Draft Finance Bill 2022—notification of uncertain tax treatment

Tax analysis: Kevin Elliott, director at KPMG and specialist in tax dispute resolution, discusses the new requirement for large businesses to notify HMRC of uncertain tax treatments.

This analysis was first published on Lexis®PSL on 4 August 2021 and can be found here (subscription required).

What, in outline, does the draft legislation do, and who will be affected by it?

The government is introducing a new requirement for large businesses to notify HMRC where they have adopted an uncertain tax treatment in a tax return. The aim of the measure is to reduce the legal interpretation portion of the 'Tax Gap' (£4.9bn per the latest estimate). According to HMRC, the intention is that the notifications:

'will provide HMRC with accurate and more timely information to inform their interventions. This will help them to identify and resolve uncertain tax treatments sooner.'

The taxes in scope are corporation tax, VAT and income tax (including amounts collected via Pay As You Earn). For the purpose of this measure large businesses are, very broadly speaking, defined as companies and partnerships with UK turnover of greater than £200m per year or a UK balance sheet total over £2bn (for groups the turnover and balance sheet amounts for all companies and/or partnerships within the charge to corporation tax need to be aggregated). Collective investment schemes are excluded, and an asset manager business's turnover and balance sheet threshold calculation does not include the attributes of fund portfolio companies. In total around 2,300 large businesses will be within the scope of the rules.

Notification is not required where the value of the uncertain tax amount is less than a £5m de minimis. There is also a general exemption for items where it is reasonable for the business to conclude that HMRC already have all, or substantially all, of the information relating to that amount that would have been included in the notification, eg where the business has discussed the item with its Customer Communications Manager. There are also exemptions in limited circumstances for certain group transactions, and uncertainties relating to transfer pricing and UK permanent establishment profit attribution.

How is an uncertain tax treatment defined?

The consultation process has helpfully moved the definition of uncertain tax treatment, from a rather subjective category of any treatment which HMRC was likely to challenge, to more targeted triggers. The draft legislation now defines an uncertain tax treatment as a treatment to which one or more of the following triggers applies:

• provision has been recognised in the accounts of the company or partnership, in accordance with generally accepted accounting practice, to reflect the probability that a different tax treatment will be applied to the transaction than the treatment which formed the basis for the amount included in the relevant tax return

• the tax treatment applied in arriving at the amount relies (wholly or in part) on an interpretation or application of the law that is not in accordance with the way in which it is known that HMRC would interpret or apply the law

• it is reasonable to conclude that, if a tribunal or court were to consider the tax treatment applied in arriving at the amount, there is a substantial possibility that the treatment would be found to be incorrect in one or more material respects

HMRC guidance is expected in the coming weeks which should give us further detail on how these should be interpreted.

What is the consultation history behind these measures?

The measure was first announced at Budget 2020 with a planned implementation date of April 2021. A first consultation on the proposals was held between March and August 2020. There were concerns from respondents on the proposals at that stage that the scope of the requirement was too broad and that the requirement could be administratively burdensome to follow. In light of this, in November 2020 the government announced a 12-month delay in the introduction of the measure to 'allow more time to get the policy and legislation right'.

A second consultation on revised proposals with a reduced scope was then held between March and June 2021. This was followed by the publication of draft legislation alongside the consultation response on 21 July 2021. There are still some gaps to be filled in by HMRC guidance, most notably what the content of the notification will be.

Are there any substantial differences between the draft clauses and the provisions outlined in March 2021?

In relation to the definition of 'uncertain tax treatment' HMRC have reduced the number of proposed triggers from seven to three. Triggers A and B were retained from the second consultation and trigger C has been added. The new trigger C combines elements of some of the previously proposed triggers and aims to capture uncertainties, including those over how the law applies to a set of facts, where HMRC does not have a known position such that trigger A does not apply.

In addition, an exemption from notification has been included for transfer pricing and profit attribution uncertainties. These are exempt from notification under the new trigger C but any treatments for which a provision has been made in the accounts or which are contrary to HMRC's known position remain in-scope. Other treatments where the uncertainty is not specific to the application of the arm's length principle but relates to other aspects of the transfer pricing legislation, for example whether the participation condition is met, also remain in scope.

What are the most difficult or contentious aspects of the new rules?

In some cases, businesses may encounter practical difficulties in applying the rules, for instance the calculation of whether the £5m de minimis is breached could prove challenging in cases where aggregation of transactions is required.

In relation to the triggers, there is a question around how businesses can know how HMRC would interpret or apply the law for the purpose of trigger B as guidance/case law can be extensive and it is not always straightforward to track where HMRC's position has changed over time. It is also currently unclear what constitutes a 'substantial possibility' that a treatment would be found incorrect when applying trigger C. HMRC are due to release draft guidance in the coming weeks on the requirement and it is anticipated that these questions will be addressed then.

In your view, are the new rules likely to achieve HMRC's stated aim of reducing tax losses caused by businesses adopting uncertain tax treatments?

My expectation is that the main impact of the measure will be to bring uncertainties to HMRC's attention at an earlier point in time and consequently it should result in HMRC becoming better informed about what differences in interpretation are generating the legal interpretation tax gap. What will ultimately drive any reduction in tax losses caused by businesses adopting uncertain tax treatments is the action taken by HMRC in response to the information they will receive via notifications. I would like to see early engagement from HMRC following notifications so that taxpayers can obtain early certainty on their tax positions as per the stated policy intention. I would also like to see the information used to inform improvements to and expansion of HMRC guidance, and improvements to the tax legislation to provide greater clarity to taxpayers. This will, however, demand resource from HMRC to implement and it is not something they have committed to at this stage.

When will the legislation come into effect?

The notification requirement will apply for returns filed on or after 1 April 2022. This means that businesses may need to make notifications to HMRC in relation to the tax treatment of transactions that are happening in the current financial year, particularly for corporation tax where the return filing deadline is one year after the end of the accounting period. Businesses should therefore give some thought now as to how they will approach the requirement.

Interviewed by Tom Inchley

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