Proskauer

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This publication is a service to our clients and friends. It is designed only to give general information on the developments actually covered. It is not intended to be a comprehensive summary of recent developments in the law, treat exhaustively the subjects covered, provide legal advice, or render a legal opinion.

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Welcome to the December edition of the Proskauer UK Tax Round Up. The main event this month has obviously been the General Election. In addition, there have been some interesting UK case law developments in relation to IR35 and VAT, as well as an updated CEST tool and associated guidance from HMRC, the conclusions from Sir Amyas Morse's disguised remuneration loan charge review and HMRC's response and the release of updated substance guidance in respect of the Channel Islands and the Isle of Man.

UK Case Developments

IR35 – no mutuality of obligation to create a contract of employment

RALC Consulting Ltd v HMRC has provided the First-tier Tribunal (FTT) with another opportunity to consider the application of the IR35 rules to a worker/client relationship. It has held that the relationship in question, between the contractor, his personal service company (PSC) and his end clients, was for services and so the contractor was acting as a self-employed worker and not as a deemed employee.

Mr Alcock, an IT consultant, used RALC Consulting Ltd as his PSC in contracting, through an agency, with end clients Accenture and the Department for Work and Pensions (DWP). HMRC issued notices for income tax and National Insurance contributions (NICs) in respect of the arrangements. RALC Consulting Ltd appealed the notices.

In considering whether the contracts between Mr Alcock and each of Accenture and DWP were of service (employment) or for services (self-employment), the FTT examined the contractual terms of the relevant contracts, the wider circumstances of the practical relationships between Mr Alcock and the end clients and considered the terms of the hypothetical contracts that would have existed between Mr Alcock and the end clients had they contracted directly.

In considering the hypothetical contracts, the FTT considered the three basic conditions of employment set out in the *Ready Mixed Concrete* case, being (i) mutuality of obligation and personal service, (ii) sufficient degree of control and (iii) consistency of other terms of the contract with employment.

In respect of mutuality of obligation, the FTT held that there was no obligation on the end client to provide Mr Alcock with work and no obligation on Mr Alcock to accept any work offered. The FTT accepted Mr Alcock's evidence that there was no obligation on the end clients to provide a minimum amount of work because all of the parties realised that the contract could be cancelled at any time and there was no obligation on the clients to pay Mr Alcock an agreed amount if they did not provide him with work. Indeed one of the contracts was terminated early with no compensation paid to Mr Alcock. Therefore, there was no mutuality of obligation for employment purposes, which requires not only the provision of personal services for pay but also the promise that work will be offered. Accordingly, he was not a deemed employee.

Despite its conclusion regarding mutuality of obligation, the FTT also considered the other limbs from *Ready Mixed Concrete*. In particular, the FTT considered in detail the degree of control which existed between the end clients and Mr Alcock and concluded that the end clients had sufficient control over when and where Mr Alcock conducted his work to suggest an employment relationship but that Mr Alcock had sufficient control over what work he completed and how he did it to counter this. Interestingly, the FTT held that these factors did not create a neutral result in respect of the degree of control but that, overall, the degree of control suggested self-employment and not employment.

The complexities of determining a worker's employment are well documented and the fact-dependent nature of any case on the issue will naturally limit its wider relevance. However, this case provides a useful indication of the possible analysis of mutuality of obligation where there is no minimum work requirement. In addition, the FTT's comments regarding control and the different aspects of this limb provide insight into the possible ways the courts may interpret this requirement.

VAT input recovery on professional fees

In *Taylor Pearson (Construction) Ltd v HMRC*, the FTT held that the taxpayer could deduct input VAT in relation to services provided by tax advisers on how the company might reward its employees in a tax efficient manner.

The company implemented a scheme under which, broadly, a new class of shares was issued, partly paid up, to those directors who the company wished to reward. If certain agreed profit targets were met by the company, the directors (as shareholders of the new partly paid up class of shares) became entitled to a larger share of the consideration payable on a subsequent disposal of the entire issued share capital of the company.

HMRC had denied the company any input tax recovery on the basis that (i) the advice was in connection with the issue of shares (which is an exempt supply for VAT purposes), (ii) the advice should not be considered an "overhead" of the business and (iii) there was no direct and immediate link between the advice and the economic activity of the business. Although HMRC formally withdrew the argument in (i), the FTT still considered this point.

The FTT considered that there were two questions for it to consider. First, what was the purpose of the transaction? Second, was the transaction in question an exempt transaction? The FTT held that the purpose of the transaction was to incentivise employees in a tax efficient manner. It stated that such a purpose was one of the more obvious overheads of a business. Furthermore, the fact that the arrangement was designed to reduce tax did not alter the FTT's view. In considering whether there was a sufficient link to the business of the company, the FTT stated that the possible reduction of tax and National Insurance contributions through implementing the incentive arrangements in the manner advised would only further enhance the company's profits and so supported this analysis.

The FTT further held that it was necessary to consider the ultimate purpose of the arrangements, not just the initial transaction. In considering this, it was clear that the incentivisation and reward of employees was the aim of the transaction, not simply the issue of shares. Therefore, HMRC's argument in (i) above was also not accepted by the FTT.

This case might provide comfort for taxpayers currently facing challenge to recovery from HMRC for VAT incurred on fees for certain arrangements. Although only a FTT decision, the FTT was clear that a supply of advice incurred in relation to incentivising employees was deductible and that the advice was to implement a transaction that might be considered to reduce tax and National Insurance liabilities was not relevant.

General UK Tax Developments

Conservative Party tax pledges

During the election campaign, the Conservative Party made a number of tax promises, the key ones being:

- no rise in the rate of income tax, VAT or National Insurance contributions during the life of the Parliament;
- no reduction in corporation tax from 19% to 17% in April as was previously promised;
- a review and reform of entrepreneurs' relief;
- a review of the proposed new IR35 rules for off-payroll workers in the private sector due for implementation in April;
- an increase in the NI threshold to £9,500 in 2020;
- a decrease in business rates for certain sectors, including retail;
- an increase in the Employment Allowance for small businesses;
- an increase in the research and development (R&D) tax credits rate to 13% and an aim to expand the definition of R&D;
- a number of reforms in respect of tax avoidance including: (i) a new specialist unit within HMRC, (ii) an increase in the maximum prison terms for tax fraud, (iii) the introduction of a new package of anti-evasion measures; and
- proceeding with the implementation of the Digital Services Tax.

The Queen's Speech, which took place on 19 December, repeated a number of the above pledges including the freeze in rates for income tax, VAT and NICs and the increase in the NICs threshold in 2020.

With the Conservatives winning a large majority in the election, it will be interesting to see which of the tax pledges come to fruition and how.

HMRC updates online "CEST" tool and ICAEW response

In advance of the changes to the IR35 rules, expected to come into force in April 2020 (subject to Government review), HMRC has updated its online "check employment status for tax" (CEST) tool.

The CEST tool allows individuals and organisations to provide answers to a number of questions on the relevant proposed client/worker arrangement in order to determine whether the worker should be treated as employed for income tax and NICs purposes under the particular contractual arrangement. HMRC will accept the result which is produced by the tool provided that the information provided is accurate and the outcome is not a result of contrived answers (although it sought to resile from the CEST answer in the *RALC Consulting* case discussed above). The tool has been available for a while but has been criticised for being too simple and erring towards determining deemed employment.

The revised tool has more questions including concentrating more on the worker's right of substitution. Critically, however, it does not focus on the question of whether work has to be provided and has to be accepted that was important in the *RALC Consulting* case (which goes to the crux of whether there is the minimum requirement of mutuality of obligation).

So, despite the update, there still appear to be a number of areas which are not sufficiently covered by the CEST tool and concerns remain that the questions oversimplify what is a very complex and fact dependent area of law. From a quick use of the updated tool, it looks like it is now more likely to return an "unable to determine status" answer than previously.

The Institute of Chartered Accountants in England and Wales (ICAEW) published its comments on the updated tool in early December. While welcoming its release, it highlighted specific concern that the tool did not ask questions about mutuality of obligation. In this regard, HMRC stated that it considered, where a contract existed, mutuality of obligation existed and so there was no need to ask further questions on this element of deemed employment status. HMRC agreed to consider this point further following the ICAEW's concerns, however. The significance of this point is illustrated by the recent *RALC Consulting* case (discussed above) which decided that there was no mutuality of obligation for employment status purposes under the contracts in question.

The updated CEST tool does attempt to improve the previous version and it remains a valid tool to gain an indication as to the correct employment status of a worker. However, despite the recent updates, users should be mindful of possible inadequacies of the tool and the danger that it provides an incorrect employment status result. It is to be hoped that end clients will not take its answers at face value as a reason to take an overly conservative view as to the deemed employment status of their off-payroll workers without giving due consideration to the overall nature of the relationship that they have with those workers.

Conclusions of the disguised remuneration loan charge review

The government has accepted the findings of a review into the disguised remuneration loan charge which was initiated earlier in the year, and has agreed to make a number of changes to the current rules reflecting the report's recommendations.

The disguised remuneration loan charge is aimed at tackling tax avoidance where income is paid as a loan which is not repaid (as opposed to salary or bonus). Such schemes, despite the government's efforts, have continued to grow in popularity over the last couple of decades. Rules were introduced which levied an immediate tax charge on such loans that had not been repaid and which applied to loans made many years ago.

Since the introduction of the rules, significant concerns have been raised that the loan charge policy went too far in attempts to tackle such schemes. In response, the government commissioned an independent review, led by Sir Amyas Morse, to consider whether the loan charge was an appropriate response to the tax avoidance. The review has now concluded and its report has been published.

In the report, Morse agreed with the purpose of the disguised remuneration loan charge but stated that the government had to act proportionately and fairly. The report made a number of recommendations designed to bring the loan charge back in line with the wider tax system, ensure that it is proportionate and fair and its impact moderated for those who will be most affected.

The recommendations include:

- the loan charge should not apply to loans entered into by employers and individuals before 9 December 2010;
- where the taxpayer has made reasonable disclosure of the tax avoidance scheme in question for a particular tax year and HMRC has not opened an investigation into that year within the general tax enquiry window, such year should not be included in the scope of the loan charge;
- affected taxpayers should have the option to "unstack" their outstanding loan balances and repay them over the course of three tax years; and
- no individual within the scope of the loan charge should have to pay unlimited amounts back within a single tax year (the amount should be limited to no more than half of their disposable income and should not result in undue hardship like the loss of home or causing bankruptcy).

The government has confirmed that it will implement all but one of the report's recommendations and has published additional guidance alongside its formal response to the review.

The key changes to the loan charge announced by the government are:

- the loan charge will apply only to outstanding loans made on, or after, 9 December 2010;
- the loan charge will not apply to outstanding loans made in any tax years before 6 April 2016 where the avoidance scheme use was fully disclosed to HMRC and HMRC did not take action (for example, by opening an enquiry);
- people can now elect to spread the amount of their outstanding loan balance (as at 5 April 2019, recalculated in line with the above changes) evenly across 3 tax years: 2018 to 2019, 2019 to 2020 and 2020 to 2021; and
- HMRC will refund voluntary payments already made in order to prevent the loan charge arising and included in a settlement agreement reached since March 2016 (when the loan charge was announced) for any tax years where:
  - the loan charge no longer applies (loans made before 9 December 2010); or
  - loans were made before 6 April 2016, the avoidance scheme use was fully disclosed to HMRC and the department did not take action (for example, opening an enquiry).

The package also includes a number of changes that will give customers additional flexibility over the way they pay:

- if the taxpayer does not have disposable assets and earns less than £50,000, HMRC will agree time to pay arrangements for a minimum of 5 years. If the taxpayer earns less than £30,000, HMRC will agree a minimum of 7 years. If a taxpayer needs longer to pay, they will need to provide HMRC with detailed financial information. There is no maximum time limit for a time to pay arrangement; and
- in line with existing practice, if a taxpayer needs time to pay, they will pay no more than 50% of their disposable income, unless they have a very high level of disposable income.

The government will introduce legislation to implement the changes to the loan charge. Draft legislation and more detailed guidance will be published in early 2020, alongside a timetable for implementing the changes. HMRC will not be able to process refunds until these changes have become law, expected in summer 2020.

Where HMRC knows a taxpayer has used a disguised remuneration avoidance scheme and either settled the tax due, or has not settled and could be liable to pay the loan charge, HMRC will write to them in early 2020 to explain what the changes mean for them.

Taxpayers who have not filed their tax return, or agreed a settlement with HMRC, should submit a self assessment tax return for the 2018 to 2019 tax year. They can either submit by 31 January 2020, giving a best estimate of the tax due, or file by 30 September 2020. HMRC will waive penalties for late filing, late payment and inaccuracies in respect of the loan charge entries in these returns. Late payment interest will not be payable for the period 1 February 2020 to 30 September 2020, as long as a return is filed, and tax paid or an arrangement made with HMRC to do so, by 30 September 2020.

HMRC updates guidance on taxation of cryptoassets

HMRC has further updated its guidance for individuals and companies on the taxation of cryptoassets (see our November UK Tax Round Up for commentary on previous updates to the guidance). A new section on the location of exchange tokens and the effect of this on the tax liability has been added.

Given the fast-changing nature of the cryptoassets industry and the continuing uncertainty regarding their tax treatment, it is hoped that HMRC will further expand its guidance on this topic for both individuals and businesses in 2020.

International Developments

Updated guidance on new substance requirements in the Isle of Man, Guernsey and Jersey

Updated guidance has been released by the Crown Dependency (CD) governments of Guernsey, Jersey and Isle of Man in relation to legislation outlining economic substance requirements (see our May UK Tax Round Up for commentary on the initial guidance).

The updated guidance includes:

- clarification that self-managed funds will be within scope (but only once the corresponding legislation has been amended to reflect this);
- clarification that collective investment vehicles (CIVs) are out of scope as long as they are subject to regulation in the relevant Island. However, subsidiaries of CIVs will have to ensure that they meet the substance requirements in relation to any relevant activities;
- new sections on core income-generating activities of intellectual property companies, shipping and the insurance industry; and
- further information in respect of the practicalities of board meeting conduct in relation to the "directed and managed" test.

Despite this update, the guidance does not offer clarification on all outstanding matters. In particular, no clarification is provided in respect of the process of determining if an entity has met the substance requirements.

Funds and companies operating in any of the CD jurisdictions should consider their existing activities and substance status in response to the updated guidance.