Proskauer

# UK Tax Round Up

**February 2024**

**Welcome to February's edition of our UK Tax Round Up. This month has seen revised HMRC guidance on the capital contribution limb of the salaried member test and an interesting case on the tax basis for an employment termination settlement payment.**

## UK Case Law Developments

### Settlement payment subject to tax as employment income

In *Mathur v HMRC*, the Upper Tribunal (UT) has upheld the FTT's decision that a £6 million settlement payment to a former employee following an employment tribunal (ET) claim was subject to income tax as employment income under section 401 ITEPA 2003 notwithstanding the claim that the payment was related to potential discrimination claims by the employee and to avoid the "nuisance value" of those claims.

The basic facts of the case were that Ms Mathur's employment was terminated by her employer (DBGSL) following an investigation by regulators into the manipulation of interbank interest rates by certain employees of DBGSL including Ms Mathur. The regulator had demanded that DBGSL terminate Ms Mathur's employment along with that of six other employees. DBGSL had offered Ms Mathur a payment of £82,135 for the termination of her employment. Ms Mathur rejected this offer and commenced proceedings in the ET against DBGSL 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 subject to deduction of approximately £2.7 million (for income tax and employee national insurance under PAYE). The tax was calculated on the basis that the payment was subject to employment tax under section 401 ITEPA as a payment "in consequence of or otherwise in connection with" the termination of Ms Mathur's employment, subject to £30,000 of the payment being tax free under section 403 ITEPA, £40,000 of it being tax free as payment for injury to feelings under section 406 ITEPA and £400,000 being tax free under section 413A ITEPA as payment of Ms Mathur's legal fees for advice in connection with her termination and the ET proceedings.

The question to be 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.

At first instance, Ms Mathur had argued that the settlement payment she received was to compensate her for the discrimination and victimisation she had experienced whilst in employment and that the issues surrounding that possible claim existed before the termination of her employment. She argued that she had a moral claim against DBGSL and that the large payment was to relieve it of the nuisance of that claim. Accordingly, the payment should be free of tax as it was not sufficiently linked 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 payment and that, while Ms Mathur might have had the basis of a claim before her termination, it was the termination that triggered the claim. The settlement payment was, therefore, paid either “in consequence of” or, at least, “otherwise in connection with” the termination. Consequently, the whole sum (except for the tax free amounts under sections 403, 406 and 413A ITEPA) was chargeable under section 403 ITEPA.

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 FTT then granted Ms Mathur permission to appeal on three grounds. First, that the FTT erred in not applying a sufficiently “strong or close nexus” between the payment and the termination. Second, that the FTT was wrong in finding that the termination was central to, or a trigger for, Ms Mathur’s discrimination claims that were the reason for the large payment. Third, that the FTT should have apportioned the payment between an amount that was subject to section 401 and an amount that was not.

The UT considered the link required between the payment and the termination and concluded that it was not particularly strong and that the “otherwise in connection with” was clearly a test that was different to the “in consequence of” test and loosened the degree of causation required. The FTT also stated that since Ms Mathur was trying to distance herself from some of the arguments which she had made before the ET, the FTT had been justified in treating her evidence before it as to the reason and trigger for the settlement agreement and payment with “a degree of caution” and to place more weight on the statements made to the ET which had not been made with a view to achieving a particular tax result for the payment. It also held that the FTT had properly considered the link between the termination and the settlement agreement and had properly concluded that the termination was a trigger for Ms Mathur’s claim and the settlement. Finally, it held that the FTT had been justified in not apportioning the payment because there was nothing in the settlement agreement itself to support an apportionment and no evidence had been put to it that would have allowed to it assess any appropriate apportionment.

The case provides another example of how difficult it is to sever amounts received in settlements entered into at the time of and in relation to termination from section 401 other than under the relevant statutory exemption provisions or with very clear evidence as to the reason for the payment (or part of it) and why the payment was not made “in connection with” the termination.

# Other UK Tax Developments

## Change to HMRC guidance on “capital contribution” salaried member condition

HMRC has published revised guidance on its interpretation of the application of the targeted anti avoidance rule (TAAR) in section 863G(1) ITTOIA 2005 to the salaried member “capital contribution” test in section 863D ITTOIA (the so called Condition C).

Under section 863A ITTOIA, members of UK limited liability partnerships (LLPs) who are treated as being “salaried members” are subject to tax on their remuneration as if they were employees. Under the rules, all members are salaried members unless they “fail” one of the three tests in sections 863B, 863C and 863D ITTOIA (Conditions A, B and C), Failing Condition A or B requires the relevant member to have “significant influence” over the affairs of the LLP or for at least 20% of their total expected remuneration to be “variable”. Failing Condition C requires the relevant member to have a capital contribution in the LLP of at least 25% of their expected “disguised salary” (being the amount of their total expected remuneration which is not “variable”.

The TAAR then states, somewhat cryptically, that no regard is to be had to any arrangement the main purpose, or one of the main purposes, if which is to secure that an LLP member is not a salaried member.

These rules were introduced in 2014 and, since then, HMRC’s published *Partnership Manual* (from paragraph PM250000) has included guidance on Condition C and the possible application of the TAAR to capital contributions. HMRC has now updated paragraph PM259200 to include an example to which the TAAR would apply involving an LLP who made a “genuine” capital contribution to an LLP on becoming a member but then, as a result of an increase in expected remuneration, makes additional “top up” contributions as and when required to ensure that the member satisfies the 25% capital contribution requirement in Condition C. The new guidance says that the additional capital contribution would be disregarded applying the TAAR. Prior to this change, the guidance on Condition C capital contributions and the TAAR, which has not been changed, had focused on capital contributions for which the funding was structured to limit risk for the member and states that “The capital contribution requirement is fairly prescriptive. A genuine contribution made by the individual to the LLP, intended to be enduring and giving rise to real risk, will not trigger the TAAR”. This clear statement has, however, unfortunately been diluted by the new example referred to above and the addition of a statement in PM259310 on “genuine finance” that now says “*Subject to its main purpose (or a main purpose of any arrangement of which it forms part) a financing arrangement that results in a* [A] genuine contribution made by the individual to the LLP, intended to be enduring and giving rise to real risk will not trigger the TAAR” (words added to guidance in italics).

While it is unfortunate that these changes have been added to the published guidance without explanation, it is unclear how the new example fits in with the prior statements on “enduring [capital] giving rise to real risk” and what sort of capital contribution arrangements HMRC now considers would or would be disregarded for the purpose of Condition C applying the TAAR. Hopefully, some clarity will be forthcoming on this and the reason for the changes.

In the meantime, if you have arrangements that might be affected by this new guidance, you should consider discussing it with your advisers.

### Finance Bill 2023-3034 receives Royal Assent

The Finance Bill 2023-2024 received Royal Assent on 22 February, becoming the Finance Act 2023-2024. This includes all measures released over the summer to form part of the 2023-2024 Bill, as well as the measures announced in the November Autumn Statement (see our November 2023 UK Tax Round Up for further details).

## Other Tax Developments

### EU Member States agree updates to the EU list of non-cooperative jurisdictions

On 20 February, EU Member States agreed to remove four jurisdictions from Annex I of the EU list of non-cooperative jurisdictions. The four states are the Bahamas, Belize, Seychelles and the Turks and Caicos Islands.

While the Bahamas and the Turks and Caicos Islands have been fully removed on the basis that they have successfully addressed concerns and deficiencies in their enforcement of the economic substance requirements, Belize and Seychelles have been moved from Annex I to Annex II. Belize and Seychelles will remain in Annex II pending the results of a supplementary review by the Global Forum on Tax Transparency and Exchange of Information.

This is a positive step in the direction of tax transparency and fair global taxation to see positive engagement from jurisdictions on the list.

Following this update, the 12 jurisdictions remaining on Annex I are American Samoa, Anguilla, Antigua and Barbuda, Fiji, Guam, Palau, Panama, the Russian Federation, Samoa, Trinidad and Tobago, the US Virgin Islands and Vanuatu.

Ten further jurisdictions appear in Annex II. These jurisdictions have shown improvements in their tax governance and will continue to be monitored.

## Related Professionals

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