UK Tax Round Up

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Welcome to the February 2019 edition of the UK Tax Round Up. This past month has seen Royal Assent given to the Finance Bill 2019 and some interesting UK and ECJ case developments.

UK Developments

Finance Act 2019

The Finance Bill 2019 received Royal assent on 12 February 2019 becoming the Finance Act 2019. Among numerous other things, this brings into force the changes to the entrepreneurs' relief conditions that we have reported on previously.

Group relief: Court of Appeal confirms that appointment of a receiver breaks a loss relief group

The Court of Appeal (CA) has confirmed the Upper Tribunal (UT) decision in *Farnborough v HMRC* discussed in our October 2017 edition of the Tax Round Up. As a reminder, this case held that when, and at the time that, receivers were appointed over the affairs of a group subsidiary, the subsidiary was removed from its parent's group relief group by virtue of the parent no longer having the power to secure that the affairs of the subsidiary were carried out in accordance with its wishes.

Perhaps importantly, the CA decision put an emphasis on the particular facts and circumstances of the case and the broad powers that were given to the receivers (and that overrode the power's retained by the subsidiary's board) which meant that the receivers had practical control of the company. Additionally, the receivership in this case was not likely to be a temporary one but was the first step towards a winding up. So, whilst technically the constitutional framework of the parent's shareholder control remained, the parent's ability to remove, add or replace directors was, in practice, meaningless. The board had no control over the company's day to day business.

The CA's focus on the facts leaves the door ajar for the possibility that a group relief group survives receivership where the receivers are given narrower powers to run the company and/or where the receivership is for a limited period, but this would require a careful and realistic assessment of the powers given to the receivers and those retained by the parent as shareholder in each case.

Employment tax: Insurance premium paid to director not taxable earnings

In *Macleod and Mitchell Contractors Limited v HMRC*, the UT has overturned the previous decision of the First-tier Tribunal (FTT) and held that insurance premia payments made by his company (MMCL) on insurance policies in his name were not "earnings" subject to employment income tax, PAYE or NICs.

The basic facts of the case were that several insurance policies had been taken out erroneously in the name of Mr Mitchell which were intended to be in the name of and for the benefit of MMCL (as accepted by the FTT).

Notwithstanding this, HMRC sought to assess the premia payments made by MMCL to employment tax on the basis that they "relieved Mr Mitchell of a pecuniary liability" to pay the premia. The FTT accepted this argument.

Perhaps not surprisingly on the facts of the case, the UT has overturned the decision of the FTT. In coming to this decision, the UT stated that the central issue in the case was whether the transaction conferred a profit or benefit upon Mr Mitchell that derived "from" his employment with MMCL. In this regard, they paid particular attention to the words of Lord Diplock in *Tyrer v Smart*, in which he said that "the test … is whether the benefit represents a reward or return for the employee's services … or whether it was bestowed on him for some other reason". The UT decided that the premia payments by MMCL (relieving Mr Mitchell of his obligation to pay the same) were not made as a reward for his services but in recognition of the fact that the insurance policies were for the benefit of and should have been taken out in the name of MMCL.

While this is a case on extreme facts, it highlights that it is not sufficient for there to be a payment by an individual's employer to an employee for such payment to amount to taxable earnings. It must be the case that the payment is properly a reward for services rather than a payment in respect of something completely different. This might prove helpful in other circumstances in which employees receive payments from, or are relieved of payment obligations by payments by, their employer. One such circumstance where this might be relevant, for instance, is on company sale transactions where a target company might pay the legal fees of its managers, who are required to enter into the sale documentation to give representations and warranties and, potentially, to transfer some or all of their existing investment into the target into the new purchaser's acquisition structure with related commercial terms to negotiate on this new investment. It might, in these cases, be said that the reason that the employer company paying the managers' legal fees is not as a reward for their services, but because their inclusion in the transaction is required as part of the sale (for the benefit of the other shareholders) and that they need to get legal invites in order to enter into the transaction.

Capital allowances: On a sale should be calculated on a just and reasonable basis

In *Glais House Care Limited v HMRC,* the FTT has decided that the capital allowances on fixtures (and other items) available to a purchaser should be determined on the basis of a just and reasonable apportionment of the total purchase price, irrespective of the amount specifically attributed to the fixtures in the relevant sale agreement. While interesting, the case is of historic value since anti-avoidance provisions introduced in 2012 have overridden the result for transactions entered into after those rules became effective.

In this case, the sale agreement had included a low amount of the total consideration to the fixtures and other equipment subject to capital allowances and the seller had brought that amount into account for the purposes of its tax calculations so that it could claim a balancing allowance. The seller had then gone into administration. In contrast, the purchaser sought to claim a much higher amount of qualifying expenditure on the basis of a just and reasonable apportionment of the total consideration that it paid for the business and a valuation supporting the amount claimed.

The FTT agreed with the taxpayer that the capital allowance rules (as they then were) provided that the disposal (and acquisition) value for the capital allowances in question were to be determined on a just and reasonable basis, and that this overrode whatever amount the buyer and seller had ascribed to the relevant equipment in the sale agreement. While of historic value in respect of such capital allowance claims, the case does highlight that the courts will not be deterred from supporting asymmetric tax results where the law is clear.

Anti-avoidance: Latest GAAR advisory Panel Opinion released

The latest GAAR Advisory Panel opinion has been released, supporting HMRC's view that the transaction in question was not a reasonable course of action in the circumstances such that the general anti-abuse rules (GAAR) applied to it.

Previous GAAR Advisory Panel opinions have been concerned principally in employment tax related schemes. This opinion relates to a film investment partnership scheme under which, broadly, investment was made into a film rights exploitation partnership with a view to generating a large initial tax loss that could be set off against the investors' other income in the year of investment with the prospect of future taxable income being generated from the partnership arrangements. The scheme as a whole, however, involved the sale by the individuals concerned of the partnership interest in what was considered to be a non-taxable transaction. This was intended to dispose of the investors' right to future income from the partnership so as to avoid tax on it altogether (and keep the loss) rather than simply create a timing mismatch between benefiting from the loss and suffering tax on the income. The disposal was structured into two elements. First, disposal of the investors' capital accounts followed by a sale of their members' interests in the partnership.

The GAAR Advisory Panel decided that the arrangements as a whole involving the investment, the first year tax loss claim and the sale of the partnership interest before it generated taxable income to convert the tax deferral into permanent tax avoidance was contrary to the principle of legislation in question, involved contrived and abnormal steps and was not a reasonable course of action in the circumstances such that the GAAR could apply to it.

This is another reminder that the GAAR Advisory Panel appears to have little difficulty in determining that structured tax avoidance arrangements are within the scope of the GAAR and that it is not uncommon for such arrangements to involve steps that can be considered "contrived or abnormal" such that the overall arrangements can be considered unreasonable for the purposes of the GAAR.

Spotlight 47: Phoenix schemes seeking to avoid income tax on company distributions

HMRC has added schemes intended to avoid income tax on "phoenix" schemes under which a taxpayer receives a capital amount in respect of their business which they quickly recommence in a different form to their "Spotlights" on tax avoidance schemes that it considers do not have their desired effect.

Prior to the introduction of targeted anti-avoidance legislation (TAAR) in 2016, individuals would look to avoid an income tax charge on receiving a distribution from their business by winding up the company and receiving a capital distribution in favour of a dividend or other income distribution. The same individual(s) would then recommence the same business (or substantially the same business) under a different company name. The TAAR put an end to this behaviour.

HMRC has become aware of various schemes that look to replicate this behaviour but bypass the TAAR by, for instance, selling the company to a third party rather than winding it up.

The new Spotlight makes clear that HMRC will challenge such behaviour either applying the TAAR or, alternatively, by seeking to apply the general anti-abuse rule (the GAAR).

HMRC advises anyone using a scheme that purports to avoid income tax in this way to accurately declare income distributions in their tax returns. Where this is not possible due to time limits having passed, individuals are advised to settle with HMRC to avoid accruing interest.

Tellingly, HMRC also notes that a successful application of the GAAR to transactions entered into after 14 September 2016 are subject to a 60% user penalty and anyone enabling such a transaction entered into on or after 16 November 2017 may be subject to a penalty as an enabler of an abusive scheme.

CIOT publishes comments on HMRC consultations on changes to capital losses and stamp taxes

The Chartered Institute of Taxation (CIOT) has expressed reservations about two recent consultations on potential changes to the corporate capital loss restriction rules and the rules on stamp taxes on share consideration. They are requesting greater clarity and guidance on both.

The capital loss consultation proposes, broadly, an alignment of the rules on the use of capital losses by companies to the new income loss use rules introduced in 2017.

Under the income loss relief rules, companies (or groups) are only permitted to use 50% of carried forward losses above a group allowance of £5 million to shelter profits in any tax year. As discussed by the CIOT, this restriction was accompanied by rules broadening the sort of profits that certain losses could be set against and the ability to group relieve carried forward losses.

The CIOT has questioned the desirability of introducing such rules at a time when the Government is keen to emphasise the UK's competitiveness as a jurisdiction to do business in. In addition, they discuss the fundamental differences between income losses (which are more likely to arise on a repetitive basis) and capital losses, where it is quite likely that a large capital loss might arise on a particular transaction and the group will not then generate a capital gain for a number of years, at which time the gain might well be significant.

The consultation on stamp taxes considers three main issues:

i extending the market value consideration rules when connected parties transfer listed shares to unlisted shares;

ii aligning the definition of consideration for stamp duty and SDRT (to which money or money's worth applies); and

iii aligning the rules on contingent, uncertain and unascertained consideration with that used for SDRT or SDLT.

The CIOT's main concern with these proposal is that there is no clarity on the policy rationale behind it or what behaviour it is seeking to deter. Added to this is the fact that, while there are discrepancies between the various stamp taxes, obtaining market value confirmation could be a costly matter and the current position for stamp duty, SDRT and SDLT is well understood.

The CIOT recommends that before proceeding with these changes in isolation, HMRC should follow the recommendation of the Office of Tax Simplification and assess a longer term plan to reform stamp taxes more generally with accompanying guidance on managing the transition.

International Developments

State aid: ECJ says Belgian excess profits exemption is not a "state aid scheme"

The ECJ has determined that the Belgian government's "excess profits" exemption is not a "state aid scheme" within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union.

The European Commission (EC) had brought a state aid case against Belgium in 2016 claiming that Belgium's "excess profit" exemption constitute a state aid scheme. The relevant Belgian provision provided for an exemption for tax for Belgian companies that were part of multinational groups where it could be said that some of the profits of the Belgian company derived from the fact that it was a member of the multinational group. This was one of a number of high profile state aid cases that were brought by the EC around 2016.

This particular case has been rejected by the ECJ because of the specific requirements of "state aid schemes" as opposed to the granting of State Aid to individual companies. In order for there to be a state aid scheme there are a number of requirements, including that the granting of the aid is not dependent on any further implementing measures or is granted to individual undertakings in a general and abstract manner. The ECJ determined that the relevant Belgian excess profits exemption did require consideration of the specific facts on a case by case basis before the exemption would be applied and did not, therefore, meet the conditions required for a state aid scheme.

While this case is a victory for the taxpayer in a state aid case, and shows that the ECJ is willing to deviate from the EC in assessing whether or not state aid rules have bene broken in the tax sphere, it is probably of little relevance to some of the higher profile cases that have been brought against individual multinational companies on the basis of specific arrangements that they have come to with the relevant tax authorities.