SLAUGHTER AND MAY

July 2026

Tax News

Podcast

ZOE ANDREWS	Welcome to the July 2026 edition of Slaughter and May's "Tax News" podcast. I am Zoe Andrews, Head of Tax Knowledge. I am delighted to welcome Amy Motherwell as my co-host today. Hi Amy, it's great to have you on the podcast.

AMY MOTHERWELL	Hi Zoe. It's good to be here. For those who don't know me, I am a senior associate in our Tax department and advise on the full range of tax matters that we cover as a firm, including transactions, disputes and general advisory work.
	
	Today we will cover:
	
	• Three recent cases:
	    o the Supreme Court's decision in *HFFX* on purposive construction and the charge to tax on miscellaneous income;
	    o the Upper Tribunal's decision in *Barclays Services Corporation* on VAT grouping; and
	    o the Upper Tribunal's decision in *Swiss Centre* on when payments qualify for deductions under the loan relationship regime.
	
	• Three UK developments:
	    o HMRC's consultation on the taxation of UK-resident individual members of US LLCs and other reverse hybrid entities;
	    o the consultation on modernising the distributions framework; and
	    o HMRC's Transformation Roadmap progress update.
	
	• International updates, including the European Commission's tax simplification package and the DAC recast.
	
	This podcast was recorded on the 14th of July 2026 and reflects the law and guidance on that date.
	
	This podcast does not include coverage of any of the Legislation Day publications as we will cover them separately at a later date.

ZOE ANDREWS	Let's start with the Supreme Court's decision in *HFFX* which is about the taxation of deferred payments to individual members of a limited liability partnership or "LLP". Although the case is about partnership taxation (and the arrangements in question would not work now because of the

	mixed member rules) the case has broader implications in the areas of purposive construction and the taxation of miscellaneous income. Amy, can you explain the facts of this case?
AMY MOTHERWELL	The part of HFFX LLP's profits at issue in this case were allocated to the corporate member, GSAM, and then reallocated to individual members as "Special Capital" under the Capital Allocation Plan. HFFX's Managing Member made indicative allocation recommendations to GSAM, but GSAM retained discretion over the final allocation. If the arrangements worked as intended, GSAM would be taxed at corporation tax rates and the individual members would not be taxed on the reallocated Special Capital. HMRC advanced three alternative arguments. First, that on a purposive reading of section 850 ITTOIA 2005, GSAM's profit shares should be treated as the individual members' shares in accordance with HFFX's "profit-sharing arrangements"; the Supreme Court rejected this (as had the Court of Appeal and the Tribunals). Second, (which is where HMRC succeeded) that the Special Capital should be taxed as miscellaneous income under section 687 ITTOIA 2005. And third, HMRC relied on the sale of occupation income rules in Chapter 4 of Part 13 ITA 2007, but the Supreme Court did not decide this point because it considered it unnecessary in light of the decision on section 687. A definitive appellate ruling on sale of occupation income will have to wait for a case where that is determinative.
ZOE ANDREWS	Let me unpick the section 850 point as it shows there are limits to purposive construction. The Supreme Court had to determine whether the profit shares allocated to GSAM should be properly regarded as the individual members' profit shares in relation to their indicative allocations of Special Capital. This required a purposive construction of the legislation. The Supreme Court considered the purpose of section 850 and concluded that it taxes partners on a look-through basis by reference to their contractual profit rights in the relevant period, giving certainty as to who is liable for tax on partnership profits. The Supreme Court rejected HMRC's "commercial reality" argument (being that a member would receive the indicative allocation unless it was decided not to pay it) as untethered from the statutory language. Section 850 must be applied according to its ordinary meaning and the legal concepts it uses, so GSAM's profit shares were not the individual members' profit shares. Amy, can you explain HMRC's second argument – what is miscellaneous income?
AMY MOTHERWELL	Of course. Section 687 is the sweep-up charge which taxes income from any source that isn't charged to income tax under some other provision. By the time the case reached the Supreme Court, HFFX and the individual members had conceded that the Special Capital payments were "income." The only live question was whether there was a "source" within the meaning of section 687. The taxpayers argued there was no source. Their position was essentially that you need some kind of legal entitlement to receive the payment for there to be a source. And because GSAM had

	discretion to make the Special Capital payments, the individuals had no legal right to receive any particular amount. The Supreme Court took a broad, natural meaning of "source" and concluded that an activity can qualify. They agreed with the Court of Appeal that the decision-making process itself (which was the Managing Member making recommendations and GSAM exercising its discretion to implement the Capital Allocation Plan (subject to the implied duty for GSAM to exercise its discretion rationally and for the purposes for which it was conferred in accordance with the Supreme Court's decision in *Braganza*)) was the source of the income. The idea that a source can only exist where the recipient has a legal right to the payment was rejected. The Supreme Court held that a source of income exists so long as there is "some relevant and sufficient factor connecting the income and the recipient."
ZOE ANDREWS	That a source does not require a legal entitlement to receive the payment, just a sufficient connection, gives a very wide meaning to source. In future cases, then, we are more likely to see miscellaneous income battles fought on whether a payment is income in nature rather than on the existence of source.
AMY MOTHERWELL	The next case we will discuss is *Barclays Services Corporation v HMRC* which is about whether a US-incorporated company with a UK branch could join a UK VAT group. The Upper Tribunal's decision touches on some fundamental questions about how VAT grouping works in the UK, particularly for overseas businesses. Barclays had a company called BSC, incorporated in the US, which provided services across the Barclays group. BSC had a branch in the UK, and the Barclays VAT group applied to bring BSC into its VAT group registration. HMRC refused that application.
ZOE ANDREWS	There were three issues in the case. The first issue was whether the UK legislation could be constructively construed so as to read in the territorial limitation on VAT grouping from EU law. Unlike most EU countries, which take an "establishment-only" approach — meaning only the local branch's activities fall within the VAT group — the UK uses a "whole establishment" approach. This means that if a foreign company joins a UK VAT group, all of its activities worldwide get swept in, not just what the UK branch does. That's always been seen as a competitive feature of the UK system. HMRC tried to argue that the legislation should be read in a way that imposes a territorial limit, bringing it into line with EU law and the *Danske Bank* decision. Both the First-tier Tribunal (FTT) and the Upper Tribunal rejected that. The Upper Tribunal said you simply can't read a territorial restriction into the statute when it goes against the underlying grain or thrust of the legislation.
AMY MOTHERWELL	That's a helpful conclusion for the UK regime going forward. But things didn't go so well for the taxpayer on the second question of whether BSC actually had a "fixed establishment" in the UK on the relevant date, which was 1 December 2017. There is no statutory test for "fixed establishment" and we still have no definitive decision on what the correct test is. Barclays and HMRC each put forward a different proposed test. The Barclays test required the UK branch to have sufficient human and technical resources to make a meaningful commercial contribution to BSC, with a degree of control comparable to ownership over those resources. The

	HMRC test required that the branch make and receive supplies in its own right. The FTT applied the Barclays test and found that the branch didn't meet that threshold at the relevant time, and the Upper Tribunal agreed concluding that the FTT hadn't made any error of law on that point. It was unnecessary, then, for either the FTT or the Upper Tribunal to consider whether the HMRC test, or some other test of fixed establishment, is the correct one because the taxpayer would not have met a higher threshold test in any event. Finally, there's the protection of the revenue point, which is worth mentioning even though it was obiter. The Upper Tribunal said that, had it needed to decide the issue, it would have found in HMRC's favour, departing from the FTT on this one. The reasoning given was that the anticipated VAT savings were substantial relative to the resources of the branch, and that the timing of the application appeared to be driven by the opportunity to secure a significant additional tax benefit.
ZOE ANDREWS	Another case that caught our eye is the Upper Tribunal decision in *Swiss Centre* that deals with the availability of deductions under the loan relationship regime. Swiss Centre was seeking deductions with respect to a payment that it considered could be broken down into two parts: a payment for the release of security over Swiss Centre, and a payment under a guarantee Swiss Centre had given in relation to another company's debts. Was Swiss Centre successful in obtaining deductions for these payments?
AMY MOTHERWELL	No – it wasn't. Nor had it been successful before the FTT. To explain why Swiss Centre was unsuccessful, it's worth taking a step back to the general principles as to when a payment is deductible for the purposes of the loan relationship regime. The general rule is that the debits to be brought into account in respect of a company's loan relationships are those that are recognised for determining the company's profit or loss in accordance with GAAP. More specifically, such debits are those amounts that fairly represent losses of the company arising from its loan relationships, interest under those relationships and certain expenses incurred for the purposes of those relationships.
ZOE ANDREWS	Focusing first on the payment for release of the security, Swiss Centre argued that could be either a loss arising from its loan relationships or an expense incurred for the purposes of those relationships. Falling within either of those buckets would have been sufficient for a loan relationship debit to arise, so why wasn't Swiss Centre successful on either basis?
AMY MOTHERWELL	This all came down to the purpose for which the payment was made. Although Swiss Centre argued the reason for the payment was securing the release of the security, the FTT didn't agree it was as simple as that. Instead, the FTT had held, looking at this objectively, there were multiple reasons for Swiss Centre making the payment – including benefits to Swiss Centre's wider group. The Upper Tribunal considered that to be a conclusion that the FTT was entitled to reach so didn't interfere with it, once again emphasising the difficulties of challenging findings of fact on appeal. Given there were multiple inseparable reasons for the payment, it did not "arise from" one cause alone. In other words, it did not arise from Swiss Centre's loan relationships and couldn't give rise to a loan relationship debit on that basis.

The expense argument failed for a similar reason. Relevant expenses can only give rise to debits under the loan relationship rules when they are incurred directly with respect to certain aspects of loan relationships (for example, making payments under those loan relationships). Here the multiple reasons for the payment meant such a direct connection to the loan relationship was lacking.

ZOE ANDREWS

And then there's the payment in respect of the guarantee Swiss Centre had given. It seems there was an even more fundamental issue there with establishing that a debit arose under the loan relationship regime as the FTT, and now Upper Tribunal, have held there wasn't a relevant loan relationship in the first place.

AMY MOTHERWELL

Yes, unsurprisingly, to fall within the loan relationship regime there does need to be a relevant loan relationship for the debits being sought to attach to.

The reason there wasn't such a loan relationship here is quite fact-specific and comes down to the FTT having found, as a matter of fact, that (contrary to how Swiss Centre saw the payment) Swiss Centre didn't actually repay the guaranteed sum to the lender. Therefore, this decision shouldn't be taken as authority for the position that there's generally an issue with establishing a loan relationship when a payment is made under a guarantee.

In fact, there is some useful guidance in HMRC's corporate finance manual which was referred to by Swiss Centre (although, ultimately, given the findings of fact, it didn't apply to Swiss Centre), with that guidance establishing when a guarantor makes payments under a guarantee it acquires the lender's rights against the borrower and a money debt is created between the borrower and the guarantor. As acknowledged by the guidance, that doesn't necessarily mean a loan relationship is created as that depends on the particular circumstances. However, the key takeaway is that this decision does not undermine that guidance so it continues to be a useful resource.

ZOE ANDREWS

Turning to other UK developments, there are two significant consultations for taxpayers and advisers. First, HMRC's consultation on the taxation of UK-resident individual members of US LLCs, open until 31 July. What issue is HMRC addressing?

AMY MOTHERWELL

The problem is a classification mismatch: where the UK and another jurisdiction treat an entity differently for tax purposes, high effective tax rates can result. The Government recognises this can deter internationally mobile individuals from coming to the UK.

US LLCs are the main example. For US federal tax purposes, they are generally transparent, so members are taxed on profits as they arise, whether those profits are distributed. LLCs can elect to be opaque, but that is uncommon.

The UK approach differs. HMRC looks at the entity's governing law, constitutional documents and facts, and has usually treated US LLCs as opaque. Although *Anson v HMRC* treated the particular Delaware LLC in that case as transparent, HMRC continues to treat LLCs as opaque in its guidance.

This opaque treatment can leave UK-resident individual members of US LLCs taxed by the US on profits as they arise and by the UK on distributions, producing effective tax rates that can exceed 75%.

ZOE ANDREWS	And this double tax cannot be relieved under the UK/US treaty or under unilateral relief because the tax charges are on a different basis?
AMY MOTHERWELL	Exactly. Relief requires the same profits, income or gains to be taxed in both states. Here, the US taxes underlying business profits while the UK taxes a dividend. HMRC is seeking a solution for individuals without disturbing the position for corporate members of hybrids. The Government favours automatic transparency matching but is also considering alternatives such as deductions or foreign tax credits against UK tax on distributions if US LLCs remain opaque for UK tax purposes.
ZOE ANDREWS	How would UK matching of transparent treatment work?
AMY MOTHERWELL	UK-resident individual members of eligible reverse hybrids, such as US LLCs, would be treated as holding them transparently for income tax and CGT. The aim is to reduce the effective rate to the higher domestic rate in either state, without creating avoidance opportunities or extra administrative burdens.
ZOE ANDREWS	What would the legal basis be for conferring transparent treatment?
AMY MOTHERWELL	Individual members would be deemed to carry on the entity's trade or business in partnership, or as a sole trader for single-member entities. Their share of profits and losses would be calculated under UK income tax rules, investment income would be attributed in line with members' proportional membership interest, and capital gains would be dealt with under Statement of Practice D12 and UK CGT rules.
ZOE ANDREWS	The lack of retrospective transparency provisions, especially for taxpayers relying on *Anson*, is a missed chance to give certainty where HMRC enquiries are underway. If transparency is not retrospective, there is a risk that taxpayers refight *Anson* and discover that *Anson* was right all along, contrary to HMRC's view.
AMY MOTHERWELL	Yes, and there are questions about transition rules, and how prior years should be handled. The key point is that the Government's acknowledgement of the problem is welcome and this consultation enables us to be involved in the design of the solution.
ZOE ANDREWS	The second significant consultation is on modernising the distributions framework. It appeared, as part of the Tax Update 2026, taking everyone by surprise. It proposes a fundamental rethink of how share buybacks, demergers, and returns of capital are taxed — specifically for shareholders within the charge to income tax. The distributions code has been largely unchanged since Corporation Tax was introduced in 1965, and HMRC have decided it's time to bring it into the modern world.
AMY MOTHERWELL	Zoe, you attended HMRC's consultation launch, didn't you?

ZOE ANDREWS	I did, yes. And there was a general consensus from the attendees that although the rules may be old, they work and there is no need to change them. In fact, changing the rules could bring additional administrative complexity into commercial transactions and could harm the UK's international competitiveness. Any changes to the distributions rules will need to be carefully considered in the round with other areas to avoid any unintended consequences. There is a lot going on in this consultation and although each aspect might appear as a free-standing proposal, HMRC see it as a package of measures. There is no rush, however, and this 12-week consultation is just the start of the process. HMRC was keen to emphasise that getting the reforms right is more important than rushing them through. We have produced a series of blog posts on the proposals which can be found on our website or at www.europeantax.blog, so we will limit ourselves here to an overview of the proposals.
AMY MOTHERWELL	Let's start with the proposal to change reductions of capital. The insertion of a new holding company, Newco, above the company making the distribution to uplift the amount of "good capital" available is a well-known technique which reduces the income tax charge on the return of capital. The proposal is to "freeze" the capital amount so it reflects what was originally subscribed on the initial investment, matching the CGT base cost deferment. The idea is the outcome should be the same as if the shareholder had simply sold the shares back without inserting Newco at all. HMRC say they do not intend this to catch shareholders restructurings for legitimate business purposes.
ZOE ANDREWS	Moving on to exempt demergers. If the capital reduction route is effectively taken away, that pushes everyone towards the statutory demergers (also known as exempt demergers). HMRC acknowledge that and are proposing some clarifications and relaxations of the rules to make this route more appealing. The trade-off is that the automatic right to a tribunal appeal where statutory demerger clearance is refused will be removed. At the moment, if clearance is refused, you can take it to the tribunal. Losing that right concentrates a lot of power in HMRC's hands at the clearance stage.
AMY MOTHERWELL	The next proposal is to change the income tax treatment of distributions from non-UK resident companies. At the moment, the income tax charge for distributions from non-UK companies is much narrower than for distributions from UK companies. It only catches dividends that are not "of a capital nature," and determining what is or isn't of a capital nature has been a source of endless uncertainty and disputes. The Government is exploring alignment — bringing distributions from non-UK companies into the same broad framework that applies to UK companies. But even then, you still need to distinguish between a "dividend" and "any other distribution," which currently depends on characterising the distribution from the non-UK entity by reference to UK law. A deeming provision is proposed to determine whether something is a dividend or another type of distribution.
ZOE ANDREWS	Then we have transactions with close companies. The proposal here is to align the distributions code with the loans to participators rules, so that extractions of value in favour of shareholders are

	charged clearly under one coherent set of rules rather than having two overlapping regimes. This makes sense in principle. The current overlap creates both gaps and traps, so rationalising it should help, provided the unified regime is well designed.
AMY MOTHERWELL	On purchase of own shares, HMRC are looking at the relief for departing shareholders of close companies. At the moment, this depends on the "trade benefit test", which is notoriously subjective. The proposal is to replace it with more mechanical requirements: objective criteria that are easier to apply and, presumably, easier for HMRC to police. That could be a real improvement in terms of certainty, provided the mechanical tests are well calibrated. If they're too narrow, you'll exclude genuine commercial transactions. If they're too broad, you lose the policy purpose of the relief.
ZOE ANDREWS	Finally, the transactions in securities (TiS) rules. HMRC describe these as reflecting an "outdated approach" to anti-avoidance and being "difficult to apply". The proposal is to move to a clearer, more principles-based regime that operates as a backstop to catch what more specific legislation does not. This is a tricky proposal to get right. Given the TiS rules interact with so many other parts of the tax code, the knock-on effects could be considerable.
AMY MOTHERWELL	As you can see from this quick overview, this is a significant consultation. If enacted, these proposals will reshape how practitioners structure transactions involving shareholders within the charge to income tax. The consultation runs until 14 September 2026. Given how wide-ranging these proposals are, we'd strongly encourage anyone working in this space to engage with the process. These rules need to be workable, and the best way to achieve that is robust input from practitioners who deal with them regularly. Time to move on to another UK development, the HMRC Transformation Roadmap. HMRC published its progress update on 2 July 2026, marking roughly the one-year anniversary of the original Roadmap. What is set out in the update?
ZOE ANDREWS	The Transformation Roadmap which was published in 2025 set out the Government's vision for a more efficient, modernised, and automated tax and customs system. The update describes some of the progress that has been made on this over the last year, which includes the roll out of Making Tax Digital for Income Tax, increasing digital interactions with customers and updating and improving guidance. It also highlights a number of proposals for the year ahead. One of those is bringing forward legislation to introduce a new obligation on third-party data holders to improve the data reported to HMRC on financial account information and card sales data. The aim is to improve the quality and timeliness of the information available to HMRC. The update also paints a picture of a more digital HMRC, for example, HMRC is proposing a single digital front door for tax adviser registration. Another good example is it plans to establish a new Digital Disclosure Service to allow customers and intermediaries to correct mistakes and to calculate and pay liabilities and penalties for all taxes and duties through a single digital service. There is also a lot of focus on closing the tax gap. HMRC announced that it will publish the "Further Closing the Wealthy Tax Gap" plan in Autumn 2026, setting out how it intends to improve compliance across the wealthy population, and sets out some targets for cracking down on what it

	calls "abusive phoenixism" — where a company enters creditors' voluntary liquidation essentially to avoid paying liabilities owed to HMRC. The final thing I'll mention is that the update details plans to introduce an improved VAT repayments tracker and to improve VAT registration processes during 2026 to 2027, including simplifying application journeys and reducing avoidable delays in registration decisions.
AMY MOTHERWELL	Looking beyond the UK now, on 24 June the European Commission adopted a tax simplification package. What does that involve?
ZOE ANDREWS	This is a major tax simplification plan that could reshape significant parts of the EU direct tax landscape. It comprises two proposals. The first is a wide-ranging Direct Taxation Omnibus Directive that would amend six existing EU tax directives, and the second is a Recast of the Directive on Administrative Cooperation (known as DAC). Together, the proposals aim to streamline a body of rules that has become increasingly complex over time and to ensure the EU's tax framework remains fit for purpose in a post-Pillar Two world. The Commission estimates the proposals would reduce compliance costs for business by approximately EUR 7.9 billion annually - so a significant figure.
AMY MOTHERWELL	The Tax Omnibus is very ambitious in scope and due to the requirement for unanimous Member State approval, its adoption is a number of years away. As such, let's focus on the DAC recast for the purposes of this podcast. Can you tell us more about that?
ZOE ANDREWS	Since 2011, DAC has expanded through nine successive amendments, layering on reporting and information-exchange requirements that have become difficult to navigate. The recast consolidates all of that into a single legal instrument. But beyond just tidying up the structure, it also makes some meaningful substantive changes. • There are a number of proposed changes to DAC6, including that groups already subject to the 15 percent global minimum tax under Pillar 2 would no longer need to report cross-border tax arrangements. • The recast aims to simplify reporting obligations by introducing a single notification which would replace separate filings for country-by-country reporting (currently under DAC4) and top-up tax information returns (currently under DAC9). • There are proposed changes to DAC7 digital platform reporting requirements designed to reduce the reporting burden, including raising the threshold for reporting online sale of goods. • The Commission is also proposing the introduction of a new tax identification number verification tool to improve the accuracy of exchanged taxpayer data. • Finally, the recast proposes expanding the scope of automatic exchange between Member States to extend coverage and close gaps. So, while the proposal is partly about consolidation, it also contains a number of targeted measures intended to reduce compliance burdens and improve the effectiveness of information exchange.

AMY MOTHERWELL	And what is the timeframe for the DAC recast?
ZOE ANDREWS	This is notably more advanced than the Tax Omnibus. Adoption could potentially be achieved by the end of 2026, reflecting the level of discussion already underway among Member States and the push by the Irish presidency. That would mean domestic implementation by the end of 2027, with the new rules taking effect from 2028. That's all we have time for today - so what have we got coming up?

AMY MOTHERWELL	• The closing dates for a number of consultations are coming up in July:
	  ○ 22 July is the closing date for the OECD's consultation on revisions to update and modernise Chapter VII of the Transfer Pricing Guidelines on intra-group transactions. There will then be a public consultation in November.
	  ○ The International Controlled Transactions Schedule (ICTS) is a new annual filing (in addition to existing transfer pricing documentation requirements) that will require in-scope multinationals to report details of their cross-border related-party transactions to HMRC for accounting periods beginning on or after 1 January 2027. The consultation on its detailed design (including draft regulations, draft HMRC notice and a draft template schedule) closes on 31 July.
	  ○ 31 July is also the closing date for the consultation on the taxation of UK resident individual members of reverse hybrid entities.
	• The consultation on introducing a criminal offence for making reckless untrue statements or declarations in direct tax (aligning the direct tax rules with existing indirect tax rules) closes on 16 August.
	• We have longer to respond to the distributions consultation, however, as that one is open until 14 September.

ZOE ANDREWS	And that leaves me to thank you for listening. If you have any questions, please contact Amy or me, or your usual Slaughter and May contact. Further insights from the Slaughter and May Tax department can be found on the European Tax Blog – www.europeantax.blog

Contacts

Zoe Andrews

Head of Tax Knowledge

T: +44 (0)20 7090 5017

E: zoe.andrews@slaughterandmay.com

Amy Motherwell

Associate

T: +44 (0)20 7090 3304

E: amy.motherwell@slaughterandmay.com