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Welcome to July's edition of our UK Tax Round Up. This month has seen more COVID-19 related developments, including confirmation that time spent on furlough will not adversely affect an employee's eligibility to hold qualifying enterprise management incentive share options. In addition, the Finance Act 2020 was granted Royal Assent on 22 July.

UK COVID-19 Developments

Furlough not detrimental to EMI options held on 19 March 2020

On 26 June, the government introduced a new provision into the Finance Bill that provides that the period during which an employee is furloughed will not count towards the determination of their "working time commitment" for the purpose of determining whether the EMI option conditions are breached.

One of the conditions for an employee share option to qualify as a tax advantaged EMI option is that the employee option holder must spend at least 25 hours per week or 75% of their working time working for the employer. There are some periods of time that can be ignored for this purpose (e.g. maternity and paternity leave), but they do not include being furloughed. The consequence of not meeting the working time requirement is that there is a "disqualifying event" and the value of the options shares acquired on exercise that exceeds the value when the condition ceased to be satisfied is subject to employment tax as an unapproved option gain.

The new Finance Bill clause (now Finance Act section) provides that if an employee held a qualifying EMI option on 19 March 2020 and then fails to meet the working time requirement for reasons connected to the coronavirus pandemic, the time which they would have spent on the business of the company will count towards their working time. This new provision will have effect until 5 April 2021 unless otherwise extended.

EIS and SEIS qualification and Future Fund investment

The government has added an amendment to the Finance Bill (and Finance Act) that means that investors entitled to benefits in companies that access finance from the recently created Future Fund will not lose their EIS or SEIS tax benefits where they invest in convertible loans in the company in accordance with the terms of Future Fund financing.

Under the terms of Future Fund financing, companies accessing such funding have to raise an equal amount from their other investors by issuing them with convertible loans. This could cause issues for EIS/SEIS investors who invested in such convertible loans because their EIS/SEIS tax benefits can be removed if they receive other value from the company that they are invested in.

The government recognised this issue when the Future Fund finance terms were announced, and this amendment to the Finance Bill provides that returns from the relevant convertible loans will not be taken into account in considering whether the investors holding EIS/SEIS shares acquired before they make their Future Fund convertible loan investment receive subsequent value from the company from their convertible loans.

The Future Fund was introduced on 20 May as part of the government's support for businesses as a result of the COVID-19 pandemic.

Further "mini Budget" announcements from the Chancellor

On 9 July, the Chancellor announced a number of tax changes intended to encourage people to start spending again with particular emphasis on the restaurant and hospitality sector.

The new provisions cover:

- a reduction of VAT from 20% to 5% from 15 July until 12 January 2021 on food (eat-in or hot takeaway food from restaurants, cafes and pubs), accommodation (in hotels, B&Bs, campsites and caravan sites) and attractions (such as cinemas, theme parks and zoos);
- an "Eat Out to Help Out" scheme that will give people a discount of up to 50% at participating businesses (up to £10 per head) for meals on Mondays, Tuesdays and Wednesdays during August with the government paying the discount amount to the relevant businesses;
- balancing the winding down of the Coronavirus Job Retention Scheme by the end of October with the introduction of a new Jobs Retention Bonus under which the government will pay an employer a £1,000 bonus for every employee that it brings back from furlough and employs until January 2021 and who is paid at least £520 on average each month from November to January;
- introducing a new Kickstart Scheme, under which the government has set aside an initial £2 billion to pay employers to create jobs for 16- to 24-year olds who are deemed at risk of long-term unemployment. The scheme will involve six-month work placements targeted at those in this age bracket and who are currently on universal credit;
- a temporary cut on stamp duty land tax on property transactions with a value of up to £500,000. Previously, the threshold for zero stamp duty land tax on residential property transactions was £125,000. The new threshold will apply to transactions from 8 July until 31 March 2021.

The new announcements are discussed in more detail in our Tax Talks blog.

Updated guidance on CJRS for 1 July-31 October

HMRC has published updated guidance on the Coronavirus Job Retention Scheme (CJRS) that will operate until 31 October. The guidance covers:

- information on paying employee taxes and pension contributions directly to HMRC on amounts paid to employees;
- recording any holiday taken by flexibly furloughed employees as furloughed hours rather than working hours;
- calculating furloughed hours for different sets of circumstances;
- treatment of statutory payments received in the claim period;
- what to do when an amount has been overclaimed from the scheme and you do not plan to make another claim;

- when employers can use the online service to delete a claim within 72 hours of submitting it. This is particularly useful if an error is made when claiming.

The Treasury has also published a press release highlighting the start of flexible furloughing from 1 July 2020 and updated accompanying guidance.

UK Case Law Developments

Fixed income member of a LLP was self-employed

In *Wilson v HMRC*, the First-tier Tribunal (FTT) considered the longstanding question of the circumstances in which a member of a limited liability partnership (LLP) could be considered to be an employee of the LLP (prior to the introduction of the salaried member rules in section 863A ITTOIA 2005). The question arises particularly because of the terms of section 4(4) Limited Liability Partnerships Act 2003, which states somewhat cryptically that a member of a LLP shall not be treated as an employee of the LLP unless, were the member and other members in partnership, the member would be treated as an employee of the partnership.

In *Wilson*, Mr Wilson claimed that he should be treated as an employee of the LLP of which he was a member following an assessment on him by HMRC for self-employed national insurance contributions (NICs). Mr Wilson joined the LLP in November 2011 and was soon in dispute with them as to whether payments to him described as "profit shares" were actually profit shares and whether he was obliged to make a capital contribution to the LLP. He left the LLP in March 2014. Mr Wilson claimed that he should be treated as an employee of the LLP on the basis that, having regard to the terms on which he joined the LLP, the controls applied to him in his work and the provision of equipment and administrative support, if the LLP was a partnership he would be regarded as employed by the partnership.

Prior to joining the LLP, Mr Wilson had worked for a chartered accountancy business that he had established with a colleague and to which he acted as guarantor for certain loans. In 2011, that business was in financial difficulties and Mr Wilson agreed to work for the LLP. The overall commercial arrangement was that Mr Wilson would work to establish an international tax practice for the LLP and would be compensated according to the revenue generated by that part of the LLP's business. The LLP agreed to pay Mr Wilson's tax liability (by agreeing a net of tax compensation package with him). The initial agreement between the LLP and Mr Wilson was that he would operate through his existing company. He requested, however, that he "be a partner in your LLP and be compensated as we have discussed as an individual partner in the LLP" so that his tax affairs would be "simple and self-evident".

The FTT placed particular weight on the documents entered into by Mr Wilson and the LLP rather than on the oral evidence that they heard. In the LLP agreement, signed by Mr Wilson, he was described as a "client member". Mr Wilson's overall rights were then set out in a deed of variation. This did not, however, state that he was not a "client member" of the LLP. Mr Wilson was stated as being entitled to a "first charge" on profits in certain amounts which were not, in the case of Mr Wilson, reduced if the profits of the LLP were insufficient to pay all members' first charges. The FTT found, however, that Mr Wilson's right to be paid his first charge was dependent on the LLP making sufficient profits for that payment.

In the case, Mr Wilson argued that the whole bundle of his rights (and lack of them) under the LLP agreement terms and the LLP's control over his work meant that he should be treated as an employee under general principles and relying on the Court of Appeal's 2012 decision in *Tiffin v Lester Aldridge* which held that a member of a LLP could be its employee.

Taking all of these facts into consideration, the FTT determined that Mr Wilson should be treated for tax purposes as a member, and not an employee, of the LLP on two bases. The first was that

the agreements that he had willingly entered into on an informed basis showed that he was a member who was entitled to a share of the profits of the LLP. The second was that section 4(4) of the Limited Liability Partnerships Act meant that a member of an English LLP (as opposed to a Scottish one) could not also be treated as an employee of the LLP for tax purposes.

While the legal reasoning behind this interpretation of section 4(4) of the Limited Liability Partnerships Act is not entirely clear, this is an interesting confirmation of the view long held by many, and which the salaried member rules were introduced to counter, that anyone listed as a member of a LLP should be taxed as a self-employed and not employed person.

Tax avoidance scheme thwarted by settlements rules

In *Dunsby v HMRC*, the FTT rejected the taxpayer's appeal against an assessment to tax under the settlements legislation, providing an interesting illustration of both the extent that purposive interpretation of legislation and the principle in the *Ramsay* line of cases can be given and their limitations.

The case involved a marketed tax avoidance scheme under which a company, Majordegree Ltd, controlled by Mr Dunsby issued a newly created S share to an unconnected, non-UK resident individual, Mrs Gower, for £100. Mrs Gower then contributed the shares to an offshore trust of which Mr Dunsby was a beneficiary. A dividend of £200,000 was then paid on the S share and Mr Dunsby received £195,400. The rest was used to pay the costs of the scheme and a fee to the promoter.

Mr Dunsby argued that he was not subject to tax on his receipt because the settlements rules applied to Mrs Gower's contribution of the S share to the trust as settled property and stated that she and only she was subject to income tax on the income arising from the settled property.

HMRC argued that Mr Dunsby was subject to income tax on his receipt from the trust on three bases:

- on a purposive construction of the distribution and dividend tax rules and the pre-ordained nature of the transaction as a whole, Mr Dunsby received the dividend paid on the S share;
- on a purposive construction of the settlements rules, Mr Dunsby was a (or the) settlor of the trust (rather than Mrs Gower being the only settlor) and so those rules attributed the trust income to him;
- the transfer of assets abroad rules applied to Mr Dunsby (as the controller of Majordegree Ltd) transferring the S share to the offshore trust so that he was taxable on the dividend paid on it.

Mr Dunsby argued that Mrs Gower was the (only) settlor of the trust and that the settlements rules precluded taxing the dividend received by the trust under any other rules.

On the first point, the FTT showed the limitations of applying a broad, single transaction approach to the distribution tax rules using the *Ramsay* principle and held that such an approach couldn't be used to assess Mr Dunsby as the actual recipient of the dividend when the concepts of company distributions and dividends were rooted in company law and the trust, as holder of the S share, was clearly the recipient of the dividend applying company law. This shows how the application a broad, purposive approach to the overall result of a composite and pre-ordained transaction must always be considered in the light of the tax rules that are being applied.

On the second point, however, the FTT showed the potential breadth of the purposive approach in deciding that Mr Dunsby was the settlor of the trust by reason of being the person that procured that the company issued the S share to Mrs Gower and bestowed the "element of bounty" to the trust as is required for there to be a settlement. On that basis, the FTT held that Mr Dunsby was either the only settlor of the trust or was one of two settlors along with Mrs Gower but was the one

to whom all of the trust's dividend receipt should be attributed because he had bestowed the bounty. The difference in the application of the broad, purposive construction to the settlement rules in contrast to the more technical approach to the distribution rules was because the settlements rules apply to a very wide ranging concept of "arrangements" and the central element to the creation of a settlement is that there is an element of bounty. This allowed the FTT to look at who, if anyone, bestowed that bounty under the entirety of the arrangements and that this was done by procuring that the company issued the S shares in the expectation that it would be transferred to the trust and that the dividend would be paid on it.

On the third point, which was not necessary for the FTT to find in favour of HMRC, the FTT held that the transfer of assets abroad rules could apply to treat Mr Dunsby as being subject to an amount equal to the dividend received by the trust. Of interest is the determination that the settlements legislation provision that the income of the trust is the income "of" the settlor and only the settlor did not prevent a tax charge also arising under the transfer of assets abroad rules because those rules operated by treating the trust income as having arisen to Mr Dunsby as not as income "of" him.

So, as is generally the case with aggressive tax arrangements, context and the fine detail of the tax provisions in question are critical to the likely approach that a court might take to them.

Other UK Tax Developments

OTS review into capital gains tax

The government has announced that the Office of Tax Simplification (OTS) will conduct a general review into capital gains tax for individuals and small businesses and the OTS has published a survey and request for information from taxpayers.

While there has been speculation that this is with a view to increasing tax take as a result of the COVID-19 costs to the government, it has said that the review had been planned before the pandemic and its costs became apparent.

The general scope of the review is stated to cover:

- the overall scope of the tax and the various rates which can apply;
- the reliefs, exemptions and allowances which can apply, and the treatment of losses;
- the annual exempt amount and its interactions with other reliefs;
- the position of individuals, partnerships and estates in administration;
- the position of unincorporated businesses and stand-alone owner-managed trading or investment companies, including the setting up, selling or winding up of such businesses or companies;
- any distortions to taxpayers' personal or business investment decisions;
- interactions with other parts of the tax system such as income tax, capital allowances, stamp taxes and inheritance tax, including potentially different definitions for similar transactions or events.

The call for evidence is in two stages with the first ending on 10 August and the second on 12 October.

While stated to be general in nature, speculation on possible conclusions is for CGT to be extended to gains arising from the disposal of an individual's primary residence and alignment (or closer alignment) of capital gains tax rates with income tax rates.

Whatever changes do come from this review, it is unlikely that they will be introduced without significant further consultation, however, given the initial stage of the OTS review.

HMRC guidance on the DAC 6 cross-border tax arrangement reporting regime

We have reported in previous editions of our UK Tax Round Up on the recently introduced reporting requirements for certain cross-border tax arrangements (under so-called DAC 6) and, in last month's edition on the delay to the first dates for reports to be made.

Following a long period of discussion with interest bodies, HMRC has now published its guidance on the regime, covering important areas such as who is a promoter, what connection with a UK tax advantage a transaction must have to be reportable in the UK, interaction with promoter in other jurisdictions and other areas, much of which is helpful in setting out the limits of what are very widely drafted rules.

The delay to the reporting obligation will also allow time for affected people to assess the historic transactions (entered into since 25 June 2018) in the context of this guidance and the determination of whether those transaction do or do not need to be reported.

EU Developments

EC extends temporary State Aid framework to assist MSEs

On 29 June 2020, the European Commission announced that it will adopt a further amendment to the State Aid Temporary Framework, in the context of the COVID-19 pandemic, to further support certain micro and small enterprises, including start-ups that were already in difficulty before 31 December 2019, and to provide incentives for private investors to participate in coronavirus-related recapitalisation measures.

This is part of the general international efforts to try to help business survive the extremely difficult economic circumstances created by the pandemic.