# UK Tax Round Up

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May 2023


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Welcome to May's edition of our UK Tax Round. This month has been relatively quiet but there were a couple of cases that affect transactions that we see in practice, including an interesting update on what could constitute a results dependent distribution payment for a UK company.

## UK Case Law Developments

### Restricted stock units treated as an incentive for income tax purposes

In *Louis Daniel Moore v HMRC*, the First-tier Tribunal (FTT) had to examine the documentation that effected a sale by Mr Moore of his minority shareholding in Wombat Financial Software Inc (Wombat) to NYSE Euronext (NYSE). The facts were complex and there were a number of rounds of negotiation between the parties and changes to the mix of consideration payable to the shareholders. However, the evidence showed that Mr Moore had not been happy with the initial allocation of sale consideration to him and had negotiated for the purchaser to issue him with $10 million worth of restricted stock units (RSUs) over shares in NYSE. These RSUs entitled Mr Moore to acquire a specified number of shares in NYSE when they vested and it was common ground that they were to be treated as employment related securities options for UK tax purposes and subject to tax under Part 7 ITEPA 2003. The question before the FTT was whether Mr Moore had given any consideration for the RSUs which constituted a "deductible amount" within the meaning of section 480(2) ITEPA which he could set against the income tax charge at the time the RSUs vested and were exercised and he acquired the NYSE shares.

Mr Moore's case was that the RSUs had been issued to him in return for a proportion of the shares in Wombat that he had sold and that, therefore, the value of the relevant Wombat shares was a deductible amount in his income tax computation on vesting and exercise of the RSUs. Indeed, he had filed his tax return for the year of the sale as including a capital gains tax liability based on the value of the RSUs forming part of the consideration for the sale of his Wombat shares. The RSUs were given a value at the time of the Wombat sale of $9 million, being $10 million discounted for uncertainty by $1 million.

The terms of the RSU plan were considered by the FTT, which stated that "The purpose of [the plan] is to enhance the profitability and value of the Company for the benefit of its stockholders by enabling the Company to offer Eligible Employees and Non-Employee Directors stock-based incentives in the Company to attract, retain and reward such individuals and strengthen the mutuality of interest between such individuals and the Company's stockholders".

Based on this and other evidence, the FTT concluded that the RSUs were not issued to Mr Moore as part of his consideration for the sale of the Wombat shares, even if he might have thought that they were, and that they were issued, at least in part, in order to retain Mr Moore in the business after the transaction closed. Accordingly, the gain that arose to Mr Moore when the RSUs vested and he acquired the NYSE shares was liable to income tax with no entitlement to deduct the consideration he claimed that he had given for his shares (the $9 million value of the RSUs) in his income tax computation. This was because section 421A ITEPA excludes as consideration the performance of any duties of or in connection with an employment.

Although this case turned on its facts, which were complex and somewhat in dispute between the parties, it is a reminder that the wording of contractual documentation is crucial to the tax analysis and, moreover, needs both to reflect the common intention of the parties and to be consistent and coherent between documents. As the FTT stated “The grant of $10 million RSUs to Mr Moore was at the very least in part an incentive and retention package, whether he viewed it as such or not. He chose to have it packaged as such” emphasising that the documents entered into will be the first point of analysis of any transaction.

While this might be considered a somewhat unfair result for Mr Moore, given he had included the value of the RSUs in his capital gains tax computation for the disposal of his Wombat shares, the terms of the income tax legislation are clear that a matching deduction for that amount is not available if the reason that he was given the RSUs was, to any extent, the performance by Mr Moore of his employment duties (leaving aside that the FTT decided that the grant of the RSUs was not, in fact, part of the consideration that he received for the sale of his shares).

## A results dependent payment was a non-deductible distribution

In *Shinelock Limited v HMRC*, the Upper Tribunal (UT) has agreed with the FTT that Shinelock was not entitled to a payment made to its main shareholder (Mr Ahmed), but for different reasons than those found by the FTT. The appeal to the UT was made both by Shinelock in respect of the denied deduction and by HMRC in respect of certain conclusions of the FTT as to whether the payment by Shinelock to Mr Ahmed was a distribution under any of the heads of section 1000 CTA 2010.

In the case, which involved a convoluted and lightly documented arrangement between Shinelock, a bank of which Mr Ahmed was CFO and Mr Ahmed, Shinelock was seeking to claim a deduction against its corporation tax on chargeable gains computation on the sale of a property used by it in its property letting business for a payment made to Mr Ahmed in circumstances where Mr Ahmed had advanced money to Shinelock. The terms of the arrangement between Shinelock and Mr Ahmed were contained to a large extent in verbal agreements between them and the details were a bit unclear but, in essence, Mr Ahmed had advanced £277,500 to Shinelock and Shinelock had agreed to pay Mr Ahmed any “capital gain” on disposing of the property to which the advance related (albeit loosely).

The FTT had held that the payment by Shinelock to Mr Ahmed was not deductible, but on different grounds to those found by the UT. In particular, the FTT had held that the payment was not a distribution for UK corporation tax purposes. The UT examined that conclusion on appeal and overruled the FTT on the basis that the FTT had erred in law on a number of points.

HMRC argued before the UT that the payment was a distribution to Mr Ahmed under one of paragraphs B, E or F of section 1000(1) CTA 2010. Each of these paragraphs required the payment to be made “out of the assets” of the company. The FTT had concluded that a payment to discharge a contractual liability cannot be said to be made “out of the assets” of a company for the purposes of any of the paragraphs of section 1000(1). HMRC appealed that ground of the decision and Shinelock conceded the point, so that it was accepted for the UT hearing that the payment had been made "out of the assets" of Shinelock. The reason for this acceptance by Shinelock is not stated. The UT then moved on to examine paragraph F of section 1000(1) (paragraphs B and E were not examined due to procedural issues).

Paragraph F covers any "distribution out of assets of the company in respect of securities of the company which are special securities" except for the principal secured and any part of the distribution falling within paragraph E. "Special securities" are securities which meet any of conditions A to E in section 1015 CTA 2010. The condition which was potentially relevant to this payment was Condition C, which applies to securities under which "the consideration given by the company for the use of the principal secured depends (to any extent) on the results of … the company's business or … any part of the company's business". The FTT had concluded that there was no "security", that the payment was not "in respect of" the loan from Mr Ahmed and that the payment did not depend on the results of Shinelock's business which was letting property and not disposing of it.

The UT rejected each of those conclusions and held that the payment was a (non-deductible) distribution for the following reasons:

- Section 1114(3) CTA 2010 treats a security as existing where any consideration is given by a company for the use of money advanced without the issue of a security;

- The payment was made to Mr Ahmed in his capacity as holder of the security since the payment was consideration for the loan made to Shinelock by Mr Ahmed. Accordingly, the payment was a "distribution out of assets of the company in respect of securities of the company"; and

- Condition C is widely framed in a number of important respects. It applies to a company's business, which is a wider concept than trade. It applies to any part of that business. The words "results of" are wider than profits and encompass both income and capital items. Shinelock's business included the acquisition, holding and disposal of the property as well as its letting. Accordingly, the payment depended to an extent on the results of Shinelock's business or part of it.

This decision makes it clear that the scope of both the distributions legislation and the "results dependent" limb of it is broad and can apply to a wide range of payments by companies to their shareholders or people providing financing to them. It is hard to draw any very clear lines around the scope based on the somewhat incomplete fact pattern in this case, but it is very clear that linking the return on an investment by a shareholder to the gains on capital items can be "results dependent" for these purposes and lead to distribution treatment. It is not simply the case that one is restricted to looking at returns that track the overall profits of a company for these purposes.

## Two cases on taxpayer legitimate expectation against HMRC

In *R (on the application of Airline Placement Ltd) v Revenue and Customs Commissioners***,** the High Court (HC) considered an application for judicial review of HMRC resiling from a non-statutory clearance (NSC) that Airline Placement Ltd (APL) and its advisers obtained from HMRC in 2009 relating to the VAT treatment of arrangements for training airline pilots. Following grant of the NSC, HMRC had subsequently issued a direction followed by a VAT assessment in excess of £10 million against APL applying a VAT analysis contrary to that in the NSC.

APL's position was that it had a legitimate expectation that the VAT treatment set out in the NSC would apply and would not be withdrawn with retrospective effect and without fair notice.

In response, HMRC contended that the request for the NSC by APL was materially inaccurate, incomplete and misleading and, therefore, APL had not given the full and frank disclosure required for APL to be able to rely on the NSC so that no legitimate expectation arose. HMRC accepted that, if the request was not materially inaccurate and misleading and there was full and frank disclosure, then a legitimate expectation would have arisen and HMRC would not have been entitled to levy VAT retrospectively and would be required to allow a reasonable time for APL to reorganise its affairs before HMRC applied VAT treatment contrary to that described in the NSC.

The High Court decided, having reviewed the relevant case law (including *Unilever* and *MFN*) that, in this case, APL had submitted a materially inaccurate and misleading request for the NSC and had not "placed all its cards face up on the table". Accordingly, HMRC was entitled to resile from the NSC and make the VAT assessment based on its analysis of its revised understanding of the arrangement in question.

This case is a useful reminder that a tax ruling is only as strong and robust as the facts disclosed. A taxpayer needs to disclose all relevant facts and arguments and update HMRC if the facts change over time.

In *Murphy v HMRC*, the Court of Appeal (CA) considered a different basis for legitimate expectation of the taxpayer. Rather than considering a HMRC clearance, this case centred on the interpretation and scope of a published HMRC Extra Statutory Concession (ESC).

The case was brought by UK resident beneficiaries of a discretionary trust whose trustees were non-UK resident. The taxpayers had received significant distributions from the trust and, in planning their tax affairs, had relied on ESC B18 to claim credit against their UK income tax liability of the distributions for UK tax already paid by the trustees on the trust income. The trustees had paid their tax more than six years before the distributions. ESC B18 had one section (relating to UK resident trusts) that contained an explicit six-year time limit on making this credit claim. The relevant part of the section dealing with non-resident trusts, however, did not mention the six-year limit although it did state that "A similar concession will operate" to that applicable to UK resident trusts. ESC B18 had gone through a number of revisions and the CA's decision was based on those revisions having changed the terms of the ESC over time.

In the months leading up to the distributions being made, the taxpayers' advisers had written to HMRC on behalf of the taxpayers and the trustees seeking confirmation that, under ESC B18, credit for underlying tax would be available to the UK taxpayers regardless of whether the income had arisen to the trustees in the past six years or in an earlier period. HMRC refused to give that assurance and instead wrote back to say that credit could only be claimed under ESC B18 in respect of payments out of trust income received by the trust within the six years before the relevant distribution.

When HMRC failed to give the credit for the earlier income tax borne by the trustees the taxpayers sought judicial review of that decision. They lost in the HC and appealed to the CA.

The CA considered afresh the relevant case law. One of the leading cases in the area (*Accenture*) held that "Where a taxpayer claims to be entitled to take advantage of an extra statutory concession promulgated by the tax authorities, its claim is in the nature of a claim to benefit from an enforceable substantive legitimate expectation".

The CA overturned the HC's decision and ruled in favour of the taxpayers. It analysed the text of ESC B18 very closely and decided that the relevant part of the text was best interpreted as not being subject to the time limit because no time limit was expressed and the development of the ESC over time had moved from referring to an underlying statutory provision that contained a six year time limit to referring to one that didn't. So, while earlier iterations of ESC B18 would have imported the six year time limit for non-UK resident trusts, the iteration in question did not. The taxpayer was justified, therefore, in relying on ESC B18 to claim credit for the income tax paid in earlier years despite what HMRC had (incorrectly) stated in its letter to the advisers. In other words, the taxpayer did have a legitimate expectation that the plain words of ESC B18 could be relied on.

# Other UK Tax Developments

## HMRC announce increase in interest rates

As a result of the Bank of England's decision to increase the base rate to 4.5%, HMRC has announced that the late payment rate of interest will increase to 7% and that the repayment interest rate on refunds of overpaid tax will increase to 3.5% from 31 May 2023.

Interest on underpaid quarterly instalment payments of corporation tax has increased to 5.5% from 22 May 2023.

## HMRC changes its policy on late payment of withholding tax on interest

As part of the post Brexit law changes, HMRC has announced that it will, from 4 May 2023, seek to enforce interest for late payment of withholding tax on interest payable to EU lenders.

Previously, there was published practice (based on the Bulgarian case of *TTL EOOD*) that, where a UK person should have withheld tax on a payment of interest or royalties to a lender resident in an EU Member State but had failed to do so, HMRC would not seek to collect interest on the late-paid withholding tax when it was settled (or relieved through a double tax agreement). This practice has now changed and HMRC will treat failures to withhold tax on payments to EU lenders in the same way as such failures on payments to non-EU lenders.