Proskauer

# UK Tax Round Up

**September 2021**

## UK Case Law Developments

### Permission to rectify imperfect SEIS application

In *Fashion on the Block Limited v HMRC*, the First-tier Tribunal (FTT) has allowed the taxpayer's appeal against HMRC's decision not to allow the taxpayer company to issue seed enterprise investment scheme (SEIS) certificates where the taxpayer had mistakenly filed an enterprise investment scheme (EIS) compliance statement instead. In coming to this decision, the FTT reiterated the need for a purposive approach to tax statutes and a realistic interpretation of the facts as well as discussing the application of the discretionary remedy of rectification.

The taxpayer was a UK based startup company founded and run by a Miss Willetts. In looking to grow the business, Miss Willets wanted newly issued shares to qualify for SEIS relief. Accordingly, she submitted a form for advanced assurance from HMRC that the company's shares would qualify for SEIS on 23 January 2019.  The application made clear that it was an application in respect of SEIS. Miss Willetts had ticked the box dealing with SEIS but also, unwittingly, the box dealing with EIS relief. HMRC provided the relevant advanced assurance (covering both SEIS and EIS relief) on 2 May 2019. The form stated HMRC's belief that compliance certificates could be issued to the company under sections 257EC(1) (in respect of SEIS) and 204(1) (in respect of EIS) of the Income Tax Act 2007 (ITA).

The company then applied to HMRC on 26 January 2020 for the required authority to issue SEIS certificates of compliance in respect of a share issue. This application included a cover letter stating, “Please find enclosed an SEIS1 form”. It transpired that the form sent to HMRC was actually an EIS1 form rather than an SEIS1 form. New shares were issued to investors on 9 February 2020. The form appeared to meet all requirements for SEIS relief with all of the key indicators of an SEIS application. However, HMRC responded authorising issuance of EIS compliance certificates. The company responded within 18 minutes of receipt of this authorisation asking for authority to issue SEIS compliance certificates instead. HMRC decided this was not possible and the company appealed this decision.

The company argued that the information required for SEIS and EIS forms are substantially the same and that the clear intention was to apply for authorisation to issue SEIS compliance statements. A mistake was made but HMRC was put on notice of that mistake as soon as practicable. The company pointed to the discretionary remedy of rectification, noting that the conditions had all been satisfied. These are, evidence of intention to apply for SEIS, evidence of disproportionate harm caused by the mistake, a compliance statement capable of rectification, a mistake HMRC was aware of at the material time and an issue that was raised at the earliest possible moment by the taxpayer.

HMRC argued that the compliance statement filed by the company did not satisfy the conditions for a valid statement under section 257ED ITA, as the form referred to EIS and not SEIS. Furthermore, HMRC could not give retrospective authority to issue SEIS compliance certificates in respect of the shares issued on 9 February 2020 because the requirements of section 257DK ITA (that no prior EIS shares had been issued) could not be satisfied because of that share issue itself having been authorised for EIS purposes. HMRC noted that there was no statutory mechanism for correcting or amending an SEIS or EIS compliance statement and no authority to withdraw EIS certificates once issued. HMRC also rejected the proposal that the discretionary remedy of rectification could be available to the company.

The FTT first considered the correct interpretation of the SEIS legislation. Citing *BMBF v Mawson*, the FTT reiterated that taxing statutes should be construed purposively and applied to the facts viewed realistically.  This is in contrast to the literal approach taken by HMRC. The FTT felt that, as Parliament's clear intention is to allow tax relief for investors and thus encourage investment in companies in the same position as the company, HMRC should have utilised its general discretion to accept a replacement/amended SEIS form.

HMRC had all the relevant background information to issue the advanced assurance and received a covering letter indicating the applicant was attaching an SEIS compliance statement. Therefore, in applying a purposive construction of the legislation and a realistic view of the facts, there had been no prior EIS investment and the SEIS legislation requirement of no prior risk capital scheme had been met. The FTT did recognise its lack of jurisdiction to direct HMRC to exercise its discretion to overlook the error.

On the point of rectification, the FTT rejected HMRC's argument that the FTT does not have jurisdiction to allow the appeal on the basis of rectification. It held that there was "cogent" evidence of the unilateral mistake made by the company. Furthermore the remedy of rectification for the taxpayer would not defeat Parliament's intention, which was for SEIS to apply to those in the company's position.

This decision to allow the appeal highlights that tax statutes should be considered purposively and facts viewed realistically. It also highlights the need for taxpayers to be vigilant in completing forms that they send to HMRC, as this is a rare example of HMRC being told to overlook a taxpayer's error, although it is to be hoped that it will lead to HMRC accepting the FTT's view that they have discretion to overlook minor errors in a wider range of cases.

## Employment source required for payment to be taxed as earnings

In *Marlborough DP Ltd v HMRC*, the FTT have found that payments made through an "untruthful" (as HMRC put it) trust arrangement to the sole shareholder and director of a company constituted neither earnings from the director's employment nor disguised remuneration under Part 7A of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) but were, rather, distributions made to the owner as a shareholder. Furthermore, the FTT said that should its finding be incorrect and the payments were earnings, the payments would be deductible for corporation tax purposes.

In this case, Marlborough DP Limited (MDPL) was a dental practice owned by Dr Thomas through which he provided dental services and of which he was a director. MDLP set up a trust arrangement (the RT arrangements) under which payments were made to Dr Thomas. In short, MDLP established a trust for the benefit of persons who provided or may in the future provide services, custom or products to MDPL. MDPL made "contributions" to the trust said to represent "part of the economics of earning [MDPL's] profits". These contributions were deducted by MDLP as a business expense in its corporation tax return. A further company, also controlled by Dr Thomas, acting on behalf of the trustee of the trust, then used the contributions to make "loans" to Dr Thomas. These loans were substantially the same amount as the relevant contribution. Dr Thomas did not treat the loans as subject to tax when received.

HMRC attacked the arrangement on two grounds:

- first, that MDPL was not entitled to a tax deduction for the contributions because they were not incurred wholly and exclusively for the purposes of MDPL's trade; and
- second, that MDPL was liable to account for income tax and NICs in respect of the contributions ultimately received by Dr Thomas as loans on the basis that the amounts were either (a) earnings from employment or (b) disguised remuneration under Part 7A ITEPA by virtue of being a third party payment made in connection with Dr Thomas's employment.

MDPL argued that the relevant sums did not constitute "earnings from employment" under the general rules in ITEPA and, therefore, they could not be liable for income tax or NICs under PAYE.  MDPL accepted that the relevant sums could be taxable as distributions and that, therefore, it could not deduct the contributions when computing its profits for corporation tax purposes. MDPL also noted that should the tribunal find that the relevant sums were taxable under ITEPA, MDPL should then be entitled to a deduction for the contributions.

The FTT found that the relevant sums were not taxable under either the general earnings rules in ITEPA or as disguised remuneration under Part 7A.

The decision rested on what degree of connection is required between an employment and a payment for the payment to be earnings or received “in connection with” employment. Case law makes it clear that in order for sums to constitute “earnings from employment” they must be paid as remuneration or reward in return for services rendered by a person as an employee. The FTT rejected HMRC’s argument that the so called Rangers case (about payments through trust arrangements) was authority for treating sums routed through trust arrangements for tax avoidance purposes to people who were, as a matter of fact, employees as taxable earnings.  Rather, the FTT said that the Rangers case simply confirmed that, where a payment is made as a reward for services, the payment will be taxed as such regardless of whether it is paid through a trust arrangement.

In determining whether a payment is earnings, the focus must be on the purpose of the payment or why or in return for what a payment is made. The tribunal must be able to say that it is satisfied that the payment is from the employment rather than from any other source. The payment does not have to be solely for the purpose of employment but the link must be “sufficiently substantial as to characterise the payment as one from employment”.  Accordingly, the FTT considered whether (a) the contributions made by MDPL and paid on to Dr Thomas were remuneration or a reward for the provision by Dr Thomas of his services to MDPL or (b) the contributions were made for another reason, so that the source of the contributions was not Dr Thomas’s employment by or directorship of MDPL.

The FTT had little evidence of MDPL’s underlying purpose but, on the evidence available and on a purposive approach to the question of earnings, it found that the relevant sums were not paid to Dr Thomas as a reward for his services as director but, instead, were paid as distributions to him as a shareholder in MDPL.

This decision was based on evidence, including that MDPL had no contractual obligation to pay the sums as a director's fees and payment by way of dividend is not uncommon, the sums paid to Dr Thomas comprised the company's total profits and were paid as and when there were profits, Dr Thomas's evidence that, without the RT arrangement, profits would have been paid by MDPL as dividends and the fact that a trust structure is used with the intention of obtaining a tax advantage does not in itself answer the question of whether the relevant payments were a reward for services as an employee (or director) or, alternatively, sums intended as a return for a shareholder. The FTT dismissed the argument that absence of a formal process for the declaration of dividends was an answer on the underlying purpose of the payment since MDPL thought that the structure would deliver the intended tax advantage. Furthermore, a sole shareholder/director is not prevented from extracting profits as salary and/or as a dividend in such proportions as they choose. It would be wrong, based on case law, to presume that a company's purpose when paying profits to a sole shareholder and director was to reward them for director services just because of the absence of a formal declaration of a dividend.

Turning to the discussion on Part 7A and disguised remuneration, there is a requirement for those rules to apply that the third party payment in question is a means of providing a reward in connection with the recipient's employment. The FTT applied substantially the same analysis to the disguised remuneration rules as it did to the basic earnings question and, for the same reasons, found that the disguised remuneration connection with employment condition was not met. Therefore, the sums were not subject to PAYE under the disguised remuneration rules.

On the corporation tax deduction, MDPL accepted that, given the FTT's approach to the questions of earnings and disguised remuneration, it was not entitled to the deduction.

The FTT noted that had it determined that the contributions were earnings, then MDPL's purpose in making the contributions to the trust would have been taken to provide Dr Thomas with earnings and MDPL would have been entitled to a tax deduction as the "ordinary, intended or realistically expected outcome" of the expenditure rather than, as HMRC argued, the payment having a separate purpose of obtaining a tax deduction. Therefore, in those circumstances the deduction would have been allowed.

While very fact specific as to the underlying purpose of rewarding Dr Thomas for his services as a director or distributing the company's profits to him as a shareholder, the decision does appear contrary to similar opinions of the GAAR Advisory Panel where similar arrangements involving owner managed companies and payments from trusts have been considered. In a number of such arrangements, the Panel has found a sufficient connection between the payment and the employment for the disguised remuneration rules to apply.  Given this, and HMRC's dislike of tax avoidance schemes linked to employment, it would not be surprising if HMRC were to appeal this decision.

## Work offered and done for payment considered sufficient to evidence mutuality of obligation

In *Professional Game Match Officials Ltd v HMRC*, the Court of Appeal (CA) has held that the FTT and UT erred in law in their previous decisions that certain referees (so called national group referees (NGRs)) were not employed by Professional Game Match Officials Ltd (PGMOL) and has remitted the case back to the FTT for it to reconsider. The CA has not itself determined that the referees were employed by PGMOL. We reported on the FTT and UT decisions in the September 2018 and May 2020 editions of the UK Tax Round Up

HMRC had argued that the referees were employed by PGMOL. As is common ground, for there to be an employer/employee relationship, there must be an irreducible minimum of mutuality of obligation and sufficiency of control by the employer. There has, however, been much discussion recently about what is required for there to be mutuality of obligation of the sort required to create an employment relationship. HMRC's view is that the only requirement is a valid contract relating to the provision of and payment for work. Taxpayers have argued that there needs to be some commitment either to provide work or to make some sort of payment in lieu of the provision of work.

The relationship between PGMOL and the NGRs in this case was governed by two contracts. The first was an overarching agreement (or umbrella contract) under which the referees were, effectively, on PGMOL's list and available to officiate at matches. The umbrella contract contained terms about how the NGRs were meant to maintain fitness, required fitness tests, recommended fitness programmes and the provision of coaches to the NGRs. Under the umbrella contract the NGRs could inform PGMOL of dates on which they were and were not available to officiate matches. The second, individual contract was the contract entered into when PGMOL asked an individual to officiate at a particular match. PGMOL operated an online match booking system through which it would allocate matches to NGRs. The NGRs could then accept or reject any allocation and, if they accepted it, could then reject it prior to match day with no penalty other than loss of match fee. PGMOL generally allocated matches to the NGRs on the Monday before the following weekend's matches.

HMRC argued that the presence of a contract (or two contracts) between PGMOL and the NGRs was sufficient to satisfy the mutuality of obligation requirement. PGMOL claimed that there was not mutuality of obligation of the sort required for there to be an employment relationship under either the umbrella contract or the individual contracts because, even when PGMOL had offered a particular engagement to an NGR and the NGR had accepted it, the referee could still notify PGMOL that he or she could not officiate the match and PGMOL would find an alternative referee.

Both the FTT and the UT found that neither contract created the sufficient mutuality of obligation of the sort required for the basis of an employment relationship because, in the case of the individual contracts, each NGR could withdraw from any appointment at any time before the match date. The FTT had also considered that PGMOL did not have sufficient control rights under the individual contracts because it could not influence how an NGR actually refereed a game.

The CA has stated that both the FTT and the UT erred in law on the question of mutuality of obligation as it related to the individual contracts and that the FTT erred in law on the question of control. The CA agreed with both the FTT and the UT that the umbrella contract did not have the required mutuality of obligation and so could not, itself, create an employment relationship between PGMOL and the NGRs.

On mutuality of obligation the CA said both the FTT and the UT had erred in law in deciding that the individual contracts did not contain sufficient mutuality of obligation because the NGRs could withdraw from an appointment at any time, and said that (a) whether the individual contracts had mutuality of obligation was unrelated to any decision on the umbrella contracts and (b) each individual contract and the engagement under it could still give rise to a contract of employment "if work which has in fact been offered is in fact done for payment". The ability to withdraw from officiating a match was irrelevant unless and until an NGR actually withdrew from the engagement.

In our May 2020 UK Tax Round Up we concluded that the UT's decision on mutuality of obligation contradicted HMRC's position that all that was required was a contract that related in some way to work and that HMRC might change their approach in this regard. While this decision must now be reconsidered by the FTT, the CA's findings point strongly to HMRC's position being correct.

With regard to the question of control under the individual contracts, the CA has found that the FTT had erred in its approach by failing to give sufficient weight to the elements of control conferred by the umbrella contract to the overall relationship between PGMOL and the NRGs and that the overall framework, fitness requirements, annual testing and so on might have conferred sufficient control over how the NGRs carried out their work to create an employment relationship.

Interestingly, the CA appears to have concluded that the referees' putative status as employees derives from each match's individual appointment but that whether PGMOL has the necessary control derives from the overall umbrella contract, which does not itself have the required mutuality of obligation to result in a contract that might itself be an employment contract. While not replacing the FTT's decision on employment with its own, the CA's decision does contain a strong implication that the NGRs should be considered to be employees of PGMOL when performing their individual match duties.

If that is the conclusion that the FTT reaches, then it seems increasingly difficult for individuals performing duties under individual contracts where there is an overall framework governing their relationship with the party to which they are providing their services to successfully argue that they are not employees (or deemed employees) unless there are other factors in the relationship which point definitively away from an employment relationship.

This decision will directly affect the outcome of *George Mantides Ltd v HMRC*, reported on in our August 2021 UK Tax Round Up. This is another case considering whether individuals should be considered to be employees (or deemed employees in the context of IR35). The UT refrained from considering the question of whether Mr Mantides should be treated as a deemed employee pending the outcome of the CA's decision in the PGMOL case.

## The meaning of a valid discovery and acting on behalf of a taxpayer

In *GC Field & Sons Ltd and Others v HMRC*, the FTT opined on the meaning of discovery, the meaning of acting "on behalf" of a taxpayer and considered whether a taxpayer or their adviser had been negligent in reporting the taxpayer's tax position to HMRC. The FTT allowed the taxpayer's appeal and found that discovery assessments issued in respect of the relevant SDLT avoidance arrangement were invalid.

ELS was a provider of an SDLT avoidance scheme entered into by the taxpayers. Following the scheme and the taxpayer's SDLT reporting in respect of it, the Finance Act 2013 (FA 2013) introduced measures designed to counteract such arrangements with retrospective effect.  Affected taxpayers were under an obligation to resubmit amended SDLT returns by 30 September 2013. The taxpayers failed to do this and HMRC failed to open an enquiry into their SDLT returns within relevant time limits.

HMRC later issued discovery assessments in order to recover the SDLT. The FTT looked at whether these assessments were valid and, specifically, at two points:

- whether HMRC had made a discovery that, with respect to the transactions in question, SDLT had been under assessed; and
- whether the taxpayers themselves, or a person acting "on behalf of" the taxpayers, had been negligent in causing the loss of SDLT.

On the first point, the FTT found that HMRC had made a valid discovery in relation to an insufficiency of SDLT on the taxpayers' transactions. The discovery was valid despite HMRC first issuing the discovery assessments on the basis that the relevant transactions were caught by anti-avoidance rules under section 75A Finance Act 2003 and then changing its view and relying instead on the new rule in FA 2013 (a change of view which was included in correspondence with the taxpayers). This follows previous case law confirming that HMRC will not invalidate a discovery assessment simply by changing the reasons for why a transaction resulted in a loss of tax provided that the conclusion on the tax effect of the transaction remains the same.

On the second point, the FTT first looked at whether there had been negligence on the part of the taxpayers in failing to submit amended SDLT returns as required under FA 2013. The FTT found that a reasonable lay taxpayer could not be expected to be aware of the legislation's retrospective effect and the subsequent requirement to revisit a transaction for which advice had been sought and which had been disclosed to HMRC. Therefore, the taxpayers could not be said to have been negligent. The FTT then considered the question of whether ELS, which provided advice to the taxpayers on the effectiveness of the scheme, could be said to be acting "on behalf of" the taxpayers. ELS had been retained to advise the taxpayers on the transaction in question and had also agreed to deal with any subsequent HMRC enquiries. In making its discovery, HMRC had written to one of the taxpayers (Mr Shaw) advising him of the need to submit an amended SDLT return and ELS had responded on his behalf, stating that he was not caught by the anti-avoidance legislation in FA 2013. HMRC had not written to the other relevant taxpayers. The FTT found, on the facts, that ELS could be said to be acting on behalf of Mr Shaw but not for the other taxpayers who had not received the relevant correspondence from HMRC.

In deciding whether ELS had been negligent in failing to advise Mr Shaw of the need to submit an amended SDLT return, the FTT found HMRC had failed to discharge the burden of proving that ELS was negligent in advising that Mr Shaw was not required to submit an amended return. HMRC had not provided any evidence on the question of what a reasonably competent tax adviser would have done in the circumstances.

It would appear that, had HMRC provided appropriate and adequate evidence discharging the burden of proving the conditions for issuing discovery assessments, the FTT may well might have found in its favour.

The case reinforces previous case law that a HMRC discovery is not invalidated by a change of reason as long as the conclusion is unchanged, and highlights the distinction between an agent providing advice to a taxpayer and acting on behalf of a taxpayer. It also reiterates that the burden is on HMRC to prove that a taxpayer or person acting on its behalf has been negligent (or careless or deliberate) in creating the loss of tax that a discovery assessment relates to.

# Other UK Tax Developments

## Date set for next UK Budget

The Chancellor will present the Autumn Budget on 27 October 2021. This will coincide with the conclusion of the Chancellor's Spending Review 2021, launched on 7 September.

Given the recent government announcements on the new health and social care levy, it will be interesting to see whether any further tax raising measures are announced.

## Basis period reform and the OTS explores potential for moving tax year end date

The Office for Tax Simplification (OTS) published a report on 15 September looking at the benefits, costs and wider implications for moving the tax year end date from 5 April to 31 March (or possibly 31 December). The report goes into lots of detail, but the key considerations are:

- moving the date to 31 March would cause the least disruption and cost. This is the end of a calendar quarter, the nearest month end date to the current tax year and is unofficially used as year end by a number of taxpayers (including the UK government);
- moving the date to 31 December would allow the tax year end to align with other countries, reducing administrative burdens and bolstering the effectiveness of data exchange for HMRC's purposes; and
- the cost would be substantial for any change of date. Systems, processes and operations would need to be updated, leading to financial and time implications. A move to 31 December could cause even greater costs as additional changes, such

as filing and payment dates and the Budget timetable, would also need updating.

In any event, the OTS has expressed its view that any such change should not take place in the immediate future.

On a different measure, HMRC has consulted on amending the basis period rules applicable to income tax reporting for sole traders and individuals carrying on business in partnership which operate to, broadly, link reportable income of a tax year to the profits of the relevant business's accounting period and lead to complications such as overlap profits in the early years of business operation.

The proposal was that basis periods would be aligned with tax years (that is, 5 April) from tax year 2023/2024 with an accelerated tax charge bringing in profits to 5 April 2023 in the tax year 2022/2023.

Following representations from a wide variety of industry bodies cautioning that the proposal will lead to difficulties for certain taxpayers and should not be rushed, the government has announced that it will delay the reform for at least 12 months to give time for proper and detailed consultation.

This delay is good news for taxpayers given the additional administrative and operational costs and complexity that the proposals would have given rise to for a wide range of businesses.

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