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Welcome to the January edition of the UK Tax Round Up. This month has been reasonably quiet, with another IR35 case decision and a decision on the recovery of input VAT incurred on a corporate fundraising and acquisition transaction among other developments.

UK Case Law Developments

VAT incurred on corporate advisory fees not recoverable

In *Ince Gordon Dadds LLP v HMRC*, the First-tier Tribunal (FTT) has decided that Ince Gordon Dadds LLP (formerly Culver Holdings Limited and the taxpayer) (Culver) was not entitled to recover input VAT on fees that were incurred in connection with the acquisition of Culver by Work Group plc (WG) in order to allow Culver to be listed and to raise additional funds with the stated intention that the funds would be used to make further acquisitions and provide working capital to the group. Culver was the representative member of the VAT group that WG became a member of after its acquisition of Culver.

The transaction involved WG acquiring all of the share capital of Culver on a share for share exchange. This was a "reverse takeover" executed to allow Culver, through WG, to obtain a listing on AIM. WG listed on AIM and raised £20 million from new shareholders on the same day as the takeover. WG also joined the VAT group of which Culver was the representative member on the day of the takeover. WG incurred certain expenses in connection with the takeover.

WG sought to recover its input VAT on the basis that the VAT should be treated as incurred by Culver, the takeover was effected to allow funds to be raised to be used, among other things, as working capital for Culver and its subsidiaries and, in any event, the expenses should be treated as general overheads of the VAT group. While WG stated its intention to join the VAT group it did not express any intention to provide services to the Culver group for consideration.

While the FTT accepted that the costs had been incurred for the purpose of allowing WG to raise the £20 million of additional funds for the group, it did not accept that there was any evidence that WG actually intended that the £20 million raised would be used for the group's working capital purposes. It held, rather, that the object of raising the funds was to make further acquisitions, albeit with a view to those acquisitions using the services of Culver and its subsidiaries.

The FTT rejected the taxpayer's claim for VAT recovery on the basis that, although WG became a member of the Culver VAT group, that did not automatically create a link between the expenses and Culver's VATable activities. Notwithstanding the VAT group membership, the question was still whether there was a direct and immediate link between the costs and WG's or the VAT group's

VATable activities and/or the costs comprised a general overhead for the purpose of the group's VATable activities. The FTT held that, as a matter of fact, the costs had been incurred by WG for the purpose of making further group acquisitions and that this did not amount to a VATable activity by WG, did not have a direct and immediate link with the group's VATable activities and did not mean that the costs should be treated as general overheads of the group's VATable activity.

The case shows how important it is for companies involved in share acquisitions to set out clearly what their purpose is in making their acquisition and creating either an associated VATable activity for themselves (by, for instance, providing management services to their target for consideration) or, where there is additional funds being raised, a link between those funds and the VATable activity of the target group. It is not sufficient simply to acquire a company and become part of its VAT group. This intention should be clearly set out in pre-acquisition documentation and evidenced by the group's activity after the acquisition.

Structured remuneration scheme ineffective

In *Wired Orthodontics v HMRC*, the FTT has held that a structured remuneration scheme that used an employee benefit trust (EBT) and gold bullion to pay £300,000 to the company's two owners and directors was ineffective and that the amounts received were subject to employment tax as earnings.

The arrangement was intended to allow the directors to receive their £300,000 in a form that was not subject to tax and for the company to be able to claim a deduction for the £300,000. The FTT has determined, however, that the company could not claim the deduction, that the £300,000 was treated as earnings paid by the company and that the two directors were subject to an additional income tax charge under section 222 ITEPA. So, all in all, the participants in the scheme were materially worse off than had the company simply paid the directors a bonus or dividend.

Under the arrangement, the company set up an EBT and agreed to make contributions of £300,000 to it over the next ten years, the company acquired £300,000 worth of gold bullion from a third party gold trader, the company transferred the gold bullion to the two directors in consideration for them taking on the payment obligation to the EBT and the directors sold the gold bullion for £300,000. The company recorded its costs as an "employee costs" expense in its accounts.

The arrangement was intended to avoid the application of the disguised remuneration rules in Part 7A ITEPA (using an omission in the rules that has since been closed) and the parties agreed that Part 7A did not apply. HMRC argued that the amounts received by the directors were earnings under section 62 ITEPA. The company argued that there were no taxable earnings because the obligation of the directors to make a future payment to the EBT meant that they had not received any "profit" and that the receipts were effectively loans. The FTT determined that the arrangement did not give rise to a loan, the gold bullion received by the directors was earnings as "money or money's worth" provided by the company and the obligation to make future payment to the EBT was not an "allowable deduction" from the earnings. In addition to this, the FTT held that the directors had received the gold bullion (so money's worth) and not £300,000 cash and that, as a result, there was an additional tax charge under section 222 ITEPA because the bullion was a readily convertible asset.

The FTT also considered the question of whether the company should be entitled to a deduction for the "employee costs" that it reflected in its accounts. While the FTT accepted that the costs were correctly reflected under GAAP, it considered the question of whether the costs had been incurred "wholly and exclusively" for the purposes of the company's trade. It concluded that they had not because the company had a dual purpose of rewarding the

directors and of rewarding them in a tax efficient manner and that the company could have achieved the purpose of rewarding the directors in a much simpler way.

This is a cautionary tale for taxpayers considering implementing highly structured reward arrangements that not only might the arrangement not meet its intended objectives but might also be more costly from a tax perspective than simply paying or lending amounts to employees and/or shareholders.

Rugby pundit not a deemed employee for IR35 purposes

In *S & L Barnes Ltd v HMRC*, the FTT has held that Mr Barnes was not a deemed employee of Sky in respect of his engagement to provide rugby co-commentary and other services. The case is the latest in a long line of cases involving broadcasters over the past few years and, although each case turns heavily on its own facts, sets out an interesting analysis of how to apply the three limb test of employment or self-employment taken from the *Ready Mixed Concrete* case.

Mr Barnes is an ex professional rugby player who (through S & L Barnes Ltd) provided commentary and punditry services to Sky television as well as writing a regular column for the *Times* and the *Sunday Times* and providing his services to various other publications and broadcasters. For the tax years in question, 2013-4 to 2018-19, Mr Barnes made about 60% of his total income from Sky, with this figure reducing significantly in 2019-20 after Sky reduced its coverage of rugby.

In order to determine whether an individual who engages through a personal service company (PSC) should be taxed as an employee under IR35, the job of the FTT is to determine the terms of the hypothetical contract that would have been entered into had the individual contracted directly with the client. This is done largely by applying the terms of the contract between the PSC and the client, but can also take into account extraneous factors around the negotiations and engagement that are known by the parties. As with previous cases on IR35, this case considered in great detail the terms of the contract between Sky and S & L Barnes Ltd, determined the terms of the hypothetical contract from those terms and then sought to apply the tests in *Ready Mixed Concrete* to the hypothetical contract.

The three limb test in *Ready Mixed Concrete* states that in order for there to be an employment arrangement the employer must have sufficient control over the employee's work and there must be mutuality of obligation between the employee providing work services and the employer providing work and paying for it. If those two requirements are met then an assessment must be done as to whether the other provisions of the contract are consistent with an employee/employer relationship and the contract being one of service rather than the provision of services.

While in a number of recent cases on the question the relevant tribunal has effectively stated that if the control and mutuality of obligation requirements are met in the hypothetical contract there is a presumption of employment unless there is evidence to the contrary in the terms of the hypothetical contract, the FTT in this case took the same approach as did the Court of Appeal (CA) in the *Atholl House* case that one must apply a multi-factorial approach and take into account all facts and circumstances known to the parties and relevant to assessing whether or not they intended to create an employment relationship.

The FTT agreed with HMRC that the hypothetical contract met the irreducible minimum requirements of control and mutuality of obligation. It disagreed, however, that the hypothetical contract would be a contract of service. Rather, it stated that the terms of the hypothetical contract and the surrounding facts and circumstances around Mr Barnes' professional life pointed to him being in business for his own account such that he would not have created an employment relationship between himself and Sky. The actual reasons for

this outcome are stated in brief terms, but particularly relevant to them appear to be that Mr Barnes carried out different services for different clients, all using his expertise as an expert on rugby, and that he specifically reserved certain periods of each year (for instance, during the Six Nations tournament) when he would not work for Sky even if asked to and would, instead, work for other clients.

The case is interesting in applying this multi-factorial approach, including an assessment of the parties' knowledge and intentions, to the often difficult question of whether an arrangement should be treated as a contract of service or contract for services for IR35 purposes.

Payments made after cessation of employment treated as employment income

In *Gain Capital Ltd v HMRC*, the FTT has held that an amount of money that was given to two ex-employees of Gain Capital up to five years after they had ceased employment in order to allow them to repay certain loans made to them to allow them to buy shares when they were employees and stated to be a gift was, in fact, earnings from the former employment and taxable as such.

The basic facts of the case were that:

I. two employees and directors of companies in the Gain Capital group (the directors) had been lent money in 2008 to allow them to pay up the capital on shares that had been previously issued to them nil paid;

II. the directors resigned in 2010 and 2011;

III. in 2011, the directors entered into call option agreements pursuant to which a group company could acquire the shares for their original cost and the relevant director would use the money to repay the loans made to him or, if the call option was not exercised, the director would be released from his loan obligations; and

IV. in 2014, the group and the directors entered into a framework agreement, a deed of gift and other arrangements under which the directors were gifted the amount needed by them to repay their loans, a group company acquired their shares for their then (very low) market value and the directors were released from their obligations to repay their loans for an amount equal to that paid to them for their shares. This arrangement was entered into in connection with the acquisition of the group by Gain Capital.

HMRC argued that the amounts paid to the directors under the deed of gift were earnings associated with their former employment and subject to PAYE and NICs. Gain Capital argued that the amounts were not earnings because they were not a reward for services and that the directors received no benefit from the gifts because the call option agreements entered into in 2011 already put them in a "flat position" which would allow them to repay their loans or be released from their obligations to repay them. Further it argued that the call option agreements were not themselves derived from the directors' employment so that the required link between the former employment and the receipt of the gift was broken and that the 2014 arrangements were entered into to allow the directors' loan obligations to be satisfied to facilitate the sale of the group to Gain Capital. Both the call option agreement and the 2014 framework agreement contained tax indemnities in favour of the directors although the indemnity in the framework agreement was broader because it covered tax in respect of the gifts.

So, the question for the FTT was whether the gifts were gratuities or a profit or other benefit "from" the former employment. In considering whether the gift was "from" the employment the FTT said that it was necessary to consider whether it was from anything else. Gain Capital argued that the link to the employment was not there because the gift had been made in order to facilitate the sale of the group to Gain Capital and/or in consideration for the directors agreeing not to enforce their indemnities under the call options. The FTT rejected these arguments and traced the gifts through the 2014 arrangements and the 2011 call option agreements and back to the acquisition of the shares and granting of the loans which were a reward for services. Having determined that the gift was an amount received "from" the former employment, the FTT considered how much of it was earnings and, as in the *Wired Orthodontics* case discussed above, held that the entirety of the gift was earnings and there was nothing that was an allowable deduction to set off against it and reduce the amount that was subject to tax.

The case shows how difficult it can be to sever the "from" employment relationship for purported gifts and simply by the effluxion of time.

Other UK Tax Developments

HMRC starts consultation on streamlining R&D credit system

HMRC and HM Treasury have published a consultation document on introducing a single scheme for R&D credits as part of the review of R&D tax reliefs regime announced at the Spring Budget 2021.

The consultation considers the two schemes that currently exist, the RDEC regime applicable to larger companies and the R&D credit scheme available to smaller companies.

The consultation considers the potential benefits of creating a single scheme based around the existing RDEC rules that would be available to all companies from 1 April 2024.

The consultation ends on 13 March 2023 and representations are requested before then.

Replacement DAC6 regulations published

On 17 January, The International Tax Enforcement (Disclosable Arrangements) Regulations 2023 were laid in Parliament and will replace the UK's implementation of the DAC 6 rules on reporting cross-border tax arrangements that were significantly narrowed by the UK in January 2021. The new regulations will come into force on 28 March 2023.

The regulations require the reporting of cross border arrangements that fall within the two heads specified in the OECD's Model Mandatory Disclosure Rules, which cover arrangements that are intended to circumvent reporting under the OECD's Common Reporting Standard (CRS) rules and passive investment structures which are designed to hide beneficial owners.

The reporting obligations for intermediaries broadly follow those in the existing DAC 6 reporting rules and, interestingly, the obligation for intermediaries protected by legal professional privilege is limited to the intermediary informing its client, and not other relevant intermediaries, of its obligation to report, in line with the recent CJEU decision on the validity of protected intermediaries giving information to other intermediaries.