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# Uncertain Tax Treatments

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The government is to enact legislation in Finance Act 2022 to place an obligation on large businesses to notify HMRC when they take a position in their tax filings which is subject to uncertain tax treatment.

The regime will require large businesses to notify HMRC of any uncertain tax treatments, defined by reference to two triggers, where the aggregate tax advantage is £5m or more in a year. It will apply to corporation tax, income tax (including PAYE) and VAT. The new regime is due to be introduced with effect for relevant returns filed on or after 1 April 2022.

This is a significant tax development that will affect all large businesses in the UK. At the very least, it will require further due diligence and add to the administrative and compliance burden of the tax function. Although the rules do not come into force until April 2022 – and may still change in their passage through the Finance Bill – businesses should already be considering their approach given that the rules may well be relevant to transactions being entered into now.

# Background

In March 2020, the government published a consultation document on the introduction of a requirement for large businesses to notify to HMRC uncertainties in the tax treatment of their tax filing position. The consultation, "Notification of uncertain tax treatment by large businesses", set out a proposal for all large businesses to be required to notify HMRC of any tax position that they take which HMRC is likely to challenge, subject to a £1m *de minimis*. The proposal was motivated by the need to reduce the "legal interpretation tax gap" i.e. that part of the tax gap arising from disputes between HMRC and taxpayers where each take a different view of the correct tax treatment but where there is no tax avoidance. For further details of that consultation, see our article, Notification of uncertain tax treatment by large businesses.

The consultation attracted much criticism for the level of uncertainty inherent in the proposed reporting requirement. The scope of the requirement to report was clearly subject to a great deal of ambiguity and, in principle, required a judgement as to what action HMRC might seek to take in relation to any tax position - covering the full range of taxes. In November 2020, the government accepted that the scope of the requirement needed to be much more clearly defined, and a further consultation followed in March 2021. For details of the second consultation, see our article Notifying uncertain tax treatment: second consultation.

The second consultation proposed restricting the rules, at least initially to corporation tax, income tax (including PAYE) and VAT only. In addition, the government proposed to make the concept of an "uncertain tax treatment" more objective by introducing a series of triggers for notification and increased the proposed *de minimis* to £5m. Draft legislation followed in July 2021 together with a consultation response document, confirming the government's intention to go ahead but introducing a number of significant changes, including limiting the application of the rules to transfer pricing and reducing the number of triggers for notification. For details of the second consultation response, see Notification of uncertain tax treatment - draft legislation released. Most recently, HMRC published draft guidance for consultation in August 2021 and this legislation (with some significant amendments) has now been included in the Finance Bill.

# Why are the rules being introduced?

The original consultation pointed out that the "legal interpretation tax gap" in the 2019 edition of 'Measuring tax gaps' was £6.2bn (18% of the overall tax gap) and the majority of the legal interpretation tax gap is attributable to large businesses. The aim to reduce this tax gap. (For the most recent HMRC report on the tax gap, see our article Mind the tax gap.)

The legal interpretation tax gap is defined as losses "where the customer's and HMRC's interpretation of the law and how it applies to the facts in a particular case result in a different tax outcome, and there is no avoidance". Specifically, this includes the interpretation of legislation, case-law, or guidelines relating to the application of legislation or case-law.

Accordingly, the government announced in the March 2020 Budget its intention to require large businesses to notify HMRC where they have adopted an "uncertain tax treatment". The measure is designed to improve HMRC's ability to identify issues where businesses have adopted a different legal interpretation to HMRC's view. The measure aims to ensure that HMRC is aware of all cases where a large business has adopted a treatment with which HMRC may disagree and accelerate the point at which discussions occur on uncertain tax treatment.

# Which businesses will be affected?

The requirement will only apply to large businesses. The threshold for what is a large business, and therefore within scope of the notification measure, will be based on other regimes that apply this threshold including the Senior Accounting Officer (SAO) regime and Publication of Tax Strategies (PoTS) regime.

Businesses fall within these regimes if they satisfy either or both of:

- turnover above £200m; and
- balance sheet total over £2bn.

It will also apply to partnerships and LLPs that meet these criteria.

The government recognises that an asset manager business's turnover and balance sheet threshold calculation should not include the assets of fund portfolio companies. In addition, the government also accepts that there will be some entities that will satisfy the turnover and balance sheet criteria but are not intended to fall within the requirement to notify, for example, collective investment schemes. Accordingly, the Finance Bill contains a number of provisions excluding collective investment schemes and qualifying asset holding companies from the scope of the provisions, for example.

# Which taxes are covered?

Initially, the government proposed that the requirement would apply in respect of the same taxes covered by the SAO regime (corporation tax, income tax (including PAYE), VAT, excise and customs duties, IPT, SDLT, SDRT, bank levy and petroleum revenue tax).

However, the scope of the measure was subsequently restricted to corporation tax, income tax (including PAYE) and VAT only. The government believes these taxes make up the majority of the large business share of the legal interpretation tax gap and limiting the scope of the measure will reduce the administrative burden on large businesses without unduly affecting the efficacy of the measure. In addition, the government has limited the application of the rules to transfer pricing (see below).

# What is an uncertain tax position?

The original consultation recognised that an "uncertain tax position" might arise from a wide range of scenarios, from a taxpayer making a judgement on a position of genuine uncertainty to a taxpayer taking a position "with the deliberate intention of pushing the boundaries of the law to their advantage". The intention was to catch all such scenarios. However, designing the requirement has proved anything but straightforward.

Perhaps the major concern and criticism of the original proposal was that the proposed definition of an uncertain tax treatment - being one that HMRC may challenge or is likely to challenge - was too subjective. The government later accepted this criticism and has instead settled on two triggers.

The two triggers will be where:

- the accounts have a provision to reflect the probability that a different tax treatment will be applied. This aims to capture those instances where a taxpayer has recognised it is more likely than not that the filing position will not be sustained; and
- the taxpayer's treatment has diverged from HMRC's known position. HMRC's position will be known where it is apparent either from guidance, statements or other material from HMRC, or from dealings with HMRC.

The draft legislation originally included a third trigger which operated where there is a substantial possibility that the taxpayer's adopted tax position would be overturned by a tribunal or court. However, it was announced as part of the Autumn Budget 2021 that this trigger would not be initially included and the Finance Bill does not include this trigger. However, the Budget announcements made it clear that the government would keep this under review for possible inclusion at a later stage.

Following feedback on the scope of the rules, transfer pricing will only be within the scope of the notification requirements to a limited extent. Due to the inherent uncertainty involved in transfer pricing calculations, the government accepts that transfer pricing should not be subject to the same tests. Instead, the government proposes to exclude uncertainties regarding the application of the arm's length principle from the requirement to notify, except where the application of the arm's length principle is contrary to HMRCs known position or a provision is made to recognise the uncertainty.

The decision whether a tax treatment is uncertain must be made at the time the taxpayer is required to submit a notification. If a tax treatment becomes uncertain after that date (perhaps due to changes in case law) there would not be an expectation to revisit that year. However, if the tax treatment is ongoing, then a notification would be required in the subsequent year.

# What needs to be notified?

Large businesses will need to notify where they have adopted an "uncertain tax treatment". However, there is no intention to duplicate existing regimes and so there will be exceptions where, for example, a transaction has been disclosed under the Disclosure of Tax Avoidance Schemes rules or if it is otherwise reasonable for the taxpayer to conclude that HMRC already have available to them all, or substantially all, of the information relating to that amount that would have been included in the notification if it had been required to be given – for example where there has been formal discussions with HMRC.

Care will be needed in this latter situation, however. Whilst there should be no need in principle to make a disclosure where communications have already taken place with the Customer Compliance Manager (CCM) of uncertainties, the information provided to HMRC must be all, or substantially all, of the information that would have been included in the notification if it had been required to be given. This may mean that existing communications with a CCM may not necessarily meet the formal notification requirements.

In addition, the mere fact that a business has applied for a clearance in relation to a situation will not necessarily exempt them from the need to make a formal notification, particularly if HMRC disagree with the suggested tax treatment.

For these purposes, the government has accepted that HMRC will need to provide access to discuss uncertainties either:

- with the business's CCM;
- by ensuring businesses without a CCM have opportunities to discuss uncertainties; and
- through a prompt pre-transaction clearance process.

The draft guidance indicates that HMRC will provide mid-sized businesses and those businesses without a CCM to complete a form requesting access to the mid-sized business Customer Engagement Team with the intention to put businesses without a CCM on the same footing as those with a CCM.

There rules include a de minimis threshold of £5m in order to ensure that the requirement does not put disproportionate burdens on businesses. The threshold test will be exceeded if it is reasonable to conclude that, by bringing the uncertain amount into account the taxpayer would obtain a tax advantage (widely defined) compared to the tax treatment based on an expected amount (for example, that based on HMRC's published position) and the aggregate value of any such related tax advantages is more than £5m.

However, it may not in practice be straightforward to determine the amount of the tax advantage for the purposes of the threshold test. The draft clauses set out rules for quantification of the uncertainty by comparing the actual tax treatment to the "expected amount" of tax due under the alternative treatment depending on which of the two triggers applies.

The draft legislation also makes it clear that intra-group transactions may be netted off for corporation tax purposes when applying the threshold. However, it appears that "netting off" will not be permissible within a VAT group.

It should also be noted that the rules do not allow for grandfathering of historic tax uncertainties. Accordingly, if transactions entered into or tax treatments adopted before the rules come into force will be in some way reflected in relevant tax returns falling with the regime, notification obligations will arise.

## When do the rules come into force?

The government proposes that the new rules will take effect in relation to any relevant tax filing required to be made on or after 1 April 2022.

In practice, this means that the new rules may be applicable to transactions carried out now but where the tax impact is included in a return filed from April 2022 onwards. This highlights the importance of businesses engaging with the requirements as soon as possible.

## Who should notify and how?

The legislation will require each affected entity to individually notify HMRC if it falls within the scope of the rules (there is no group notification). However, there will be no requirement for an entity to provide a nil return if it has nothing to notify.

The draft legislation contemplates that separate notifications will be required for each relevant tax. Notification will be required at the same time as the tax relevant tax return for annual tax returns (such as corporation tax and income tax), but for non-annual returns, the draft legislation will require notification by the date when the last return for a financial year is due. This means that there may well be different deadlines for different taxes.

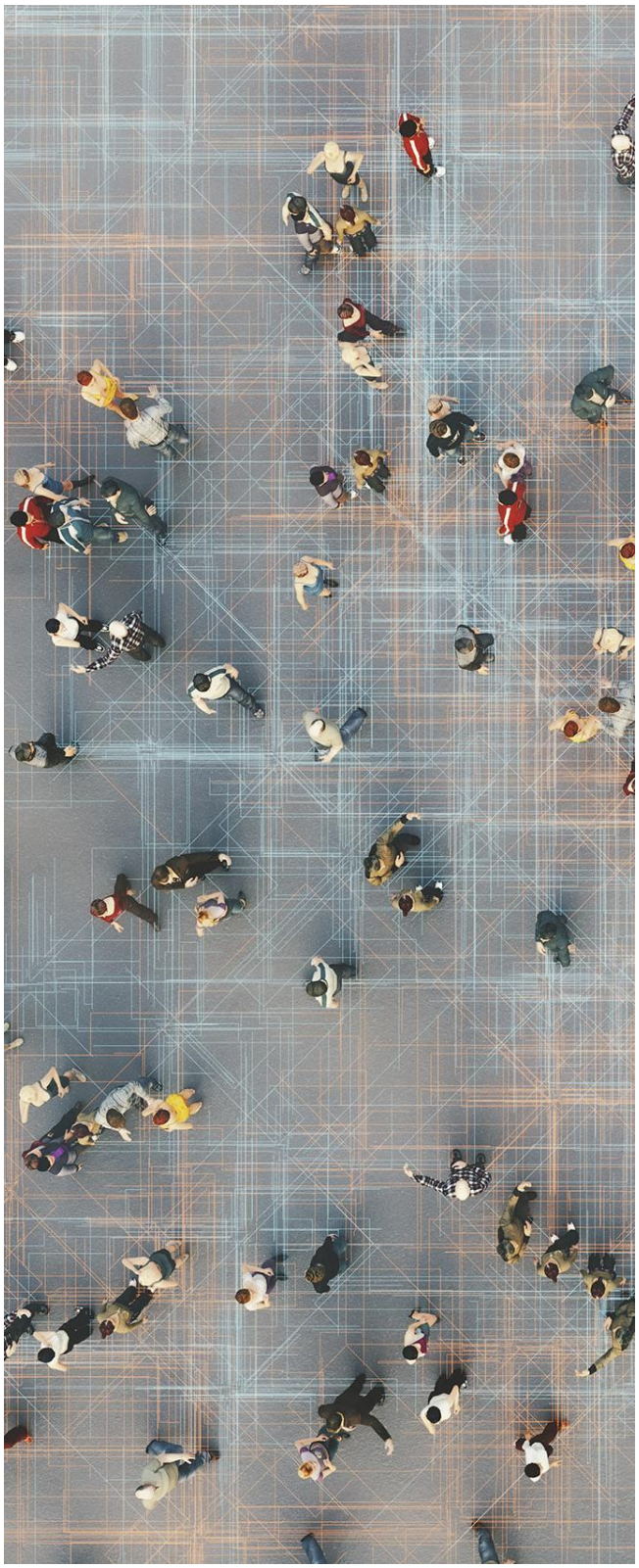
Details of how, and in what form, a notification must be given and what information must be included are to be specified by HMRC notice. However, based on the draft guidance, it is expected that a business will be required to complete an online form and provide details of the uncertainty and the notification trigger under which disclosure is being made, a description of the tax issue, an explanation of the uncertainty, reference to relevant law or HMRC guidance to which the uncertainty relates and an indication of the amount of tax advantage relating to the uncertainty.

## What are the penalties for failure to comply?

The draft legislation sets out the penalties for failing to comply with the rules. These penalties of:

- £5,000 for a first failure in a three year period;
- £25,000 for a second failure in a three year period; and
- £50,000 for a third failure in a three year period.

These penalties are subject to a defence of "reasonable excuse".



## Comment

HMRC has also published draft guidance on the application of the uncertain tax treatment rules. The guidance is an important element in the design of this new requirement and it is hoped that the guidance may help provide the certainty that businesses need to ensure that it can be applied effectively. The draft guidance aims to provide helpful examples of the application of the rules in a number of scenarios, in particular covering the tests of what amounts to an uncertain tax treatment. Nevertheless, some uncertainty will persist. For further details of the draft guidance, see our article Notification of uncertain tax treatment: draft guidance.

The new rules, and the administrative requirements they introduce, will require careful analysis by businesses and their tax compliance functions. The scope of the requirement is clearly subject to some remaining uncertainty. It will be important for businesses to actively address these new requirements to ensure that they are able to comply from day one.

## Contact

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