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Notification of uncertain tax treatments – it's time to take notice

The UK government is pressing ahead with legislation requiring large businesses to notify uncertain tax treatments. The proposals have been improved on following two rounds of consultation with the seven triggers for notification reduced to three, although a new 'sweeper' trigger is potentially very wide. These new rules will still create a significant compliance burden and, for some businesses, will apply to transactions entered into now. In-scope businesses should start thinking about their processes for identifying uncertain tax treatments and for deciding whether to raise these with HMRC in real time or to disclose them alongside their tax returns.

L-day 2021 was a relatively muted affair, with less draft legislation than might have been expected and little in the way of surprises. This is no bad thing, not least because it gives space to consider important tax compliance measures, such as the new rules on notifications of uncertain tax treatments which might otherwise have been overlooked in favour of more eye-catching substantive announcements. The new rules will apply in relation to uncertain tax treatments reflected in returns filed on or after 1 April 2022, and so they are potentially relevant to transactions and other activities occurring now. Businesses and advisers will want to start familiarising themselves with the legislation to assess what, if anything, they will need to change about their existing compliance processes. Draft guidance on the rules is also promised in the coming weeks, and will hopefully address some of the remaining areas of uncertainty.

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The stated policy objective is to reduce the portion of the tax gap that's attributed to legal interpretation (ie reducing the number of situations in which a taxpayer adopts a position with which HMRC does not agree) by encouraging large businesses to discuss uncertain tax treatments with HMRC in real time. Where they don't do that, they will need to notify the uncertain tax treatment in their returns, and they should expect an enquiry. The aim is to improve HMRC's ability to identify these situations early and accelerate the point at which discussions or enquiries over the uncertain treatment occur.

The rules themselves have been the subject of extensive consultation since they were first proposed in March 2020, and the resulting draft legislation offers a good illustration of the benefits (and some of the limitations) of the consultation process. The basic shape of the proposal has remained essentially unchanged throughout: large businesses (being those with a UK turnover of more than £200m per annum or a UK balance sheet total over £2bn) will have to notify HMRC where they have adopted an 'uncertain tax treatment' in relation to corporation tax, income tax (including PAYE) or VAT. That obligation is subject to a £5m threshold (this was increased from £1m following representations made during the consultation process). In essence (the rules are a bit fiddly), a taxpayer group needs to have benefited from adopting the uncertain treatment by more than £5m over a 12-month period before it is required to notify.

Notifications are to be given annually in relation to each relevant tax in a form to be specified. Respondents to the consultation had suggested that notifications should not be

able to be used against taxpayers in litigation - otherwise, there is a risk that an accounting provision could become a self-fulfilling prophecy. This point has not been addressed in the draft legislation but is something that might usefully be picked up in guidance.

The key point of contention with these rules is what counts as an uncertain tax treatment that results in an obligation to notify. The original consultation in 2020 proposed, in effect, that it would be any treatment which HMRC was likely to challenge. Reaction to this was uniformly negative, citing its subjectivity and uncertainty, and these criticisms were heeded in a second consultation published in March 2021. The response then was to rework the test in the form of seven 'triggers' which it was hoped would provide more objective tests. That was generally welcomed as a step in the right direction, although responses to the consultation still highlighted problems with the scope and clarity of several of the proposed triggers.

The three triggers

Once again, the government has listened and the draft legislation has recast the triggers and reduced them in number to three (eliminating several of the more controversial suggestions from the March 2021 proposal). Broadly speaking, the obligation to notify will now apply if:

- the business has recognised a provision in its accounts, in accordance with GAAP, to reflect the probability that a different tax treatment will be applied to the relevant transaction;
- the business has applied a tax treatment which relies 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; or
- it is reasonable to conclude that, if a tribunal or court were to consider the tax treatment applied by the business, there is a substantial possibility that the treatment would be found to be incorrect in one or more material respects.

The first trigger (that an accounting provision has been recognised) was trailed in the March 2021 consultation and, in principle, does seem to offer a suitably objective trigger for the notification obligation. The judgment involved in determining whether an accounting provision should be made is both familiar and a reasonably high threshold, and the risk of this trigger giving rise to excessive notifications therefore seems low. It remains to be seen whether any difficulties may arise in applying the accounting trigger – eg where an accounting provision relates to a portfolio of multiple uncertain treatments viewed in the round – but overall this can probably be regarded as a success of the consultation process.

Moving down the scale of satisfaction, the second trigger (a treatment which is contrary to HMRC's known position) was again trailed earlier this year, and responses to the consultation seem generally to have accepted that it is reasonably objective and (in policy terms) appropriate as a trigger - this is, after all, precisely the sort of situation that HMRC wants to be brought to their attention under the new regime. Perhaps the biggest difficulty with it is working out when HMRC's position is 'known'. The legislation states that HMRC's position on a matter is taken to be known if it is apparent from published material of general application or from dealings with HMRC by the taxpayer in question. This is a helpful clarification, but it does not address concerns that were raised over the sheer volume of HMRC's published material, the difficulty in accessing older guidance or in assessing whether it still represents HMRC's view, etc. The accompanying materials do raise the possibility of an argument, on appropriate facts, that HMRC's guidance is too uncertain or unclear for it to be 'apparent' what HMRC's view is, and this is certainly an area on which the draft guidance could usefully elaborate. Query also whether the fact that HMRC is appealing a tribunal or court decision that has gone against them would count as a 'known' position for this purpose – presumably businesses are not expected to

keep track of the positions HMRC is taking in every case under appeal, but guidance confirming this point would be welcome.

The third trigger (a substantial possibility that a court would disagree) is the most problematic. It is a new addition following the 2021 consultation and appears to have been introduced as a 'sweeper' provision to capture situations that would have fallen within the scope of the triggers that were discarded following consultation. For example, the response to consultation suggests that conflicting non-privileged advice (as set out in the discarded trigger G) would be treated as an indicator that this new trigger applies. The new trigger is also expected to address novel products or transactions of the type envisaged by discarded trigger D, while setting a higher level of uncertainty as the requirement for notification. The response to consultation also suggests it will also pick up the instances covered by discarded trigger F (covering excessive deductions and income non-inclusion, where there is no known HMRC position and genuine uncertainty about the correct tax outcome). This is unfortunate, as it has resulted in a trigger that is potentially very wide indeed and could expand the scope of the regime far beyond its stated intentions (a point that would doubtless have been made had there been opportunity to do so in advance of its publication). There is however no hint of apology. The government apparently believes the new trigger is in line with what large businesses' tax teams already commonly consider and draws parallels with a test used by the Australian Tax Office in its reportable tax positions regime.

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The accompanying materials explicitly recognise that the new trigger overlaps with both of the other triggers, but applies a lower threshold test than the accounting provision trigger and may capture situations that do not fall within the second trigger because HMRC's guidance does not provide a known view (eg because the question is too fact sensitive). In practice, therefore, it seems likely that the third trigger will require consideration in most situations where either of the other triggers are potentially in play.

Turning to the substance of the new trigger, the key question is what is meant by a 'substantial possibility' that a court would disagree about the treatment adopted by the taxpayer. The accompanying materials offer few clues (so presumably the gap will be addressed in the draft guidance) but taken at face value this is potentially a very low threshold indeed. Most readers will have experience of tax positions that have comfortably the better of the arguments but are not free from doubt in the event of a challenge, and under the current drafting it seems that a view will need to be taken on how substantial that possibility of losing is in order to determine whether notification is needed. Is 20% substantial? If not, what is the tipping point? The legislation is, of course, still in draft and it may be that the trigger can be further refined and clarified before its final enactment. Another option would be to defer implementation of the new trigger to give more time for guidance to be drafted and consulted upon.

Exemptions from notifying

In addition to the threshold test, there are a number of exemptions from the reporting obligation, including exemptions for profit attribution positions and transfer pricing matters as well as for certain intra group transactions where the net value of the tax advantages is below the threshold. There is no exemption for new legislation where HMRC has yet to issue guidance, for taxpayers with low risk ratings or for VAT partial exemption matters (although these were suggested in the consultation process). Nor is there an exemption for targeted anti-avoidance rules, many of which are inherently uncertain (particularly if they rely on motive/purpose tests).

Importantly, however, there is a general exemption from the reporting obligation if it is reasonable for the taxpayer to conclude that HMRC already have available to them substantially all of the information that would have been included in a notification. That information may be available because of a notification under another set of disclosure/notification rules, or simply from dealings between the taxpayer and HMRC. The accompanying materials suggest that, as a result of this exemption, there is not

expected to be a significant increase in the administrative burden for businesses that are already open and transparent with HMRC about any points of uncertainty. (There is no specific exemption for banks which comply with the code of practice, apparently because it is thought that they will normally fall into the category of taxpayers that can rely on this general exemption.)

The general exemption is clearly a helpful and pragmatic provision, and may be the key to the long-term consequences of this new regime. The ability to avoid making a formal notification by providing HMRC with the same information through less formal channels introduces a heavy element of choice, and some taxpayers may well find it preferable deliberately to opt for the latter course. Even if they do not, transparency in their dealings with HMRC may offer a defence in any dispute over whether or not a formal notification should have been made. As is probably intended, these new rules are therefore likely to act as a further driver for behavioural change in the dealings taxpayers have with HMRC. This should be relatively straightforward for taxpayers with HMRC customer compliance managers (***CCMs***). For taxpayers without CCMs, HMRC says it will use the existing customer engagement team to provide a structured opportunity to discuss tax uncertainties, so that those taxpayers can also benefit from this exemption. In either case, taxpayers looking to rely on this exemption as a result of dealings with HMRC should keep records of their communication to evidence the position that a formal notification is not required (which could be particularly important if there is a change in CCM over time).

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Where does this leave us?

At present the sanctions for failing to comply with a notification obligation are limited to a penalty of £5,000 (which escalates if there are repeated failures to notify). However, hanging over any new notification or disclosure regime is the potential for 'mission creep'. This was a feature of the DOTAS regime in that DOTAS notifications have, in the years since the regime was first introduced, been used as trigger points for other punitive tax regimes, such as accelerated payment notices. That would seem wholly inappropriate here. Many large taxpayers, particularly businesses in the digital space or undergoing transition, will have uncertain tax treatments. This might be relevant to their risk rating but they should not be penalised simply for operating in a world where the tax code has not kept up with business models.

The new rules are expected to impact around 2,300 businesses, although the burden will not fall evenly on all large businesses. Those impacted will be relieved the government has heeded some of the concerns expressed during the consultation process, but the compliance burden is still likely to be high, particularly if the new third trigger is retained in its current form. In-scope businesses should start thinking now about their processes for identifying uncertain tax treatments and either discussing them with, or notifying them to, HMRC.

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