

TAX AND THE CITY

CLIENT BRIEFING

October 2025

Discussions are ongoing at the OECD/IF on the design of the 'side-by-side' system. In its unanimous judgment in *Prudential*, the Supreme Court provides much-needed clarity on the interaction of the VAT grouping rules and the time of supply rules which apply to successive payments for services. HMRC publish a technical note on the detailed tax rules applicable to the reserved investor fund. HMRC issue guidelines for compliance recommending taxpayers disclose any 'finely balanced' tax positions, or positions relying on an untested view of the law, to HMRC when filing a tax return.

Pillar two 'side-by-side' proposals

The OECD/Inclusive Framework (IF) has the unenviable task of having to design and implement the side-by-side system supported by the G7 earlier this year to prevent certain aspects of the global minimum tax rules from applying to the low-tax profits of US-headed groups whilst protecting the integrity of the rules and keeping a level playing field. The clock is ticking and pressure is mounting from the US because the current safe harbour which effectively prevents the undertaxed profits rule (UTPR) from applying to US companies expires at the end of 2025 for taxpayers with calendar-year ends.

There are significant issues to be resolved. China and India have reportedly been arguing that the side-by-side system should not be limited to recognition of the US GILTI system but other countries, like themselves, should be able to have similar access. The UTPR safe harbour is drafted in general terms and is not specific to the US so the OECD/IF is likely to seek a principled approach to a side-by-side system. Indeed, media coverage of documents sent to delegates of Working Party 11 (which is tasked with dealing with the design of the side-by-side system and other outstanding pillar two points) suggests the income inclusion rule (IIR) and the UTPR would not apply to tax low-taxed profits of in-scope MNE groups headquartered in jurisdictions which have an 'eligible side-by-side regime'.

Documents leaked to the press last month reportedly included a 30-page discussion paper on the side-by-side

system in which three options were proposed. The simplest to introduce, because it would not require changes to the Model Rules or to the EU Directive (and domestic legislation) enacting the Model Rules, would be a new safe harbour enabling an MNE group to elect to deem its IIR or UTPR taxes in a jurisdiction to be zero where there is an eligible side-by-side system operating.

The OECD/IF will also be concerned to prevent profit shifting from global minimum tax implementing countries to side-by-side regime countries. There will inevitably be some anti-abuse rules as part of the package.

If the side-by-side system cannot be agreed upon, US retaliation (in the form of a revival of the dropped s 899 withholding tax or under an existing retaliatory provision such as s 891) is likely. We may see a temporary extension of the UTPR safe harbour for another year to buy more time to implement the side-by-side solution.

Where does this leave qualified domestic minimum top-up taxes (QDMTTs)?

QDMTTs play a vital role in ensuring a level playing field as they apply to both US-parented and non-US parented groups. As they are creditable taxes from a US perspective, they do not disadvantage US companies so there is not the same pressure to remove them but there may be political pressure to remove them to improve competitiveness.

What about other work the OECD/IF have in the pipeline that will ease the administrative burden of the pillar two rules?

It is hoped that by the end of 2025, the OECD/IF will have reached agreement on a permanent replacement for the CbCR safe harbour which will be a simplified ETR safe harbour. It is understood that it will be based on ETR on an in-country basis and will not have the 'once out always out' rule of the CbCR safe harbour. This will be a welcome development.

What's next?

OECD/IF meetings are ongoing on the design of the side-by-side solution. As the UK's Autumn Budget is not until 26 November, there is pressure from business for an earlier announcement of the UK government's reaction to any agreement on the side-by-side solution so that changes to

the UK's MTT/DTT rules can be built into the pillar two compliance processes.

The 'Amsterdam dialogue' (organised through the Forum on Tax Administration) continues to agree interpretative issues and practical guidance (questions may also be referred back to Working Party 11 where necessary). Although this would not have the same status as Administrative Guidance (because it would not be agreed by all IF members) and is unlikely to be published centrally, HMRC expect to reflect agreed points as HMRC's view in their *Multinational Top-up Tax and Domestic Top-up Tax Manual*.

Prudential: interaction of VAT grouping and time of supply rules

In *The Prudential Assurance Company Ltd v HMRC* [2025] UKSC 34, the unanimous judgment of the Supreme Court provides much-needed clarity on the interaction of the VAT grouping rules and the time of supply rules which apply to successive payments for services.

In brief, the facts of this case were as follows. Silverfleet provided investment management services to Prudential whilst both were members of Prudential's VAT group. Silverfleet ceased providing the services when it left the VAT group following a management buy-out. The consideration for the investment management services comprised quarterly management fees (which were all paid before Silverfleet left the group) and success fees payable in respect of certain funds in the event their performance exceeded a set benchmark rate of return. Years after Silverfleet left the group, the benchmark was exceeded and success fees of more than £9m were payable. When Silverfleet invoiced Prudential for VAT on the success fees, Prudential queried this with HMRC who determined that VAT had properly been added to the invoices.

The question which went all the way up to the Supreme Court was whether the payments of the success fees made after Silverfleet left the VAT group, in respect of supplies of services rendered when part of the VAT group, but payment for which was contingent on the value of the funds exceeding a fixed threshold, which did not happen until after Silverfleet left the VAT group, were subject to VAT.

The relevant legislation

The VAT grouping rules in VATA 1994 s 43 provide that a supply by one member of a VAT group to another is to be disregarded and any business carried on by a member shall be treated as carried on by the representative member. Regulation 90 provides for services supplied for consideration which is determined or payable in whole or in part periodically ('successive supplies of services') to be treated as separately and successively supplied at the time of the invoice or payment, rather than at the time the services are supplied 'in the real-world'.

The Supreme Court had to determine whether regulation 90 applied, and if so, how regulation 90 interacts with s 43. Both rules have deeming provisions that look to something other than the 'real-world' situation.

The Supreme Court's decision

The Supreme Court agreed with the majority of the Court of Appeal that the success fees were 'successive fees' within the meaning of regulation 90 and the PVD. Regulation 90 was to be applied to determine when the supplies took place and there was no basis for inferring a timing rule for VAT groups that depends on when the services were actually performed in the real world. The effect of regulation 90 is to change the timing of the chargeable event from the time the investment management services were performed to the time of payment of the success fees. As this delayed the chargeable event until after Silverfleet left the VAT group, it was correct to charge VAT.

The Supreme Court also confined an earlier authority (*B J Rice* [1996] STC 581) to its facts and rejected an argument that would have limited regulation 90 to mere timing of collection of tax rather than the timing of the chargeable event.

The fact that this case went all the way to the Supreme Court shows that the question whether there is VAT on a supply can often be more complex to answer than at first glance, especially where deeming rules like the VAT grouping rules and/or the time of supply rules are involved. The VAT rules can produce unexpected (and sometimes seemingly harsh) results. In this case, HMRC won but it shows that, prior to this decision, it was unclear how success fees were supposed to be treated.

This case is particularly significant for financial institutions for whom VAT is a real cost. The additional VAT cost should be factored in, if a supplier leaves the group before success fees or other contingent fees are invoiced, because the VAT group disregard cannot be relied on to ensure there is no VAT on those fees even where those services were performed before the supplier left the VAT group.

Reserved Investor Fund: HMRC's Technical Note

The Reserved Investor Fund (RIF) is a new type of co-ownership investment fund developed in response to industry demand for a UK-based unauthorised contractual scheme with lower costs and more flexibility than the existing UK alternatives. It is expected to be particularly attractive for investment by institutional investors, such as UK pension funds, in UK commercial real estate.

The primary legislation to define the RIF was enacted in Finance (No. 2) Act 2024, s 20 which included a power for making regulations that would set out the detailed tax rules. Those regulations, the Co-ownership Contractual Schemes (Tax) Regulations 2025 (SI 2025/200), came into effect on 19 March 2025 providing the detailed tax rules

for investors and an administrative framework for co-ownership schemes to enter and exit the RIF regime.

HMRC have published a [technical note](#) on these regulations providing commentary on the main rules that apply to schemes that have given a valid entry notice into the RIF regime and the tax rules applicable to investors (referred to as ‘participants’). HMRC’s *Investment Funds Manual* will be updated to provide more detailed guidance and further worked examples.

Guidelines for compliance 13: Help ensuring documents filed with HMRC are correct and complete

Since 2022, HMRC have been issuing a series of ‘guidelines for compliance’ (GfC) setting out HMRC’s view on complex, widely misunderstood or novel risks that can occur across tax regimes. The GfC series expands the scope of HMRC material, beyond interpretation of the law, offering insights into the practical application of the law and HMRC’s administrative approaches. The intention is that following the GfC will lower the risk of tax non-compliance and reduce the likelihood of HMRC checks.

GfC 13, titled ‘Help ensuring documents filed with HMRC are correct and complete’, is intended to reduce the risks of inaccuracy in tax returns and other documents filed with HMRC. Under law, most tax returns and similar documents sent to HMRC must contain a declaration that they are correct and complete to the best of the taxpayer’s knowledge. HMRC receive some documents where HMRC consider taxpayers do not have good reason to believe the information they have provided is correct. The GfC explain that this is often because insufficient checks are carried out to satisfy themselves that the information provided is correct and complete; a novel view of the law is adopted without satisfying themselves it is correct; or an interpretation of law is applied even though the taxpayer does not believe it is most likely to be found correct before a court or tribunal.

Large businesses in the UK are already required to notify HMRC of uncertain tax treatments (UTTs) but, as expected, the latest HMRC statistics showed there have been very few formal UTT notifications made. Most of the time, large businesses will discuss such uncertainties as they arise with their CCM. It is interesting, then, that HMRC’s 13th GfC ‘recommend’ that taxpayers disclose any ‘finely balanced’ tax positions, or positions relying on an untested view of the law, to HMRC when filing a tax return, even if the statutory requirements for disclosing an uncertain tax position are not met. The guidelines include examples (some based on case law) of legal uncertainty, finely balanced arguments and novel and improbable arguments of the law.

Where more than one interpretation of the law is possible, HMRC’s view is that the view that is on balance most likely correct should be adopted. If the filing position is not one the taxpayer reasonably believes to be correct, HMRC will take this into account when considering penalties for inaccuracy.

HMRC consider the law to be finely balanced ‘when there is more than one reasonable interpretation, with no clear position most likely to be found correct by the courts and tribunals’. In such a case a judgment has to be made but in order for the declaration to be made honestly, it must be believed on balance to be correct. HMRC recommend that information about finely balanced arguments should be included alongside the filing and should be sufficient for HMRC to understand the legal interpretation the taxpayer has adopted and the impact on the tax assessment.

A novel interpretation of law is one not yet considered by a court or tribunal. According to GfC 13, a novel interpretation should not be adopted unless the taxpayer has good reason to believe it is correct and that on balance the courts/tribunals are most likely to find that interpretation to be correct. A taxpayer should consider if they need to consult a professional adviser ‘trained and competent for the task at hand’ to satisfy themselves that the interpretation is correct and should tell HMRC about any novel interpretations adopted.

What to look out for:

- Between 13 and 15 October, the Upper Tribunal hearing is scheduled to take place in *CATS North Sea Limited v HMRC* on transfers of trade and capital allowances.
- 15 October is the closing date for making budget representations to HM Treasury.
- On 5 or 6 November, the Court of Appeal is scheduled to hear the appeal in *A D Bly Groundworks and Civil Engineering Limited v HMRC* (on the deductibility for corporation tax purposes of pension liabilities).

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