Proskauer

UK Tax Round Up

August 2020

UK COVID-19 Developments

HMRC updates Coronavirus Job Retention Scheme guidance

HMRC has updated its guidance on the Coronavirus Job Retention Scheme (CJRS). The changes include the removal of parts of the guidance that related to the application of the CJRS up to 30 June 2020 and to update employers on changes to the CJRS from 1 August 2020.

The deletions include information about the minimum furlough period requirement, working out claims and pension contributions on or before 30 June 2020, backdating claims to 1 March 2020 and consolidating PAYE schemes. Certain examples which were relevant for claim periods ending before 30 June 2020 have been deleted.

Additional guidance that has been added includes:

- how an employer can calculate the amount it can claim when a fixed pay employee has worked overtime in the 2019-2020 tax year;
- confirmation that a furloughed employee who has been made redundant must receive her/his redundancy pay based on her/his normal (i.e. pre-furlough) wage not the furloughed wage; and
- confirmation that employers should only contact HMRC to submit National Insurance numbers if the employee in question has a temporary number or has genuinely never had one.

UK Case Law Developments

Upper Tribunal decides sufficient mutuality of obligation existed in IR35 appeal

In *HMRC v Kickabout Productions Limited*, the Upper Tribunal (UT) has allowed HMRC's appeal against the First-tier Tribunal's (FTT's) decision that a radio broadcaster was not a deemed employee for the purposes of the IR35 legislation.

Pursuant to two contracts, Mr Hawksbee provided his services as a radio broadcaster for a daily show to Talksport through his personal service company, Kickabout Productions (KPL). HMRC argued that the IR35 legislation applied to KPL to treat the fees paid by Talksport as employment income because the hypothetical contracts between Mr Hawksbee and Talksport, had Mr Hawksbee contracted with Talksport directly, would have been contracts of employment (or contracts of service).

The FTT had previously found that this was not the case because Talksport was not obliged to provide Mr Hawksbee with work and so there was an insufficient degree of mutuality of obligation between them (this being the first of three conditions required for there to be a contract of service - together with sufficient degree of control and the other provisions of the contract being consistent with its being a contract of service - as laid down in the *Ready Mixed Concrete* case) for the hypothetical contracts between Mr Hawksbee and Talksport to be employment contracts.

In examining the first of the two contracts, the UT determined that Talksport was required to provide Mr Hawksbee with work (through KPL) as there was a fixed two year period for which KPL was engaged to provide the services. The UT noted that further provisions in the contract supported this conclusion, including (i) a termination provision requiring four months' notice by either party, (ii) a suspension provision (which allowed Talksport to suspend the contract on the occurrence of certain events) and (iii) restrictions on Mr Hawksbee's ability to seek work with other clients.

The UT further considered that the second of the two contracts also contained an obligation on Talksport to provide Mr Hawksbee with work. Although the contract stated that Talksport was not obliged to engage with KPL for any particular project (and KPL was not obliged to accept any such engagement), once a project (i.e. the radio show) was assigned there was an obligation on Talksport to offer work and for KPL to provide Mr Hawksbee's services for a minimum of 222 shows per year.

Based on these findings, the UT agreed with HMRC that the FTT's decision that there was insufficient mutuality of obligation was an error of law and, given the rest of the FTT's original decision and the facts before the UT, it was open for the UT to remake the decision.

In applying the three-stage test set out in *Ready Mixed Concrete*, the FTT had decided that Talksport had sufficient control over Mr Hawksbee's work, since it had rights under the contracts to dictate where, what and when Mr Hawksbee provided his services (even if they did not always exercise such rights). The UT also concluded that there were no other factors which were inconsistent with the hypothetical contracts being contracts of employment, alongside its determination that there was sufficient mutuality of obligation.

The UT concluded, therefore, that, under each of the hypothetical contracts between Talksport and Mr Hawksbee, Mr Hawksbee would have been an employee of Talksport.

This case highlights once again the complexities in determining deemed employment status for the purposes of the IR35 rules and the importance of considering carefully whether the mutuality of obligation requirement is met, particularly given the general criticism of HMRC's approach to the question (being that there is mutuality of obligation under any valid contract) and that this question is not properly considered in HMRC's online check employment status for tax (CEST) tool.

So, although the facts in this case were reasonably favourable to HMRC (in that Mr Hawksbee had worked continuously for Talksport for 18 years), it further indicates the importance of parties taking a realistic view of the contractual rights and obligations that govern their relationships in these sorts of cases. With the extension of the IR35 legislation to the private sector expected in April 2021, this case offers further guidance for end clients when determining whether or not the rules should apply.

High Court decides SPA tax gross-up clause covers only actual tax liabilities

In *AXA v Genworth*, the High Court (HC) has held that the words "subject to taxation in the hands of the receiving party" contained in a SPA tax gross-up provision mean "actually taxed in the hands of the receiving party".

The question was linked to claims made by AXA as purchaser against the seller of a business relating to the mis-selling of payment protection insurance. The SPA included a tax gross up provision which stated that, if the basic claim amount was “subject to tax” in AXA’s hands, then the claim amount would be increased to cover the amount of the tax. AXA argued that “subject to tax” meant only that the payment was within the scope of tax and not exempt. This would cover any amount which was included in AXA’s tax calculation regardless of whether any tax was actually payable by AXA on the claim amount. This argument would result in any sums payable by Genworth being required to be grossed up at the date of their payment. In making this argument, AXA acknowledged the possibility of a windfall if such amounts were grossed up in respect of tax which AXA would not have any liability to actually pay.

Conversely, Genworth contended that the words “subject to taxation in the hands of the receiving party” meant “actually taxed in the hands of the receiving party”. This would cover tax on the payment in question which the receiving party was under an enforceable obligation to pay having been assessed by the relevant tax authority and such tax determined to be due. Genworth’s argument would result in any additional amounts payable under the tax gross-up provision only being payable if and when the recipient was under an enforceable obligation to pay the tax.

The HC agreed with Genworth’s argument that the words “subject to taxation in the hands of the receiving party” meant “actually taxed in the hands of the receiving party”. The HC held that the purpose of the clause was to make the receiving party whole for its loss (i.e. as if no tax had been required to be paid) and so should only apply if tax was actually payable (i.e. at the time that AXA ceased to have been made whole). The HC noted that AXA’s construction did not reflect the ordinary and natural meaning of the words in question and, if the parties had intended the tax gross-up to operate as AXA argued, the provision should have contained clear and distinct language to that effect. It further noted that Genworth’s construction is a “business like” construction of the clause which makes perfect commercial sense and the HC could not see a reason why the parties would have intended the clause to operate to give AXA a potential windfall.

The case highlights again the importance of contracting parties documenting clearly their commercial intentions in respect of the allocation of tax risk and when amounts relating to tax should be paid. The HC's decision confirms that the courts will be unwilling to look beyond the ordinary and natural meaning of contractual terms and where an agreement contains potentially ambiguous provisions they will seek to apply those terms on a straightforward, "business like" basis.

FTT decides no deduction for partners for interest on loan to finance capital contribution

In *Shiner and other v HMRC,* the FTT dismissed the taxpayers' argument that loans made to trusts of which they were beneficiaries to fund contributions to a partnership in which those trusts were partners should be treated as loans to the partnership itself. Consequently, the FTT held that there was no basis on which the trusts (or the taxpayers) could claim a deduction against their share of the partnership profits for interest paid on the loans.

The taxpayers were business partners who ran a UK property development group. They had entered into a tax avoidance arrangement involving two Isle of Man trusts under which the trustees of the trusts entered into a partnership for the purposes of carrying on a trade of property development. The trustees had also entered into interest-paying loan agreements with another entity in the UK group, with the money borrowed under the loan agreements being contributed to the partnership.

Whether the tax avoidance scheme was successful had been the subject of judicial review but, at the point of this judgement, it was accepted by the taxpayers that they were liable to income tax on the trading profits of the partnership. In relation to the calculation of the trading profits, the taxpayers argued that the interest which was payable by the trust partners on the loans was deductible in computing those profits.

The FTT dismissed the taxpayers' appeal and held that the interest was payable by the relevant trusts as partners in the partnership and not by the partnership itself. The FTT did not accept that, because the partnership was a tax transparent entity, the loans taken out by the partners should be treated as loans of the partnership. Therefore, the interest was not deductible when computing the partnership's trading profits.

The FTT also dismissed the taxpayers' argument that the interest, as payable by the partners, was still deductible because the loans had been taken out to allow the partnership to purchase trading assets and so was used (and the interest expense incurred) wholly and exclusively for the purpose of the partnership's trade. Instead, the FTT held that the sole reason for taking out the loans was to fund a contribution to the partnership and not to purchase trading assets directly and so was not wholly and exclusively for the purpose of the partnership's trade (which it might have been if the loans were taken out directly by the partnership).

Although in the context of a tax avoidance scheme, this case highlights the importance of paying careful attention to the details of funding arrangements to ensure that the correct person incurs costs and that the requirements for claiming deductions on relevant taxable receipts are satisfied as well as the importance of considering critically the relationship between a partnership and its partners for tax purposes.

UT decides essay writing company was acting as principal for VAT purposes

In *All Answers Limited v HMRC,* the UT has upheld the decision of the FTT that an online essay writing company was acting as principal for VAT purposes and not as agent for the people who wrote the essays. Accordingly, All Answers was required to account for VAT on the full fees paid to it by its customers and not just the amount it retained after paying the essay writers.

All Answers was an online company which offered customers the opportunity to receive written academic work in return for a fee. The third-party writers, mainly lecturers, teachers and PhD students, received a percentage of the fee (typically one third) while All Answers retained the rest. The writers were not employees of All Answers.

In respect of VAT on the supply of services, HMRC contended that All Answers was acting as principal with its customers and, therefore, was required to account for VAT on the full payment made by the customer. Conversely, All Answers contended that it was acting as an agent for the third-party writers and so only had to account for VAT on the percentage of the customer's payment that it retained. The FTT had previously agreed with HMRC.

The UT considered in detail the terms of both the customer contract and the third-party writer contract in light of the economic and commercial reality of the transactions. Agreeing with the FTT, the UT held that the customer contract contained obligations only binding All Answers in relation to supplying the academic work (except a “no plagiarism” requirement, which the UT noted was rarely invoked) and that there was, therefore, a legal relationship between the customer and All Answers. Given this, the UT held that for VAT purposes there was a single supply of the work by All Answers to the customer and so All Answers was required to account for VAT on the full customer payment and not just the amount it retained. The UT stated that, even though the third-party writers had given All Answers authority to enter into contracts on their behalf, this did not mean that All Answers was acting solely as agent and that it could not be bound as principal in its own right under the customer contracts. The third-party writer’s fee was consideration for a separate supply from the third-party writer to All Answers which allowed All Answers to perform its services for the customer.

This case is a useful illustration of how the courts might review contractual relationships in the context of possible agency and principal arrangements and the need to document such relationships carefully to ensure that a particular relationship is established since, as here, the courts are likely to conduct a thorough review of the relevant contractual provisions in order to determine their overall effect.

FTT finds “voting rights” means votes exercisable at a general meeting for the purpose of entrepreneurs’ relief

In *Holland-Bosworth v HMRC*, the FTT dismissed the taxpayer’s appeal concluding that his disposal of shares did not qualify for entrepreneurs’ relief (ER) (recently renamed business asset disposal relief) as the voting rights attached to the shares did not carry the required 5% votes exercisable at a general meeting.

The case concerned whether Mr Holland-Bosworth was entitled to ER on disposal of certain shares (termed B Ordinary Shares). In order for ER to be available, the company in question needed to be Mr Holland-Bosworth's "personal company". One of the requirements for that to be the case was that the relevant taxpayer could exercise at least 5% of the voting rights in the company. The term "voting rights" is not further defined in the legislation. The articles of the company stated that holders of B Ordinary Shares did not have the right to receive notice of, attend or vote at general meetings but did give such shareholders the right to vote on changes to their own class of shares (that is, standard minority shareholder protection). Mr Holland-Bosworth argued that this right was sufficient to satisfy the voting rights required for ER to apply (because he could exercise more than 5% of the votes in respect of that particular matter).

The FTT disagreed with Mr Holland-Bosworth, stating that the voting rights required for ER qualification are those exercisable at a general meeting and that the statutory language is clear that the votes must be exercisable against the company (and not merely against other shareholders of the same class of shares). The FTT also rejected the taxpayer's additional arguments that (i) the company considered the B Ordinary Share shareholders to have voting rights and so the articles should be interpreted on this basis, the FTT stating that there was insufficient evidence to support this argument and (ii) the B Ordinary Share shareholders could unilaterally change their rights to give themselves voting rights and so should be treated as having such rights. On the last point, the FTT stated that even if such rights could be given under the articles, until such rights were in fact given, the B Ordinary Shares shareholders did not have any relevant voting rights.

Although the decision in this case is not surprising and the facts were favourable to HMRC, it does provide useful clarification of the meaning of voting rights in the context of ER qualification.

HC allows HMRC to argue that taxpayer company did not disclose full information in seeking to rescind a settlement agreement

In *HMRC v IGE USA Investments Ltd*, the HC has allowed HMRC, in its attempt to rescind a settlement agreement with a taxpayer company, to run the argument that the company deliberately failed to disclose full information when negotiating the settlement.

The case involves HMRC's attempt to rescind a settlement agreement reached with the taxpayer group relating to the anti-arbitrage rules in Finance (No.2) Act 2005 (now repealed), in relation to a particular transaction involving US, UK and Australian entities, on the basis that the group had not provided adequate disclosure when the agreement was being entered into.

It is important to note that the HC did not find that the taxpayer company had deliberately failed to disclose information, nor did it consider whether the anti-arbitrage rules in fact applied (both of these points will be examined at a later hearing), but it did permit HMRC to make its argument of incomplete disclosure as part of its case. Although the HC was not examining whether the taxpayer company had deliberately withheld information from HMRC, its detailed consideration of the communication between HMRC and taxpayer and subsequent decision to allow HMRC to run its argument highlights the importance of taxpayers ensuring that communications with HMRC requesting clearances are as full and open as possible to avoid any possible future claim that the facts provided were incomplete or misleading. This is of particular importance whenever, as in this case, a long period of time had passed since the events under consideration which can reduce the weight given to oral evidence.

The substantive hearing should provide useful guidance from the courts on what needs to occur, and what needs to be established, for HMRC to be able to rescind an agreement with a taxpayer.

Other UK Tax Developments

HMRC publishes initial list of countries with digital services tax regimes considered "similar" to the UK's

HMRC has updated its guidance on the digital services tax (DST) to begin identifying which other countries' DST regimes are considered to be "similar" to the UK DST for the purposes of cross-border relief.

Revenue arising from the provision of an online marketplace may be subject to both UK DST and a similar tax regime in another country. As a result, a 50% relief from the UK DST charge may be available on certain cross border transactions, but the overseas tax must be sufficiently similar to DST for this to apply. HMRC makes it clear in the guidance that the overseas tax does not have to be identical to the UK DST and that it will consider the essential nature and character of the foreign tax in question focusing on the objectives of the tax and not the detailed mechanics in place to achieve those objectives.

HMRC has previously committed to creating a list of which other countries' DST regimes it considered to be similar to the UK DST for the purposes of the cross border relief. HMRC has now provided an initial list, which includes:

- France
- Italy
- Malaysia, and
- Turkey

HMRC will keep this list under review and will update it as appropriate and will consider requests from taxpayers for other countries' tax to be included.

HMRC updates guidance on 2019 disguised remuneration loan charge

HMRC has updated its guidance relating to the settlement of loans that are not subject to the 2019 disguised remuneration loan charge to reflect the changes resulting from the provisions in the Finance Act 2020 (FA 2020).

Following the recommendations made by Sir Amyas Morse's independent loan charge review (see our December UK Tax Round Up), FA 2020 amended the loan charge provisions so that they only apply to loans entered into on or after 9 December 2010. The changes brought in by FA 2020 also provided that the loan charge will not apply to users of loan schemes between 9 December 2010 and 5 April 2016 where (i) the user provided a reasonable disclosure of the scheme in their tax return(s) and (ii) HMRC had not taken any action by 6 April 2019.

HMRC’s updated guidance is intended for use by agents and advisers assisting clients to calculate and settle liabilities not subject to the loan charge under the new, updated terms. HMRC confirmed that the November 2017 guidance on disguised remuneration settlements will be withdrawn on 1 October 2020.

The updates also include information about voluntary restitution refunds (i.e. refunds to taxpayers who had settled with HMRC in relation to loans to which the loan charge, as a result of the FA 2020 changes, no longer applies), details of HMRC’s debt management strategy and the situations where HMRC will agree time to pay arrangements with taxpayers.

Further guidance in relation to loans that are subject to the loan charge will be published in autumn 2020.

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