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1 June 2021

Dear Mr Morton,

RE: CITY OF LONDON LAW SOCIETY'S RESPONSE TO NOTIFICATION OF UNCERTAIN TAX TREATMENT BY LARGE BUSINESSES

Please find below The City of London Law Society's ("**CLLS**") response to the HM Revenue & Customs ("**HMRC**") consultation document entitled "Notification of uncertain tax treatment by large businesses – second consultation" (the "**Consultation**") of 23 March 2021.

The CLLS represents approximately 17,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response to the Consultation has been prepared by the CLLS Revenue Law Committee. The current members of the committee are herewith:-

http://www.citysolicitors.org.uk/clls/committees/revenue-law/revenue-law-committee-members/

The CLLS responded to the first consultation and, whilst the proposal has developed and some issues have been resolved, other concerns remain. Therefore in some cases our previous comments have been restated where relevant.

1. Do you support the government taking action to close the legal interpretation portion of the tax gap?

Per our responses to the previous consultation, we do not think it is proportionate to introduce any additional reporting obligations. As per our response to the prior consultation, the 'legal interpretation' part of the 'tax gap' necessarily involves situations where the taxpayer reports on a basis that is too favourable as a matter of law, but it is not clear that a reporting obligation of this kind would be necessary or proportionate to deal with this issue:

a) If the taxpayer has filed on a basis that is legally correct, then there is in no sense a 'gap' here, even if HMRC might disagree with the taxpayer's view.

b) There would be a legitimate concern for circumstances where the taxpayer is not right, but where the point does not surface in a way that enables HMRC to test and prove its view. However, in our view the existing legal framework of tax compliance already adequately incentivises taxpayers not to take overly aggressive positions in their returns.

Additionally, HMRC's estimates show that this measure raises very little additional tax revenue. In particular the revenue raised represents only a tiny fraction of the 'legal interpretation' part of the tax gap it is intended to address. We would therefore question whether it is proportionate to impose this significant additional compliance burden on large business. Therefore, in our responses, we have suggested ways that this measure can be focused on triggers that will be easy for large business to apply without material additional burden.

2. If you do not agree with the government's proposed course of action, what alternatives do you suggest to address the problem?

We consider that HMRC's existing policies and powers to investigate large business taxpayers, combined with the cooperative relationships that many large businesses have with HMRC, and penalties and interest which make it important to adopt careful and correct treatments, ought to be sufficient to ensure that any such 'legal interpretation' gap is minimal.

If the government intend to proceed with a measure of this kind, the rules must be simple for business to apply, without creating additional layers of complex analysis and judgment – especially in order to be proportionate with the small amount of revenue to be raised here. Focusing the measure on the first three triggers (a) to (c) would be the most sensible approach. In our view these measures are the most straightforward to apply, whilst also being reasonably focused on the intended target of areas where a legal interpretation 'tax gap' may exist.

3. Is there an objective alternative to using BRR+ ratings that could exempt low-risk businesses?

No comment.

4. Should there be other specific exemptions from the notification requirement?

Transfer Pricing

As HMRC notes in paragraph 2.31 of the Consultation Document, an obligation to report transfer pricing cases would create a substantial compliance burden, and we welcome the suggestion that there would be exceptions for reporting transfer pricing cases.

It is suggested that this exemption from transfer pricing should be in respect of specific triggers. However, it seems appropriate to us that it should be exempt from all triggers. The difficulties with reporting transfer pricing positions apply equally in all cases.

Prior discussions with HMRC

We welcome the recognition at paragraphs 2.7 and 2.15 of the Consultation Document that if businesses are already discussing any uncertainties with HMRC, they will not be required to notify again under this regime. This is an important means of ensuring this measure is proportionate.

The caveat that this specific exemption would not apply where "the business treats the transaction contrary to HMRC's recommendation" should be clarified. This should only apply where HMRC gives a clear written indication of its views about the applicable treatment. (See also our comments on proposed trigger (b) below.)

We note that at paragraph 2.27 it is noted that "HMRC will expect the same level of detail in these discussions as will be required if a notification was made (refer section 5)." We think that most discussions with CCMs on these issues will be open and large taxpayers are generally forthcoming on whatever information CCMs reasonably ask for. We therefore would recommend against being too formalistic in what exactly must have been discussed with CCMs in order to benefit from this exception. For instance, if the CCM has not asked for an estimate of the tax at stake but has been made aware of the technical query, this should not impede relying on this exception to reporting. As a further example, where a potential transaction has been discussed in advance under the Code of Practice on Taxation for Banks, certain details such as the transaction date or the amounts of tax in issue based on pricing and commercial terms of the transaction would not necessarily be available (given the nature of pre-transaction discussion). In such cases, further reporting of the transaction details should not be required.

Legal privilege

No reporting should be required in circumstances where to do so would disclose the content of legally privileged advice.

5. Do you think that the triggers are sufficiently objective?

Trigger (a). In principle, trigger (a) seems appropriate; however, if it is to be appropriately objective, it needs to be significantly clarified as to exactly when HMRC has a "known position".

This trigger does put more onus on taxpayers to be aware of HMRC's guidance, but in our experience large business taxpayers will routinely check HMRC's guidance anyway. It also means that it is important for HMRC to keep guidance up to date and in line with positions it is taking in practice (see (i) below for a related recommendation in this regard).

In terms of clarifying this trigger, we make the following recommendations:

(i) The "known position" of HMRC should be one that is fairly settled and established. The Consultation at paragraph 3.9 proceeds on the basis that HMRC's published guidance can be taken to represent HMRC's "known position" – but that is not always the case: a taxpayer should not be required to notify taking a position contrary to published guidance, if in fact it is known that HMRC does not follow the relevant guidance in practice. In addition, commentators have noted that (for example) HMRC's views on the VAT treatment of contractual compensation payments have undergone considerable changes recently. It does not seem fair to require a notification from taxpayers in situations where HMRC's view has been subject to recent change. It would be particularly unfair for taxpayers to need to report retrospectively on a transaction if HMRC subsequently publishes guidance with a change of view, since taxpayers will not routinely monitor HMRC's guidance for changes after implementing a transaction.

(ii) The Consultation at paragraph 3.9 indicates that HMRC's known position would include "HMRC's view, as established in dealings between the business and HMRC". We would suggest that this should be confined to situations where HMRC has reached a settled view with the taxpayer on a particular matter; and ideally, HMRC should be required to identify when it has reached a firm view for this purpose. This is because it is quite common in our experience for HMRC to develop its views during the course of engagement with taxpayers. One yardstick might be to identify HMRC views that have been reflected in a closure notice.

(iii) The "known position" of HMRC should only be taken as present for treatments which are clearly applicable to the taxpayer's facts. We would suggest that the "reasonable apportionment" treatments described in the guidance at EIM12965 (referred to in paragraph 3.12 of the Consultation) are unlikely to fall into this category, since the question described in that guidance is one that is highly dependent on the facts and circumstances of the compensation payment to the employee.

(iv) We would query whether it is appropriate for taxpayers to be required to survey HMRC's known views based on court decisions, as is suggested by paragraph 3.30 of the Consultation. If something has been decided by a court as ratio decidendi, then this is simply part of the law, and it is not clear to us how this could be a view expressed by HMRC on an uncertain treatment. If HMRC are instead suggesting that taxpayers must review all positions taken in the reported arguments of counsel for HMRC, whether or not featured in the decision of the court, then this seems disproportionately onerous. Similarly, HMRC's views expressed in argument in ongoing litigation should not be a source of HMRC's known view.

Trigger (b). Trigger (b) may be difficult to apply if it is not clear when a taxpayer belongs to a particular industry or is a new entrant to a particular business line and not yet engaged with relevant industry body, or is engaged with one industry body but not others. Moreover, publications by industry bodies frequently cover a range of topics including tax alongside other non-tax topics. It would be unduly burdensome to require taxpayers to search for any mention of standard tax treatments among such publications. Therefore, it would be preferable to confine this to treatments in HMRC's published guidance, in which case this trigger may be superfluous to trigger (a) and could be removed.

If it is proposed to include a version of trigger (b) that includes the published materials of industry bodies, it would be simpler to apply if published materials from industry bodies were relevant only where the taxpayer was a current member of that industry body. Furthermore, taxpayers would not necessarily be aware of published views from industry bodies dating before they became a member – so the range of materials that the taxpayers would be required to check should be restricted accordingly. We also suggest that HMRC should publish a list of industry material that are identified as providing an industry view on particular tax treatments – for instance, it would be useful to understand what materials taxpayers should be expected to read in order to be aware of the treatment of heavy goods vehicles and trailers described in paragraph 3.14 and 3.15 of the Consultation.

We can see some risk that this trigger would ultimately lead to industry bodies ceasing to publish materials on tax treatments. It may also have the effect of 'chilling' industry bodies from engaging on tax consultations such as this, for fear of being treated as publishing a view on a tax treatment that one or more of their members may disagree with.

Trigger (c). This trigger seems reasonable. However, it should be clear that transactions are not equivalent (and so the trigger would not apply) where there has been a relevant change in *facts*. In the example HMRC give in paragraph 3.17 of the Consultation Document, this trigger should not apply if there had been a change in

the facts relevant to the legal analysis. For example, if the business genuinely changes the character of the supplies it makes (e.g. through differences in the marketing, delivery, or pricing of the supplies concerned), it would be entirely appropriate to revisit the VAT analysis afresh in that circumstance and the trigger should not be engaged.

We also recommend that this trigger should be confined to treatments the taxpayer has adopted in transactions of material size or frequency in the last 4 years; it is unreasonable to expect taxpayers would have institutional knowledge that dates back a long time or that covers small transactions that the tax function or its advisors would not reasonably be aware of. The trigger should also be confined to previous positions taken by the particular company; it would be difficult to monitor previous positions taken by different companies in a group, particularly if companies change hands through M&A.

Trigger (d). This trigger is the most uncertain and burdensome of all, and should be removed. Failing that, it should be clarified in what circumstances a treatment "*cannot reasonably be regarded as certain*", and what counts as "*novel*".

Firstly, we think it will be hard to establish when something is 'novel'. Is this based on the perspective of the taxpayer company, the individuals concerned, or the experience of their advisors? Furthermore, we think that genuinely novel products, transactions, or business structures are rare – more often there is a process of incremental change and iteration. Where there are analogous precedent transactions or structures with features that are pertinent to the same tax treatment that is proposed, even when there has been some modifications / iteration, this should not be a case of being 'novel'.

We also think that it is misconceived to say that there are situations, in relation to a product, transaction or structure, where "*there are various ways that it can be treated*". Except where the legislation itself provides an elective treatment, or in transfer pricing type cases where there is an acceptable range, there is generally only ever one correct tax treatment.

In practice, we also find that large businesses take extensive professional advice on tax treatments for new products, transactions, or business structures. Where professional advice has been sought, and a reasonably confident view of the correct tax treatment given by the advisor, the taxpayer should not need to report the transaction simply because it is in some way 'novel'. In such a case, faced with a clear recommendation from the advisor of the correct treatment, this should not be treated as a situation in which "*there are various ways that it can be treated*" or which "*cannot reasonably be regarded as certain*".

We find it difficult to understand what is "novel" about the example given at paragraph 3.20 of the Consultation Document. (It also seems to us that this example is one concerning 'avoidance' rather than the 'legal interpretation' tax gap.) While the example at 3.21 is better, as it is clear that the food is new (and this is not a case of avoidance), the food example illustrates how onerous this trigger could be if cases of incremental change cannot be excluded where analogies with prior experience enable a sensible view to be taken.

Trigger (e). We believe that this trigger may require some refinement and/or clarification in order to ensure that it can be applied with sufficient certainty to produce meaningful notifications (and without imposing an excessive compliance burden). In particular, we understand that due to the way large businesses often construct their accounting provisions for corporation tax risks on an aggregated basis, simply requiring disclosure of all treatments covered by a provision is likely to result in a vast amount of disclosures for matters which are not (viewed individually) particularly uncertain.

We understand that it is common for large businesses to recognise provisions for corporation tax based on an aggregated approach, i.e. by reference to a "*group of uncertain tax treatments considered together*" as described in paragraph 7 of IFRIC 23. This may lead to recognition of a single provision in respect of a large number of transactions (not necessarily involving a single or common technical issues), where there is (on an aggregated basis) some small level of uncertainty, and a commensurately low provision (relative to the theoretical tax at stake). Such a provision may cover transfer pricing issues alongside other issues. Viewed individually, each particular treatment may not be materially uncertain; but in line with paragraph 11 of IFRIC 23, the taxpayer may nonetheless recognise a provision based on an assessment that "*it is not probable that the taxation authority will accept an uncertain tax treatment*" – meaning only, in the aggregated context, that it is not probable that the aggregated positions will be accepted *in full*.

The Consultation refers to a provision being recognised "*to reflect the probability that a different tax treatment will be applied to the transaction*". In order to capture that scenario, and in light of the points made above, the trigger would be best formulated by focusing on situations where an *individual* matter has been identified (through the taxpayer's existing provisioning processes) where applying the test in paragraph 11 of IFRIC 23 to that individual matter, "*the entity concludes it is not probable that the taxation authority will accept an uncertain tax treatment*" and, applying either one of the methods in paragraph 11(a) or (b) (the most likely amount or the probability weighted expected value), a provision of more than 50% of the tax at stake is applied.

Trigger (f). This trigger should be removed on the basis that it is too uncertain, and seems misdirected towards 'avoidance' rather than the 'legal interpretation' tax gap.

Tax laws generally do not operate by reference to concepts such as "economic outcome", on the basis that these are too subjective and uncertain; and for the same reason we do not think there should be a reporting trigger by reference to such a concept. Were this trigger included, we think that it would require notification of a large number of cases in particular in areas of the tax code (like the Part 9A Corporation Tax Act 2009 dividend exemptions, or capital allowances) that involve a divergence of taxation from accounting / economics, wherever there was a complex situation not covered explicitly by HMRC's guidance.

The framing of this test also seems inappropriately directed at 'avoidance' cases, which are out of scope of this measure.

Perhaps the main example where such concepts have been employed previously are as one of the statutory hallmarks of "abusive" avoidance as part of the GAAR in section 207(4) Finance Act 2013 (and in similar fashion as part of the hallmarks of loan relationships avoidance for the TAAR in section 455D(1)(a) and (b) Corporation Tax Act 2009). Whilst we would not hold these up as model legislation, in each case the tests are focused on identifying avoidance, use the concept in an indicative rather than determinative way, and are subject to the important qualifier that the result must be contrary to the intentions of parliament. In the case of the GAAR, the tests are also supplemented with the extensive guidance and examples to assist an exercise of judgment. We do not think it is viable to present a similar test without a filter based on the intentions of parliament, as there are so many ways in which tax treatments can diverge from accounting and economics, and there may not be a readily available source to confirm HMRC are "known to accept" any particular application of such rules. This rather serves to illustrate that this trigger is more targeted at 'avoidance' than 'legal interpretation' issues and should be removed on that basis.

Trigger (g). We welcome HMRC's recognition that reporting requirements, including the triggers, must not infringe on the right to legal privilege. However, we would nonetheless strongly discourage the adopting of this trigger as a whole, on the basis that it places taxpayers who seek advice in a worse position than those that do not.

In doing so it may disincentivise taxpayers from seeking formal advice and, as a general principle, taxpayers should be encouraged to seek advice on tax law (whether that is privileged advice from lawyers or non-privileged advice from accountants and other tax advisers).

Additionally, this measure would deepen the distinction that prevails currently favouring advice from lawyers over tax accountants, in a manner which does not carry justification. In the split judgment of the Supreme Court in *Prudential plc* [2013] 2 A.C. 185, even the majority finding in favour of maintaining the distinction between tax advice from lawyers and tax accountants found the distinction illogical. Lord Neuberger, in the majority, commented: "*There is no doubt that the justification for LAP is as valid in the modern world as it was when it was first developed by the courts. However, its restriction to advice from members of the legal profession, while it can fairly be said to be illogical in the modern world, is explicable by reference to history*." However, the court felt unable to change the current scope of LAP, because to do so would be a substantial change that deserved to be made by Parliament. We would say that, as Parliament considers this new proposal, it would be unwise to create new measures which deepen this "illogical" distinction.

As to the drafting, it is not clear to us what HMRC is suggesting with the two versions of this trigger. In particular, what is caught by the first trigger that is not caught by the second? Where there is conflicting advice, necessarily one set of advice is not being followed.

Is HMRC suggesting that the first category would capture a situation where a matter is the subject of privileged professional advice, and then subsequent non-privileged advice gives a different recommendation, and the latter is followed? To require reporting in this situation would be a clear breach of legal privilege.

Further, in relation to the first category of conflicting advice, we do not think this situation is a reliable indication of matters which should be reportable. It is often the case that an initial high-level review may be conducted, but a second opinion sought on a more detailed and authoritative basis. If subsequent advice is more detailed than the initial advice, or shows that the initial advice was clearly mistaken, then we do not feel this situation is a matter of uncertainty worthy of being reported.

6. Can you suggest ways to make them more objective and certain?

See answers to Question 5.

7. Do you think any of the triggers will not capture the uncertain treatments they are intended to identify?

See answers to Question 5.

8. Are there additional triggers that would identify uncertain tax treatments that would not be identified by these triggers?

See answers to Question 5. We think a sub-set of the triggers here would be sufficient.

9. Which of these triggers do you consider should apply in respect of transfer pricing uncertainties (refer paragraph 2.31), and why?

There should be an exemption for transfer pricing uncertainties that applies to all triggers. The difficulties with reporting transfer pricing positions apply equally in all cases.

10. Do you agree with the threshold of £5m for both direct and indirect taxes?

The proposed £5m threshold seems reasonable for direct and indirect taxes.

11. Considering the concerns outlined about a materiality threshold, do you have further points to support one?

Given the wide ambit of the triggers, and the amount of additional work that would be required to test if some of them are met, it seems clear that some level of materiality threshold is essential for this proposal to be proportionate. However, if the triggers were narrowed substantially, then a materiality threshold may not be needed.

12. Do you agree with the proposed rules to calculate the threshold?

The method for calculating the threshold seems reasonable.

13. If you do not agree with the proposed rules to calculate the threshold, can you suggest an alternative calculation?

No comment.

14. Do you think requiring notification for each tax within scope will be easier to comply with than a single notification?

The proposal to file these uncertainties with each of the relevant returns is preferred.

15. Do you agree with the notification being required when the return is due?

Yes.

16. Do you agree, for non-annual returns, with the notification being required when the last return for a financial year is due to be filed?

Yes.

17. Do you agree that tax neutral inter-entity transactions should be excluded?

It is not clear to us what exactly this question is about.

We think that reporting should be as streamlined as possible with existing returns. Therefore, the proposal for possible group returns makes sense, for example for VAT cases where the group would typically report for VAT on a group basis.

Intra-group transactions which are not treated as supplies for VAT purposes, or which benefit from tax neutral treatments under direct tax rules, may be considered lower risk, and you could consider an exemption from reporting around these areas. However, if an exemption of this kind is required, then that seems to indicate that the triggers are too broad in the first place. It should not be a surprise or viewed as 'uncertain' that certain tax neutral intra-group treatments can result in divergences of tax results from economics or accounting.

18. Do you agree that the information required in a notification should be covered in guidance?

The proposed information required in items (1), (2), (4) and (5) seem appropriate. But some guidance or examples could be useful.

Item (3) could be clarified – it is not clear what is meant by "periods affected by the uncertainty". For a notification as part of a CT return for an accounting period, which is subject to an uncertain treatment, would the taxpayer need to add anything for this

item? Are HMRC suggesting that the taxpayer should identify any past or expected future periods that might be subject to the same treatment? Having done so, would the taxpayer need to make the same report with the CT returns for those future periods? Or is this more directed at an annually reported VAT return, in which case would the taxpayer be required to specify (say) the quarter in which the uncertain treatment was relevant?

As noted above, no reporting should be required in circumstances where to do so would disclose the content of legally privileged advice.

19. Do you agree failure to notify regarding a partnership return should be charged on the nominated partner?

No comment.

20. If the penalty is not on the nominated partner, on whom should the penalty be charged?

No comment.

21. Do you have any comments on the assessment of equality, and other impacts?

No comment.

POINTS OF CONTACT

Should you have any queries or require any clarifications in respect of our response or any aspect of this letter, please feel free to contact me by telephone on 020 7296 5783 or by email at Philip.harle@hoganlovells.com.

Yours faithfully

Philip Harle

Chair City of London Law Society Revenue Law Committee