Proskauer

UK Tax Round Up

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February has seen some interesting developments in and relating to the imminent IR35 rule changes and the addition of the Cayman Islands to the EU's blacklist of countries deemed to be guilty of non-cooperation in the area of tax.

UK General Tax Developments

HMRC updates to the private sector IR35 rules

On 7 February 2020, HMRC confirmed that the new private sector IR35 rules will only apply to payments made for services provided on or after 6 April 2020. Previously the rules would have applied to all payments on or after 6 April 2020 irrespective of when the services were carried out.

HMRC has also updated its guidance on the IR35 rules in its Employment Status Manual in preparation for the widely expanded application of the rules from 6 April. Of particular note is the guidance on the meaning of "reasonable care" in the context of the private sector end client's obligation to take reasonable care in determining whether the worker would have been an employee if engaged by it directly. Examples given by HMRC of indicative behaviour pointing towards reasonable care include accurately completing HMRC's Check Employment Status for Tax (CEST) tool, applying HMRC guidance, ongoing monitoring of determinations to ensure they remain accurate and checking the processes of subcontractors responsible for making the determination. Examples of behaviour that might indicate a lack of reasonable care include a blanket determination that every worker providing services through an intermediary is caught by IR35, making a determination for a group of workers without giving proper regard to the different working arrangements for each worker, not updating determinations where there is a material change in circumstances and a lack of training or support for those end client personnel responsible for making the determinations.

HMRC has further stated that if an end client does not take reasonable care in making its status determination assessment, HMRC might seek to recover any tax due from the end client even where it has already been paid by another entity in the chain between the end client and the worker's intermediary.

Following the consultation to ensure that the implementation of the IR35 legislation is smooth and efficient, the government has confirmed that the new rules will be introduced from 6 April. It has also announced some changes to the rules and that it will take a "light touch" to penalties for the first 12 months and has published some commentary and additional documents in an attempt to assist taxpayers.

Amendments to PAYE direct collection, STBVs and special arrangements

The Income Tax (Pay As You Earn) (Amendment) Regulations 2020 amend regulation 141 of the Income Tax (Pay As You Earn) Regulations 2003 for cases where it is not practicable for the employer to make the required tax deductions. This will often be the case in respect of short term business visitors (STBVs) from overseas branches or territories with which the UK does not have a double taxation agreement. In these situations, HMRC will collect the tax directly from the employee unless HMRC agrees a special arrangement with the employer.

The regulations permit special arrangements to have an extended deadline for the employer's payment of the tax to HMRC, this date being no later than 31 May following the end of the tax year to which the special arrangement relates. The new regulations come into force on 6 April 2020. Therefore, from that date the current PAYE special arrangements for employers with STBVs, known as "STBV Appendix 8", and the filing and payment deadline will be extended to 31 May 2021 (for the tax year 2020-2021).

Extension of EU State Aid approval for EMI options schemes

EU State Aid approval for EMI option schemes has been extended for options granted up to the end of the Brexit transition period (i.e. the end of 2020). This means that EMI options granted prior to the end of 2020 at least should retain their beneficial tax status irrespective of when the options are exercised, and subject to satisfying and continuing to satisfy the usual requirements.

We understand that HMRC will provide more information, when known, on what the new domestic regime will be following the end of the transition period.

UK Case Law Developments

IR35 – FTT says Eamon Holmes is a deemed employee of ITV

Veteran broadcaster Eamon Holmes is the latest television personality to have his working arrangements scrutinised by the First-tier Tribunal (FTT) under the IR35 rules. In *Red, White and Green Limited v HMRC,* the FTT held that if Mr Holmes had provided his services to ITV directly, rather than through his personal service company, the hypothetical contract between Mr Holmes and ITV would have been a contract of employment and, therefore, IR35 applied. Surprisingly, the case was heard in June 2018 and it has taken over 18 months for the judgement to be published. This might account for why the decision appears harsh on Mr Holmes given other recent decisions in this area.

As the lead presenter on the ITV programme "This Morning", Mr Holmes's services were provided to ITV through his personal service company Red, White and Green Limited (RWG). Mr Holmes asserted that he was "totally freelance" and regarded himself as "a gun for hire – on my terms". The FTT disagreed. Looking at the fundamental requirements for determining whether Mr Holmes should be treated as an employee and the terms of the contract that RWG entered into with ITV it considered the following, particularly control and mutuality of obligation, as indicative of a deemed employment relationship:

- ITV's control was illustrated by its ultimate editorial control over the programme and the restrictions placed on Mr Holmes set out in the contracts between RWG and ITV (including that he wasn't permitted to wear branded clothing on the show or do work for third parties which could conflict with his services to ITV); and

- there was clear mutuality of obligation as Mr Holmes was required to work on a minimum number of shows and was entitled to receive payment if a show was cancelled without being rescheduled. ITV had to provide work on particular dates for a fixed fee and Mr Holmes had to work on those dates for that fee with there being "a regular and consistent pattern" in each contract period when Mr Holmes appeared on shows.

The judge in this case took a very prescriptive approach to the actual contractual terms, especially on control. This was notwithstanding evidence from the programme's editorial team that, in practice, ITV had very little control over how Mr Holmes decided to run the programme once it was on air and the questions that he chose to ask his guests. This can be contrasted with the cases involving Lorraine Kelly (*Albatel Limited v HMRC*) (reported by us in March 2019), and Kaye Adams (*Atholl House Limited v HMRC*) (reported by us in April 2019) where the taxpayers were successful in arguing that they were self-employed and so outside IR35.

The FTT in these former cases determined that the presenters had control over their respective programmes in its determinations that they were self-employed. In the latter case, the BBC had ultimate editorial control, yet the FTT decided that in reality it was unlikely that the BBC would exercise such control. The FTT also ignored a specific provision in the actual contract between the BBC and Atholl House stating that the BBC had ultimate control over what other work Ms Adams could undertake and determined that the hypothetical contract between the BBC and Ms Adams that was construed to determine whether Ms Adams would or would not have been an employee would say that the BBC did not have the right to object to Ms Adams's other work. In the former case, the FTT accepted that Ms Kelly decided on the running order of the programme, led the team and in reality was able to carry out other work and activities without any real restriction from ITV (despite the actual restrictions set out in her contract).

Overall the case shows, once again, how difficult it is to come to a determination of employment or self-employment and to second guess how a court will come to its decision applying IR35.

This issue is, of course, of considerable interest given the imminent and widely discussed introduction of the changes to the IR35 rules from 6 April as they apply to small and medium sized end clients in the private sector and the requirement for the end client to make a "status determination" assessment for all of its workers who operate through intermediaries.

Upper Tribunal discussion of "reasonable excuse" for VAT penalty purposes

In *Marlow Rowing Club v HMRC* the Upper Tribunal (UT) allowed an appeal against a decision of the FTT. The FTT had previously rejected Marlow Rowing Club's (Marlow's) appeal against HMRC's decision that Marlow was liable to a penalty for an incorrect zero-rating certificate despite Marlow having sought and been given prior advice from counsel and accountants. The FTT held that Marlow did not have a reasonable excuse because a taxpayer in Marlow's position would have sought HMRC's opinion, could have appealed any subsequent decision or could have requested the decision be stayed pending the outcome of the case of *Longridge* (this case resulted in Marlow's certificate being shown to be incorrect).

The UT have allowed Marlow's appeal against this decision. The UT held that Marlow did have a reasonable excuse as a result of having obtained advice from VAT specialist accountants and counsel surrounding the law after the *Longridge* decision in the FTT (but before the Court of Appeal decision) and relying on this advice despite having tax expertise on its committee. It held that Marlow also acted reasonably in relying on the specialists and not obtaining additional advice from HMRC.

Points of interest from this case include (a) the UT confirmed that the background of the members of Marlow's committee was relevant in evaluating how and why advice was obtained and followed, although reaffirming that each case must be examined on its merits and that obtaining legal advice does not always ensure a person has a reasonable excuse, (b) the UT agreed that the objective in seeking advice is a relevant factor but rejected HMRC's contention that Marlow only sought counsel's advice to avoid a penalty it feared would be imposed (and in any event, the latter motive is not necessarily objectionable), (c) the UT held that it was clear from the terms of the instructions to its advisers that Marlow genuinely sought advice on the question of liability and the request that counsel advise in stages suggested that Marlow did appreciate the risk that counsel may not advise in its favour and (d) with regards to whether Marlow should have obtained advice from HMRC, the UT noted that, in circumstances where it was known that HMRC was appealing a decision which was adverse to HMRC's policy, HMRC would only be providing its own view of the law and HMRC was in no better position to advise on the correct interpretation of the law than was a professional adviser (although the UT did note that in some circumstances seeking advice from HMRC would bolster one's defence of reasonable excuse).

The case is informative on what might support a "reasonable excuse" defence in other areas of dispute with HMRC.

Mixed partnership rules examined by the court for the first time

The mixed partnership rules, which apply when partnerships have both individual and non-individual partners, were examined for the first time by the FTT in *Nicholas Walewski v HMRC.* Mr Walewski set up a Luxembourg equity fund which was managed by two UK limited liability partnerships (LLPs) (AAM and AF) in which he was a member. A UK company (WL Ltd) was also a member of AAM and AF. Mr Walewski was the only employee and director of W Ltd. Mr Walewski appealed against HMRC's decision to reallocate profits of AAM and AF to him under section 850C ITTOIA 2005 where those profits were paid to W Ltd. HMRC held that the profits allocated to W Ltd should be allocated to Mr Walewski as member of AAM and AF because the profits were not earned by W Ltd and were allocated to it only so that Mr Walewski could enjoy those profits (through an offshore trust fund to which W Ltd distributed the money).

The FTT dismissed Mr Walewski's appeal. The question for the FTT was whether it was reasonable to suppose, as HMRC held, that W Ltd's profit share was attributable to Mr Walewski's power to enjoy that profit share or whether, as contended by Mr Walewski, the profit allocation was attributable to W Ltd and Mr Walewski's connection to it was only as its employee. The FTT agreed with HMRC's decision and held that Mr Walewski was basically playing a single role for each of W Ltd, AAM and AF (each controlled by Mr Walewski) so that there was "no commercial, physical or temporal separation of Mr Walewski's activities". It held that it could not be said that W Ltd's profits were earned by reason of Mr Walewski's activities for the clients of AAM or AF as an employee of W Ltd and there were no agreements or other clear evidence demonstrating Mr Walewski's services through W Ltd. The allocation of profits could not be explained by the efforts of W Ltd to earn those profits. Therefore, the reason for the allocation to W Ltd was for Mr Walewski's power to enjoy them through the offshore trust.

This case is significant as it is the first to examine the mixed partnership rules and the FTT was clear in its rejection of Mr Walewski's arguments, with over £20 million of profits being reallocated to him. It demonstrates that clear evidence is likely to be required to successfully argue that, in circumstances where an individual is able to enjoy the profits of a corporate member of an LLP, the allocation of profits to the corporate member is other than by reason of the individual's ability to enjoy those profits. Having said that, the facts in this case were particularly stark, and the question might be more difficult to conclude on with a different fact pattern.

Entrepreneurs' relief and transactions in securities considered by the FTT's microscope

In *Assem Allam v HMRC,* the FTT considered three different tax issues: the availability of entrepreneurs' relief (ER), the transactions in securities (TiS) rules and the availability of business investment relief (BIR). We consider the ER and TiS issues here.

The judgement related to a disposal of shares by Dr Allam in Allam Developments Limited (ADL) to Allam Marine Limited (AML). AML was a wholly-owned subsidiary of Allamhouse. Allamhouse was a holding company owned by Dr Allam and his wife. ADL, AML and Allamhouse were close companies owned by either Dr Allam or Dr Allam and his wife. HMRC rejected Dr Allam's claim for ER and issued a counteraction notice under the TiS rules in respect of this transaction.

The first issue centered on HMRC's rejection of Dr Allam's claim for ER. If such a claim was allowed, it would have reduced Dr Allam's liability to capital gains tax on the disposal from a rate of 20 per cent to 10 per cent. HMRC rejected the claim on the basis that ADL was not a trading company because its activities included to a substantial extent non-trading activities. HMRC's Capital Gains Manual states that substantial in this context means more than 20 per cent taking into account certain indicators. Dr Allam's counsel argued that for non-trading activities to be substantial those activities should predominate or be at least 50 per cent. ADL carried on a mixed business of property development (trading) and letting for rental income (non-trading). The FTT rejected the appeal, holding that ADL carried out a significant activity of letting property with the proportion of the income of ADL from non-trading rental income and the proportion of its asset base devoted to properties let for rental income demonstrating that the non-trading activities were substantial. This element of the case is interesting as the FTT did not rely on HMRC's figure of 20 per cent (or accept Dr Allam's of over 50 per cent), instead finding that the legislation did not warrant a numerical threshold and holding that substantial should mean "of material or real importance in the context of the activities of the company as a whole". This demonstrates that care should be taken when relying on HMRC guidance or relying on a numerical cliff edge in assessing the activities of a business, with that being no substitute for assessing the words and purpose of the relevant legislation as applied to the specific facts in question.

The second issue concerned the application of the TiS rules. The TiS rules permit HMRC to issue a notice to counteract certain income tax advantages arising from "transactions in securities". The TiS rules may apply in certain cases where an individual receives consideration on which she pays capital gains tax and the tax is less than the income tax which she would have paid if she had received the consideration as an income distribution and where obtaining that tax advantage is a main purpose of the transaction. HMRC had issued a counteraction notice seeking to charge Dr Allam with additional income tax on the consideration from his share sale, contending that one of the main purposes of the sale was to obtain an income tax advantage.

The FTT allowed Dr Allam's appeal. It held that the transaction was not caught by the rules as Dr Allam's reasons for the transaction were not motivated by a desire to obtain a tax advantage despite there being a different way of structuring the transaction which would have given rise to an income tax receipt. The FTT accepted the commercial purpose for the transaction to unite the companies under common corporate ownership as well as Dr Allam's personal purpose of applying the cash proceeds of the sale towards his retirement fund.

International Developments

Cayman Islands added to the EU's list of non-cooperative tax jurisdictions

As reported in our Tax Talks blog on 20 February 2020, the ECOFIN committee of EU finance ministers agreed to add the Cayman Islands to the EU blacklist of non-cooperative jurisdictions for tax purposes as a result of its rules on "economic substance" for collective investment schemes not meeting EU requirements. You can read more about this here.

This could have adverse consequences for funds and investments in a number of EU jurisdictions where the fund or investment structure includes Cayman Islands entities, and advice should be taken where this might be relevant.

It is expected that the Cayman Islands will do all that they need to satisfy the EU "economic substance" requirements and to ensure that they are removed from the blacklist at the next opportunity (expected to be around October).