Proskauer

March 2022

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Welcome to the March edition of the Proskauer UK Tax Round Up. In his Spring Statement, the Chancellor focused on measures to alleviate the increasing cost of living and to boost investment in the economy but there were no major immediate business tax announcements. We also summarise some HMRC and OECD announcements and two interesting court decisions.

Spring Statement

The Chancellor delivered his Spring Statement on 23 March and announced a number of immediate changes but used the occasion primarily to announce potential changes for the future.

The headline points were:

- **Rise in the national insurance starting thresholds to £12,750 from July 2022**

To ease the cost of living pressures, national insurance contribution primary threshold will rise to £12,570 (the current threshold is £9,570) to align with the income tax personal allowance.

- **Employment allowance increase from 6 April 2022**

The maximum employment allowance will increase by £1,000 from £4,000 to £5,000 from 6 April this year.

- **Basic rate of income tax**

The basic rate of income tax will be reduced from 20% to 19% with effect from April 2024, provided that the fiscal principles set out in the Spring Statement are met. This will apply to the basic rate of non-savings, non-dividend income. A three-year transition period for gift aid relief will apply to maintain the income tax basic rate relief at 20% until April 2027.

- **R&D tax relief reform**

The government set out in its Tax Administration and Maintenance Command Paper that R&D tax reliefs would be reformed to include some cloud and data costs and refocus support on R&D carried out in the UK. From April 2023, all cloud computing costs associated with R&D, including storage, will qualify for relief. Further announcements on this are likely to be made at the Autumn Budget.

- **Reforming tax reliefs and allowances**

The Spring Statement confirmed that the government will continue its work to reform tax reliefs and allowances "ahead of 2024" and will announce its plans before any reforms are implemented.

UK Case Law Developments

Deduction allowed for share issue accounting debit

In *HMRC v NCL Investments Ltd & Williamson Corporate Services Limited,* the Supreme Court (SC) ruled that the accounting debit arising to a company on the issue of share options to its employees by an employee benefit trust (EBT) can be deducted for tax purposes, dismissing HMRC's arguments that such debits do not constitute "incurred" losses, do not arise for the purpose of the company's trade and/or were capital in nature.

The taxpayer companies in this case were subsidiaries of a parent company over whose shares the options were granted and employed personnel that they made available to other group companies in return for a fee. The parent company established an EBT which granted options to the companies' employees which allowed the employees to acquire shares in the parent company.

When the options were granted to the employees, the taxpayer companies recognised both a debit in their accounts equal to the fair value of the options and a capital contribution received from the parent company in the same amount. The matter to be determined was whether the debits, which were required to be recognised by IFRS 2, were allowable deductions under the relevant provisions in CTA 2009.

HMRC had argued for the disallowance of the deduction of the debits on three grounds. First, a deduction is only allowable for an expense which is "incurred" and the debits were not so "incurred". Second, the debits were not incurred for the purposes of a trade. Third, the debits were capital in nature.

The SC agreed with the Court of Appeal (and the lower tribunals), stating that the debits are deductible expenses if they are recorded in line with proper accounting principles for determining trade profits and are not disallowed by any specific statutory provision.

The SC agreed that the debits had been incurred since the relevant provision in CTA 2009 stated that debits and credits reflected in a company's accounts in accordance with generally applicable accounting practice are treated as expenses and receipts and the word "incurred" bore not more than its natural meaning. It did not matter that no money or money's worth had been expended by the taxpayer companies. It was enough that they had properly reflected an accounting debit as a result of the grant of the options. The SC agreed that the debit (or expense) had been incurred for the purpose of the taxpayer companies' trades on the basis that they provided staff to other group companies and charged a fee for the staff and the options were part of the incentives provided to their staff. The SC also rejected HMRC's arguments that the debits were capital in nature on the basis that they were part of taxpayer companies' employees' remuneration which was itself revenue.

Following the initial decisions in the case, Section 1038A CTA 2009 has been introduced by Finance Act 2013 to partially reverse the effect of the decision. This provision affects when deductions can be claimed in respect of options to align them with when, if ever, the employees are subject to tax. The decision makes clear, however, the supremacy of the accounts when determining deductions available in determining trading profits, and that HMRC will have to identify a specific statutory provision to disallow debits properly reflected in the accounts.

Settlement payment subject to employment tax

In *Mathur v HMRC*, the First-tier Tribunal (FTT) has given guidance on the right approach to determining the tax treatment of a payment made to settle employment tribunal (ET) proceedings. This case stands out by reason of the amount involved and that Ms Mathur's own arguments made

in the ET proceedings did not align with the position claimed in respect of her argument that no tax was due on the settlement amount.

The basic facts of the case are that Ms Mathur's employment was terminated by her employer DB Group Services (UK) Ltd (DBGSL) following an investigation by regulators into the manipulation of interbank interest rates. Ms Mathur commenced proceedings in the ET against her employer alleging unfair dismissal, whistleblowing detriment, sexual harassment, unequal pay and victimisation.

The parties settled the ET dispute for £6 million and the settlement payment was paid more than a year after the termination of Ms Mathur's employment. DBGSL deducted approximately £2.7 million (for income tax and employee national insurance under PAYE) from the sum paid to Ms Mathur.

The question considered was whether the settlement payment received by Ms Mathur was made "indirectly in consequence of or otherwise in connection with" the termination of her employment for the purposes of section 401(1) ITEPA.

Ms Mathur argued that the settlement payment she received was to compensate her for the discrimination and victimisation she had experienced whilst in employment. She argued that she had a moral claim against DBGSL and the payment was to relieve it of the nuisance of that claim. Accordingly, the payment should be free of tax as it was not related in any way to the termination of her employment.

HMRC argued that the termination was an integral part of the claims that Ms Mathur settled in exchange for the settlement payment. The settlement payment was, therefore, paid, at least, "otherwise in connection" with the termination. Consequently, the whole sum (except for the first £30,000) was chargeable under section 403 ITEPA.

Since Ms Mathur was trying to distance herself from some of the arguments which she had made before the ET, the FTT treated her evidence with "a degree of caution" where statements made to the ET did not align with the tax analysis on which she was trying to rely.

The FTT concluded that the required connection between the payment and the termination existed since (i) the termination allowed Ms Mathur to take a "nuisance claim negotiating position" against DBGSL and (ii) the termination of her employment was central to the significant claims made by Ms Mathur in the ET proceedings (including her claim based on discriminatory conduct by DBGSL). The FTT also concluded that it could not apportion the disputed sum because the settlement sum was undifferentiated, there was no factual evidence before the FTT to support apportionment and there was no expert evidence before the FTT to permit apportionment.

The case shows both the importance of the taxpayer taking a consistent approach to the tax and employment law aspects of any claim and also the difficulty in severing a settlement payment from tax under section 403 ITEPA when the payment is related in any way to or is coterminous with termination of employment.

Other UK Tax Developments

HMRC launches consultation on online sales tax

HMRC has launched a consultation on its proposal for an online sales tax (OST) to rebalance the taxation of the retail sector between online and in-store sales. While no decision has been made on whether to go ahead with an OST, the consultation will look at potential design and impact on consumers and businesses of implementing such a tax.

The OST differs from the digital services tax (DST). The DST is a tax on revenues from certain digital services, including social media, search engines, and online marketplaces. It is a temporary solution to the challenges posed by digitalisation to the international system for taxing corporations' profits and will be removed once a solution from the so-called "Pillar One" of the OECD's initiative to address tax challenges arising from the digital economy has been identified.

An OST would raise revenue from the increasing volume of online retail in the UK with that revenue used to fund a reduction in business rates for retail properties.

Question asked of respondents include (but are not limited to) the following:

- Which goods and services would be subject to the OST?
- How to define an online sale and whether this should extend to "remote" sales made by phone or post?
- What would be the distinction between a reservation and a completed transaction for the purposes of an OST?
- Would any exemptions be appropriate, such as for click and collect purchases or for certain goods and services?
- At what point in the transaction would an OST be levied – consumer, or vendor? And what would be the role of intermediaries such as marketplaces?
- What would be the territorial scope of an OST and how would cross-border sales be treated?
- Would a threshold or allowance be appropriate to account for smaller firms or those with a lower proportion of sales made online?

The consultation closes on 20 May 2022 and responses should be sent to: OSTconsultation@hmtreasury.gov.uk

HMRC announced end to relaxation of EMI rules

As part of the government's response to the disruption to normal working life under COVID, HMRC announced relaxations to the working time requirements for employees to qualify for or retain qualifying ownership of EMI options.

In June 2020, the government introduced an exception to the working time requirement which meant that employees were not treated as failing the minimum 25 hours per week or 75% of working time to qualify for EMI options if the failure was due to COVID or being furloughed. The exception was time limited.

HMRC has now announced in ERS Bulletin 41 that this exception will cease to apply from 6 April this year.

OECD Tax Developments

OECD commentary regarding Pillar Two model rules and consultation on implementation framework

On 14 March, the OECD published its commentary for the domestic implementation of a global minimum tax rate of 15%, which will apply to the profits of the largest multinational enterprises (MNEs) that exceed a consolidated annual revenue threshold of €750 million and is aimed at addressing the taxation of the digital economy. The OECD commentary provides MNEs with in-

depth and detailed technical guidance on the application of the Global Anti-Base Erosion (GloBE) Model Rules under Pillar Two released in December 2021 together with illustrative examples.

For further background on the GloBE Model Rules, please see our Tax Blog on the OECD's October 2021 and our Tax Round Up published in January 2022.

Key points to note in the OECD commentary:

- Taxpayers within the scope of the model rules will have to calculate their effective tax rate for each jurisdiction in which they operate and pay a top-up tax (known as the Income Inclusion Rule or IRR) which reflects the difference between their effective tax rate in the jurisdiction in which they operate and the 15% minimum rate. The commentary sets out that a Qualified Domestic Minimum Top-Up Tax will provide a low taxed jurisdiction with the primary taxing right over the top-up tax and, therefore, precedes the application of the IIR or the Undertaxed Payment Rule (UTPR). All entities located in the Member State implementing such rules should pay the top-up tax to this Member State, and the top-up tax payable under the IIR or UTPR should correspondingly be reduced. It is expected that many jurisdictions will safeguard their right to levy their local top-up tax by introducing a Qualified Domestic Minimum Top-Up Tax which will be available on election by the Member States for a 3-year period, automatically renewable unless revoked.
- A Qualified Income Inclusion Rule refers to a set of rules that is implemented in the domestic law in accordance with the GloBE Model Rules. Guidance will be provided outlining a process to assist jurisdictions to determine if they had introduced a Qualified Income Inclusion Rule.
- Companies that will be subject to the GloBE Model Rules will be able to treat tax credits as qualifying for the purposes of the computation of the 15% minimum tax rate per jurisdiction.
- GloBE Rules would apply after the application of the domestic tax regimes, including regimes for the taxation of CFC.

In addition, the OECD has launched a public consultation on the Implementation Framework which focuses on the coordination of the implementation and administration of GloBE Model Rules to preserve consistent outcomes for multinational companies and avoid the risk of double taxation. The consultation closes on 11 April ahead of a planned virtual consultation meeting at the end of April and responses should be sent to: taxpublicconsultation@oecd.org

On 15 March and 5 April, EcoFin meetings took place and failed to reach an agreement with respect to the European Commission's proposed Directive, which sets out how the Pillar Two minimum tax rate will be applied in practice within the EU. For further background on this proposal, please see our Tax Round Up published in January.

Finally, a twelve-month delay has been proposed in implementing the rules meaning that the EU Member States would be expected to implement the IRR for tax years beginning on or after 31 December 2023 and the UTPR on or after 31 December 2024. Member states in which there are fewer than 10 parented groups in scope of Pillar Two can choose not to adopt the IIR and UTPR until 2025.