Proskauer

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Welcome to the February edition of the Proskauer UK Tax Round Up. Although there have been no major developments since our last issue there have been several interesting cases published.

Case law developments

Settlement payment not deductible as an expense of a trade (*Vaines v HMRC*)

Mr. Vaines was a solicitor. In the 2007/08 tax year he paid a settlement amount to a third party that had made a claim against his former partnership. His new partnership lent him the money to settle the claim. In 2007/08 the only income Mr. Vaines received was from his new partnership, and he sought to deduct the settlement amount from that income.

The Court of Appeal found in favour of HMRC that the settlement amount was not deductible on the basis that the payment had not been wholly and exclusively incurred for the purposes of Mr. Vaines' current trade.

It was noted by the Court that although a successful claim by the bank could have bankrupted Mr. Vaines, thereby preventing him from practicing as a solicitor with his new partnership, the settlement payment benefitted him generally by permitting him to continue practicing, whether with his new partnership or otherwise.

The Court of Appeal's decision reminds us that partners in a partnership or members of an LLP carry on their trade collectively and not as a collection of individual partners and, accordingly, for the settlement expenditure to be deductible it would have had to have been incurred wholly and exclusively for the purposes of the trade of Mr. Vaines' new partnership as a whole.

We are also reminded that "wholly and exclusively" questions turn largely on the specific facts of the particular case. It was noted that if the new partnership had paid the settlement amount itself, or if the payment of it had been discussed by partnership management, then the payment might have been deductible.

"Just and reasonable" does not mean the most just and reasonable (*Maersk Oil North Sea UK Limited v HMRC*)

This case related to the apportionment of company profits during a transitional period in which the supplementary tax charge on ring fence oil and gas profits increased from 20% to 32%. The legislation provided for time-based apportionment of taxable profits during the transitional period but companies could, where such basis of apportionment produced an unreasonable result, apportion on a "just and reasonable" basis.

The FTT permitted the taxpayer's use of a just and reasonable apportionment basis. In particular, the taxpayers only had to show that their approach was a just and reasonable approach, not that it was the most just and reasonable approach.

This is of general interest because profits arising in accounting periods straddling the introduction of the interest deduction restriction and new carried forward loss rules, among other similar rules, need to be apportioned for the purposes of those rules on a just and reasonable basis across the periods before and after the new rules come into effect and the decision limits HMRC's ability to second guess a taxpayer's reasonable approach to that apportionment.

Composite supplies follow the VAT treatment of the principal supply (*Stadion Amsterdam v Staatssecretaris van Financien*)

The ECJ has reconfirmed the general principle that the whole of a single supply of goods or services which is comprised of a principal element and an ancillary element must be subject to VAT at the applicable rate of the principal element of the supply, even if the ancillary element, if supplied separately, would be subject to a different rate of VAT.

This particular case related to tours of AFC Ajax's football ground, the Amsterdam Arena, with the stadium tour being the principal element of the supply and a visit to the club museum being the ancillary element. Supplied separately they would have been subject to different rates of VAT (21% and 6% respectively), but the higher rate of VAT attaching to the principal supply was held to apply to the entire composite supply.

Stadion Amsterdam's argument that two separate VAT rates should apply was based on *Talacre v HMRC*, where it was held that the two supplies making up a composite supply should be taxed at different rates (as an exception to the general principle set out above). The ECJ confirmed that the exception to the general principle did not apply where, as Stadion Amsterdam had argued, each supply could be separately identified and priced. Rather the exception applied only where the relevant VAT legislation specifically provided for particular separate VAT treatments. As was the case in *Talacre*, in the UK the supply of a caravan is zero-rated but the relevant VAT legislation notes specifically exclude from zero-rating removable contents of that caravan, and that specific legislative provision overrode the general principle.

Broker does not create a UK VAT establishment (*Hastings v HMRC*)

Hastings is a company established and operating in the UK that acted as broker for a number of insurers, including Advantage, a company established and operating in Gibraltar.

Hastings sought to recover its input VAT costs attributable to its brokerage services supplied to Advantage under specific VAT provisions which provide for input VAT recovery on costs attributable to certain insurance services (including brokerage) supplied outside the EU. However, if the supply was actually made to a fixed establishment of Advantage in the UK Hastings would not have been able to recover its input VAT as its supplies would be VAT exempt.

The question for the FTT was whether Hastings was acting as a fixed UK establishment of Advantage and supplying its services to that establishment. A fixed UK establishment requires, as a matter of law, a permanently present establishment that has the human and technical resources necessary for providing or receiving services. HMRC effectively argued that Hastings, as agent of Advantage, was a fixed UK establishment of Advantage as a result of Advantage effectively making supplies of insurance services to UK customers in the UK through Hastings.

The court determined that Hastings was not a fixed UK establishment of Advantage. The court noted that, as a general matter, questions of permanency were to be considered on their specific facts and, specifically, in order for an establishment to be sufficiently "permanent" to create a fixed UK establishment, the fixed UK establishment should be able to make/receive supplies on a stand-alone business (in particular, without reference to the main business/VAT establishment in Gibraltar). There is also a requirement for the host (Advantage) to have a degree of control over the resources of its establishment.

The case will be of interest to UK investment fund managers managing funds with offshore general partners, since HMRC have, in the past, tried to argue that the UK manager is a UK fixed establishment of the non-EU general partner, and the case should give some comfort that any such argument is unlikely to succeed in normal circumstances with properly constituted general partners.

Discovery assessments by HMRC in the context of DOTAS (*J Hicks v HMRC* and *HMRC v Raymond Tooth*)

After the usual time limits for enquiry into a tax return have passed, HMRC can issue a "discovery assessment" where new facts or information come to light showing a previous assessment to tax was insufficient or inaccurate.

In order to make a discovery assessment, HMRC must show that either (i) the insufficiency of tax is brought about carelessly or deliberately by the taxpayer (or his or her tax advisor) or (ii) the investigating HMRC officer could not reasonably have been expected to be aware of an insufficiency of tax based on the information available to them.

In the first case, Mr. Hicks had participated in a tax avoidance scheme which purported to give him significant tax losses to offset against taxable income. The scheme had been disclosed to HMRC by its promoter under DOTAS. The relevant tax returns (08/09 and 09/10) included the DOTAS scheme reference number.

In 2015, HMRC issued discovery assessments in respect of the relevant tax returns. The FTT reiterated previous case law in confirming that neither Mr. Hicks nor his tax advisor had acted carelessly or deliberately in respect of either return. The FTT's view is particularly interesting given the DOTAS issue on these particular facts as it shows that it is not necessarily careless to enter into a potential tax avoidance scheme even in the knowledge that HMRC may challenge it.

HMRC v Raymond Tooth similarly involved a controversial tax planning scheme but here the scheme had not yet been given a DOTAS reference number. The taxpayer instead made a "white space" disclosure of his involvement in the controversial scheme in his tax return, stating that the interpretation of the law that he had adopted in determining his tax bill for the relevant period was controversial and that he expected an enquiry to be raised.

No proper enquiry was raised in the ordinary enquiry period and when HMRC sought to raise a discovery assessment it was rejected. The return had become wrong, because the taxpayer's controversial reading of the law had subsequently been determined as incorrect, but it was not wrong at the time of submission and he had brought the controversy to the notice of HMRC. It was also held that in any event there would have been no proper discovery of new facts or information and hence a discovery assessment was inappropriate.

Employees through personal service companies and IR35 (*Christa Ackroyd Media Limited v HMRC*)

The so-called IR35 rules can treat an individual engaged to provide services to a client through a personal service company (PSC) as an employee of that client when the hypothetical contract which would exist if the individual were engaged directly with the client would be akin to an employment contract (as opposed to a self-employed contract). Where IR35 applies, the PSC has to account for income tax and NICs to HMRC in the same way that an employer would on (most of) the payment received for the services. This case involved the application of the IR35 rules to a BBC presenter providing her services through a PSC. The FTT found in favour of HMRC, that the presenter would have been an employee of the BBC had she contracted with them personally.

This case provides a useful summary of the relevant factors in determining whether or not the IR35 hypothetical contract is equivalent to an employment contract. It is also of note because it is the first IR35 case that HMRC has won in the seven years since the rules were introduced.

The FTT identified the following as being of particular significance in determining whether there would have been a contract of employment:

i the length of the contract;

ii who has control of the individual's work;

iii other activities the individual is entitled to undertake in addition to their work with that client;

iv whether the individual was bound by internal guidelines and policies (in this case, the BBC editorial guidelines); and

v who provided the equipment used to carry out the work.

Other Tax Updates

Taxation of termination payments update

The taxation of termination payments and in particular the distinction between contractual and non-contractual PILONs (payments in lieu of notice) has long been unclear and complicated.

Under the Finance (No. 2) Act 2017, in many cases whether the PILON is contractual or non-contractual will no longer make any difference to its tax treatment, and the payment will be subject to PAYE income tax and employee and employer NICs.

The new legislation was unclear as regards whether it applied to all PILON payments made on or after 6 April 2018 or only to PILON payments made or on after 6 April 2018 where the employment was terminated on or after 6 April 2018.

HMRC have informally confirmed that the latter is the case, and so the current rules will apply where the employment was terminated before 6 April 2018. It is expected that this informal confirmation will be set out in revised guidance in due course.

Consultation on employment status

Following Matthew Taylor's report on modern working practices, as discussed in our July issue, HMRC have published a consultation on employment status, and particularly the distinction between employment status and self-employment status for both tax and employment law purposes in order to clarify employers' obligations.

Responses are required by 1 June 2018.

UK property beneficial ownership register

Following a consultation in April 2017, the UK government has announced that from 2021 a register of information of beneficial ownership of overseas companies and other entities that own or purchase UK property is to be maintained.

It is expected that the register will be based on the people with significant control (PSC) register which was launched in April 2016 and, accordingly, would require disclosure of 25% direct or indirect beneficial owners of the property.

Once the register has been launched, in order for an overseas entity to take ownership of UK property it will be required to apply for registration and provide its beneficial ownership information. This could have timing implications for real estate transactions where an overseas entity is acquiring UK property, particularly where a newly incorporated overseas vehicle is making the acquisition.

It is understood that overseas entities that already own UK property will have one year from the start of the register to comply.

More details will be provided when draft legislation is published and we will update you further accordingly.

HMRC Guidance

Latest non-dom guidance

HMRC have published new guidance in relation to the new deemed domicile rules, changes to the remittance basis of tax and the new ability to cleanse mixed funds.

This guidance relates to the new rules that came into force on 6 April 2017.

In particular, taxpayers wishing to cleanse their offshore mixed funds need to do so before 6 April 2019, and this is a complicated area on which expert advice should be sought.

Requirement to correct guidance

The requirement to correct offshore tax errors legislation introduced in Finance (No. 2) Act 2017 is designed to require taxpayers to correct undeclared past UK tax liabilities in respect of their offshore financial interests on or before 30 September 2018.

This date coincides with the start date for the OECD's "common reporting standard" when more than 100 countries will commence the exchange of tax and financial information.

Failure to disclose the relevant information by this date will result in very significant penalties (the standard penalty being 200% of the tax liability, subject to reduction to a minimum of 100% of the tax liability depending on the seriousness of the failure to correct).

On 19 January, HMRC published updated taxpayer guidance in respect of the requirement to correct legislation which can be found here.

In particular, these rules could apply to non-domiciled taxpayers who have received carried interest from non-UK assets since July 2015, and, if in doubt, such taxpayers should seek advice on how the rules might affect them.