that is where there is real doubt as to how the arm's length standard should be applied or there is a high likelihood of double taxation. If customers are interested in an APA, they should contact HMRC for an Expression of Interest meeting.

Dependent agent permanent establishments (DAPEs)

There exists a concern that EU Exit restructuring plans could lead to the creation of a DAPE in the UK. This might arise in a situation where regulatory drivers lead to the creation of formal or informal agency arrangements between a new company in the home state of an inbound bank and its UK operations. It may be appropriate for customers to consider whether a DAPE has been created from the implementation of their revised business model and how best to manage any tax liabilities arising therefrom. This could include ensuring that transfer pricing policies correctly attribute the appropriate profit to the UK and may require the separate registration of a DAPE for Corporation Tax purposes.

More information on this can be found in the OECD's Additional Guidance on the Attribution of Profits to Permanent Establishments and in HMRC guidance.

Diverted Profits Tax (DPT)

There is a concern that EU restructuring plans could lead to structures which are susceptible to challenge by Diverted Profits Tax (DPT) legislation. Generally customers should consider whether their new structures include arrangements to avoid the creation of a UK DAPE and review their transfer pricing policies to ensure the correct profit is attributed to the UK. In particular, it may be appropriate for customers who have been relying on the Investment Manager Exemption to exempt their pre-restructured arrangements from DPT to consider whether that exemption continues to apply to their new arrangements and affects the potential for a DPT liability.

Guidance on Diverted Profits Tax has recently been updated. This guidance covers a number of common scenarios in the financial services sector.

In paragraph DPT1141, HMRC states in relation to investment managers:

"Where a company is unable to obtain regulatory authority to perform certain activities and this directly leads to limitations imposed or agreed this should normally be regarded as pointing away from those limitations constituting design to ensure that the foreign company does not carry on its trade in the UK for the purpose of corporation tax."

The question of whether the restructuring leads to a DPT liability will depend on all the facts but customers can expect HMRC to approach restructuring as a result of change in regulatory regime in a manner consistent with this statement.

Other Corporation Tax issues

Deductibility of costs

If areas of legal uncertainty are identified HMRC will be happy to work collaboratively with businesses and advisors to update guidance to provide clarity. However, HMRC considers that the law and practice on the deductibility of restructuring costs is clear.

Guidance on the capital revenue divide can be found in HMRC's Business Income Manual at BIM35000 and guidance on the wholly and exclusively rules can be found in the Business Income Manual at BIM37000.

As explained in HMRC's Business Income Manual at BIM35525 expenditure incurred in connection with the acquisition, alteration, enhancement or defence of the fundamental structure of a business are capital. This is because the effect of expenditure relates to capital assets. Therefore customers should disallow as capital expenditure the costs of:

- Forming, renewing, varying or dissolving a partnership.
- Negotiating a merger between companies or partnerships.
- Forming and registering a company, or changing a company's status (for example, from limited to unlimited or to a PLC).

Expenditure that would have been capital had the activities it was predicated on been carried out does not change its character merely because those activities were aborted.

A series of tax cases in the 1990s relating to building society demutualisations dealt with a variety of issues surrounding business restructuring. Guidance on these cases can be found in the Business Income Manual at BIM37690.

It is key that customers consider whether the expenditure is incurred wholly and exclusively for the purposes of the trade of the entity incurring the expenditure rather than partly for the purposes of another entity's trade. Further guidance on this point is available in the Business Income Manual at BIM38210.

HMRC recommends early engagement in cases of legal uncertainty and that customers provide a high level of disclosure relating to EU Exit costs in their filings to reduce the need for post-filing engagement. However, there is unlikely to be sufficient legal uncertainty to warrant a non-statutory clearance as HMRC does not give clearances on matters of fact.

Available for Sale Assets – Unwind of Transitional Adjustment

Where paragraph 115 of Schedule 7 Finance (No.2) Act 2015 provides for a transitional adjustment in respect of an available for sale asset (falling with the Loan Relationships regime) and that asset is transferred, the treatment of the transitional adjustment depends on whether the transferor remains within the charge to CT.

Where the transferor remains within the charge to CT following the transfer the transitional adjustments will remain with the transferor.

However, if the transferor ceases to be within the charge to CT as a result of the transfer then the transfer would coincide with an event that falls within para 119(1)(b) Sch7 F(No.2)A15. As such, the debit or credit will be brought into account in that final period prior to the transfer. The nature of the debit or credit will be determined by reference to the particular facts, and in particular whether the loan in question was held for the purposes of the company's trade.

Available for Sale Assets – Tax adjusted carrying value on intragroup transfer

Where there is an intragroup transfer of available for sale assets falling within the Loan Relationship regime (as during, say, a Part VII FSMA2000 transfer) the 'tax-adjusted' carrying value will be the fair market value in the accounts, adjusted for accumulated gains in other comprehensive income (OCI). As a result, the release of any accumulated gains or losses through the profit and loss account (P&L) on transfer are disregarded under s340 CTA09, assuming the conditions for that section are met. The assets will be treated as being acquired in the hands of the transferee at the same tax-adjusted carrying value. The assets will then need to be tracked individually in the transferee to eventual realisation, with P&L gains being adjusted in the transferee to reflect the tax basis on transfer.

Section 465B CTA09 explicitly sets out that amounts which have been recognised in OCI and have not yet been recycled or reversed out should be taken out of the fair value of the instrument to determine the tax-adjusted carrying value.

Loan relationships

In HMRC's view, the legislation and case law surrounding loan relationships and derivatives apply to customers' EU Exit arrangements as they would in any other corporate restructuring. Customers should ensure that they carry out a careful review of the legal basis on which restructuring is undertaken as this may affect the tax analysis. In certain circumstances it may be relevant for customers to assess and evidence whether loan relationships at the point of restructuring can still be considered as being on normal commercial or business terms and, where appropriate, on an arms-length basis.

Hybrid and other mismatches

HMRC recognises that customers' plans to restructure in response to EU Exit concerns may give rise to questions on the application of the hybrid and other mismatches legislation contained in Part 6A TIOPA10. Any analysis is likely to be heavily dependent on the facts presented. Customers can contact the HMRC hybrids team at hybrids.mailbox@hmrc.gov.uk or via their CCM.

Stamp Duty/SDRT/SDLT

HMRC expects companies to determine whether there are any Stamp Duty, SDRT or SDLT consequences arising from their restructuring plans. Parties must determine if a transfer for chargeable consideration has taken place which would be taxable under Schedule 13 Finance Act 1999 (in the case of Stamp Duty); whether there has been an agreement to transfer chargeable securities which would fall to be taxed under section 87 Finance Act 1986 (in the case of SDRT); or whether there has been a chargeable land transaction potentially chargeable to SDLT under Part 4 of Finance Act 2003.

In the case of transactions in securities, the company should determine whether any reliefs (such as group relief, intermediary relief, stock lending relief or reconstruction or acquisition relief) will apply or will continue to apply following the transaction. Depending on the type of EU Exit planning involved, where a position in relation to a stock loan or repo is open at the point that a transaction occurs, parties may need to determine if stock lending relief continues to apply (since stock lending relief requires a party to the agreement to transfer stock to the other and for the other to return the stock to the original transferor at the end of the arrangement).

In the case of land transactions, again there may be the possibility of group relief, reconstruction or acquisition relief being available.

Companies can approach their CCM to discuss the possible Stamp Duty/SDRT/SDLT consequences of EU Exit planning in cases of doubt.

International Relationships

The UK's obligation to share certain tax information with other EU member states is set out in a number of directives that can be found here.

In HMRC's view, a valuation of an intangible that has been agreed with HMRC would not automatically fall within point 14 of Article 3 of the Directive on Administrative Cooperation (DAC) 2011/16/EU (as amended). Neither would it automatically be considered to be a ruling covered by the spontaneous exchange framework under the BEPS Action 5 Report. However the matter is not free from doubt and HMRC may share a valuation with an overseas tax authority where the wider circumstances suggest that this would be appropriate.

HMRC is committed to working collaboratively with overseas tax authorities, not just in the EU, to promote tax compliance and bear down on evasion and avoidance. Although the terms of HMRC's future relationships with and obligations towards EU tax authorities have not yet been agreed, the UK is committed to the implementation of DAC6, ATAD and ATAD2.

DAC6, the latest amendment to DAC 2011/16/EU, entered into force on 25 June 2018. Disclosure will be required in 2020 of cross border arrangements, the first step of which was implemented after the entry into force of the Directive. The precise scope of these new rules has not yet been determined. HMRC is working closely with stakeholders to address concerns, and will publish draft regulations in 2019 and consult on them in the usual way.

The UK has adopted and will continue to apply the Anti Tax Avoidance Directive (ATAD) that can be found here. It is expected that the UK will continue to adopt ATAD2 which extends the provisions in respect of hybrid mismatches and aims to implement the Organisation for Economic Cooperation and Development (OECD) final report on Action 2 of the Base Erosion and Profit Shifting (BEPS) project. The UK remains committed to working with international partners to deliver the BEPS agenda.

The UK is also bound by existing Double Taxation Agreements.

VAT

Transfer of going concern (TOGC)

Cross-border TOGCs

Where the transferor is located outside of the UK and the transferee is based in the UK ('inbound transfer'), HMRC accepts that UK legislation does not necessarily prevent an inbound TOGC. Where a taxpayer is seeking to rely on an inbound TOGC, HMRC will expect there to be sufficient evidence available for HMRC to confirm the assets were sufficient to constitute a business or a part of a business which was operating as a going concern prior to the transfer. If a customer meets this condition HMRC will accept a preapproval request to confirm that the cross border dimension does not preclude treatment as a TOGC.

HMRC does not consider that UK law permits outbound transactions to be treated as a TOGC. Article 19 of the Principal VAT Directive provides that member states (MS) may introduce arrangements to disregard certain transfers of business assets and treat the transferee as the successor of the transferor. The UK has made provision for TOGCs but not all other MS have done so. In respect of outbound transfers of business, therefore, it is for the MS into which the business is being transferred to determine the applicable VAT treatment in that country.

Supply where no TOGC

In the absence of TOGC treatment, normal VAT rules will apply. It will be necessary for a business to consider whether a supply has taken place and, if so, what the nature of that supply might be. HMRC would expect that in most circumstances this would be a single supply of the business activity that is being transferred (rather than breaking the transaction down to the underlying assets) following well established case law (*Card Protection Plan*).

Valuation matters

When assets forming part of a business are transferred or disposed of a supply is deemed to have taken place under paragraph 5, Schedule 4 VATA94. In that case VAT will be due at open market value in accordance with paragraphs 6(1) and (2), Schedule 6 VATA94. If a business can show that the assets and liabilities transferred were of equal value at the time of the transfer, they would have no net value and there would be no reason for HMRC to place a different value on them. HMRC will not be looking to issue Open Market Valuation Notices under Schedule 6 VATA94 in respect of EU Exit transactions unless there is perceived VAT avoidance.

An EU Exit transaction may have a different value for indirect tax purposes than for direct tax.

A transaction in these circumstances may stretch over a period of time, including a number of years. HMRC will consider the fact pattern and any supporting documentation in reaching any determination. As in other areas of tax, the retention of contemporaneous documentary evidence should be carefully considered by customers.

VAT Grouping and Fixed Establishment

For an entity established outside the UK to join a UK VAT group it must possess a UK Fixed Establishment (FE).

Fixed Establishment – Key Indicators

HMRC considers the definition of an FE for VAT grouping purposes is consistent with the definition of an FE used in the context of the place of supply rules and associated case law including *Berholz*, *Planzer Sarl*, *ARO Lease*, *DFDS* and *Welmory*. HMRC therefore considers that to constitute an FE, a business must have 'real trading presence' in the UK. For this to be the case, the following are essential indicators:

1) Having *sufficient permanent human and technical resources* to be able to make and receive supplies on an *independent basis*; and
2) Those human and technical resources must have a *sufficient degree of permanence* in the UK.

These indicators are examined in more detail below.

Sufficient Permanent Human and Technical Resources

For an FE to exist it must have sufficient permanent human and technical resources to make and receive supplies. The focus is on the permanency of the role rather than the permanency of the staff member. Secondments are acceptable if the role filled by the secondee is sufficiently permanent. Replacement of secondees in a role indicates permanency. Different secondees undertaking different tasks one after another does not convert them into permanent resources undertaking a sufficiently permanent role.

The secondees are expected to be integrated into the branch, i.e. they should have a clear role that is dedicated to branch activities (although dual roles – 'dual hatting' - is acceptable).

A normal pyramid structure for reporting is assumed. Secondees from an overseas head office reporting back to the head office would not normally be considered to be resources of the branch unless they are responsible for overseeing the branch.

Making Supplies on an Independent Basis

There are two issues:

1) Whether the FE is 'making supplies' for UK VAT purposes; and
2) Whether it does so on an 'independent basis'.

Does the FE make supplies?

For an FE to exist, it must supply goods or services to separate entities. As such, a UK branch of a non-UK entity will not normally be regarded as an FE for UK VAT purposes if it only provides services to its head office (as such transactions are not supplies in line with *FCE Bank*). There are exceptions, as set out in HMRC guidance and which are dealt with in the section below on *Skandia*.

If an FE is directly involved in the provision of services to clients and most of the resources involved in providing the services are in the UK, it may well be the supplier of the services for VAT purposes. In such circumstances, the branch could still potentially be an FE and therefore able to be added to a VAT group.

It will also be making supplies and able to join a VAT group where its only supplies are to other legal entities within the VAT group. Although they are disregarded for VAT purposes by virtue of the VAT grouping provisions, such transactions are still supplies.

Does it make supplies on an 'independent basis'?

Where a UK FE entity is directly involved in the provision of services to clients, those services must comprise separate supplies in their own right made by the UK FE.

'Independent basis' means that the FE must not rely too heavily on its head office in order to make the supplies for which it is responsible. The FE must have a suitable structure within which agreements can be drawn up and decisions taken. Liaising with customers is an important factor, but so is concluding contracts, setting prices, invoicing, etc. No one factor is decisive but, overall, HMRC would expect more to be undertaken in the UK than outside in respect of those particular supplies.

To qualify as an FE, the supplies it makes should be material to the business of the company and not, as in *Planzer*, 'preparatory or auxiliary' to those made by its head office.

In addition, the FE's supplies should not arise merely due to the splitting of a single contract into two client contracts, that is, one between client and head office and a second contract between client and branch, whereby the second contract seeks to create a new, separate supply by the FE.

Sufficient degree of permanence

In order for an FE to exist the human and technical resources available to it in the UK must be examined over a period of time to ascertain that there is a sufficient degree of permanence in the UK.

This does not mean that there is a minimum length of time that an FE must exist in order that a company can join a VAT group. Instead, the human and technical resources must be permanently present in the UK for the duration of the time that it is included within the UK VAT group.

FEs: Interaction with *Skandia*

When establishing whether an FE exists for VAT purposes it is necessary to consider whether the transactions between an FE and its overseas head office (or other branches/FEs) are impacted by the CJEU judgment in *Skandia America Corp (USA), filial Sverige (C-7/13)*. HMRC's current position on *Skandia* is set out in HMRC Briefs 2/2015, 18/2015 and 23/2015.

A transaction between an FE and another establishment must be treated as a supply for UK VAT purposes where the other establishment is a member of a VAT group in a Member State that has implemented 'establishment only' VAT grouping, and the Member State treats such transactions as supplies for VAT purposes. For businesses with operations in countries where this applies, a branch can be an FE, capable of VAT grouping (subject to all other conditions being met), even where its only transactions are with other establishments of the same legal entity. This is because the establishment and the branch are treated as separate taxable persons by the Member State where the services are being received.

Protection of the revenue

HMRC can refuse VAT grouping or remove an existing VAT group member where this is considered necessary for the protection of the revenue.

The main concern in relation to cross border services is with services being imported into the UK VAT free. HMRC is unlikely to use these powers in circumstances where a branch is exporting services from the UK and where businesses are required to restructure for reasons beyond their control (e.g. restructuring resulting from regulatory change arising from EU exit).

These powers remain available to HMRC, however, and may be used if it is considered that a taxpayer is attempting to use restructuring as cover to implement arrangements that go beyond the acceptable use of VAT grouping i.e. where the supplies of the UK FE are not material in comparison to the value of the supplies brought into the UK through the company or where the supplies made by the UK branch have little relationship to those supplies.

Consequences of not joining a VAT group
Where a non-UK entity does not have an FE in the UK, then the entity is not entitled to join a VAT group. It will also not qualify as an FE for the purposes of a separate VAT registration and will therefore not be required to separately register for VAT and account for reverse charge VAT. Supplies received by it, other than exceptions to the normal rule such as property costs which are taxed where the land is based, will not be taxed in the UK.

If requested to do so by a business, HMRC will provide written confirmation that the UK presence of a business does not constitute a UK FE for VAT purposes to enable it to provide evidence to its suppliers.

Joining a VAT group
If customers wish to request that a new or existing FE be added to a VAT group, the normal process should be followed. In order to facilitate customer restructuring through the EU Exit process, HMRC has set up a dedicated mailbox. In addition to the normal process, if partially exempt customers wish to contact the mailbox team, they should set out full details of the FE that it is proposed will join the group including how the FE meets the conditions set out above. Large Business customers should ensure that they send a copy of this email to their CCM.

The email address is: financesectoreuexitvat.lblondon@hmrc.gsi.gov.uk

Partial exemption special methods (PESMs)

Customers will need to ensure that their PESM is updated to reflect their revised business model.

Specified supplies order (SSO)

The Value Added Tax (Input Tax) (Specified Supplies) Order 1999 (SI 1999/3121) provides for VAT to be deducted on certain ‘specified’ supplies of VAT exempt financial services. Currently, VAT deduction applies to those services supplied to customers, or in connection with exports of goods to customers, belonging outside the EU.

On 1 March 2019 a Statutory Instrument was laid that will extend deduction under the SSO to supplies of financial services made to customers belonging in the EU (whilst retaining the current VAT treatment in respect of UK to UK supplies). This SI will only be brought into force in the event that the UK exits the EU without a deal. If a deal is agreed, the current VAT treatment will continue throughout the implementation period.

Any decisions concerning the VAT treatment of financial services beyond an implementation period will depend on a wide range of factors, not least the shape of a future economic partnership with the EU.

VAT on EU Exit costs

Where there is an intention to make taxable supplies, VAT on related expenditure can be recovered as input tax. This also applies to holding companies. Where a holding company incurs expenditure with the intention of making taxable supplies, it can recover input VAT where it can evidence that the intention was genuine or by ensuring that the services are recharged to the company that was intending to trade. For partially exempt businesses that operate an approved Partial Exemption Special Method (PESM), input tax recovery is governed by the PESM. If this is not addressed by the PESM, recovery is based on the use, or intended use, of the costs incurred.

Employees

Employee issues are currently being discussed within HMRC. It is anticipated that an Employer Bulletin will be issued that will address certain EU Exit matters. Employer Bulletins can be accessed here.

Client Tax Matters

Client Account Reporting

Reporting of client information is required under both domestic legislation and Automatic Exchange of Information (AEOI) agreements.

Schedule 23 Finance Act 2011 provides for the reporting of interest earned or credited to accounts of UK residents on either a Bank, Building Society Interest (BBSI) or Other Interest (OI) return. The information must be provided in a prescribed format as set out in guidance.

Financial institutions are also obliged to use an online system to report to HMRC under AEOI agreements covering:

- the United States Foreign Account Tax Compliance Act (FATCA)
- Crown Dependencies and Overseas Territories (CDOTs)
- the Common Reporting Standard (CRS).

This guidance can be found here.

HMRC is aware that many of its customers are undertaking corporate restructuring in response to regulatory change. This could mean that reportable client accounts will move from one reporting entity to another. If this is the case, reporting can be done in one of the following ways:

1. by the transferor entity to the date of transfer and by the transferee entity from that date until the end of the reporting period, or
2. by the transferee entity for the whole reporting period.

The transferee entity will need to set up its own HMRC account on the online reporting system. For FATCA, a new GIIN will be needed.

If a client account transfers out of the UK, financial institutions will need to report relevant information to the date of transfer.

Assistance on BBSI and OI can be obtained from cni.enquiries@hmrc.gsi.gov.uk.

For FATCA, CDOTs and CRS, there is a helpline (03000 576748) and mailbox: enquiries.aeoi@hmrc.gsi.gov.uk.

Treaty Passporting

Corporate restructuring might also mean that changes to Double Taxation Treaty Passport Scheme arrangements are required in respect of the existing borrowers of financial institutions. The Large Business Double Taxation Treaty Team would not expect existing borrowers to reapply for permission to pay gross or at a reduced rate of withholding. In line with established practice, the Treaty Team will agree arrangements with financial institutions that allow temporary “grandfathering” of existing permissions for a limited period. Typically this would see the interposition of a UK company as quasi collecting agent for borrower interest payments under the terms of a servicing agreement or similar.

In the first instance customers should explain their restructuring plans in detail and include their proposals for ensuring treaty compliance and write to:

HM Revenue & Customs
LB DT Treaty Team
Barkley House
Castle Meadow
Nottingham
NG2 1BA

The LB DT Treaty Team can also be contacted on 03000 547584.

Life Insurance Policyholders

HMRC does not foresee any changes to the taxation of UK resident policyholders as this does not depend on the regulatory status of the policy provider. The tax treatment of policyholders follows the contractual arrangements and nature of the receipt. For example, insurance proceeds received by a trader will be taxable if they are paid to compensate for a loss of profits or replace trading assets. Some payments from life insurance policies may also be taxable under the chargeable events legislation.

The tax treatment of policyholders resident outside the UK will depend on the relevant tax regime on which HMRC cannot comment.

Contacting HMRC

In line with existing policy in Large Business, Customer Compliance Managers can discuss matters with customers in advance of the submission of returns provided that appropriate analysis has been undertaken by the customer and full disclosure of the facts and circumstances is being made.

HMRC has a service for mid-sized businesses that also covers business restructuring. Customers can apply online here using their Government Gateway user ID. Alternatively a mid-sized financial services customer can contact the specialist financial services team by email on midsizebanks.wmbc@hmrc.gsi.gov.uk provided that appropriate analysis has been undertaken by the customer and full disclosure of the facts and circumstances is being made.

In situations where, despite published guidance, there is uncertainty about HMRC's interpretation of tax legislation, customers can apply for Non-Statutory Clearances in the usual way. Information on how to do so can be found here.