Proskauer

UK Tax Round Up

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UK Case Law Developments

Entrepreneurs' relief – voting rights not imputed for equitable reasons

In *George v HMRC*, the First Tier Tribunal (FTT) decided that they could not apply the equitable principle that "equity looks on that as done which ought to be done" to impute voting rights to shares for the purpose of a shareholder being able to claim entrepreneurs' relief (ER). One of the conditions to claim ER is that the individual is able to exercise at least 5% of the votes in the relevant company "by virtue of" his or her shareholding in the company.

In the case in question, Mr George had been appointed as an executive director in a family-owned company (TLR) which was managed by one of the family members (Mr Thornton). A few years after joining the company, Mr George was allowed to acquire shares in the company. This was the first time that a non-family member had held any shares in TLR. The shares acquired by Mr George represented 6.9% by nominal value of the company's ordinary share capital but did not carry any voting rights. Following a failed attempt to sell TLR, at which time Mr George was advised that he did not qualify for ER because his shares did not carry any voting rights, Mr George and Mr Thornton agreed that Mr George's shares would be given voting rights. This agreement was not documented. In addition, Mr Thornton was concerned that giving voting rights to Mr George would result in a 'value shift' tax charge falling on the other shareholders. As a result of this, the rights were not formally granted to the shares held by Mr George.

On the subsequent sale of the company, Mr George claimed ER on the basis that the High Court would grant specific performance of his voting rights as an equitable matter, notwithstanding that the shares had not been formally enfranchised to give him any voting rights. The FTT held against Mr George and decided that it could not impute the voting rights into the shares because the equitable principle could not be used to take rights away from the other shareholders who had not personally agreed to the granting of the voting rights to Mr George and, in any event, even if a court did impute voting rights to Mr George his voting rights would not exist 'by virtue of' the holding of his shares. Rather, the voting rights would have existed by reason of equity requiring them to be imputed to Mr George.

This case shows how important it is that parties to agreements relating to share rights (or other rights) fully document the arrangements that they have agreed to enter into and ensure that the rights are embedded in the correct instrument to ensure that the relevant benefit, tax or otherwise, is obtained.

Lower league referees not employees

In *Professional Game Match Officials v HMRC*, the FTT has determined that individuals who are not contracted with the Professional Game Match Officials (PGMO) through its general list of individuals available to act as referees or match officials for a wide range of football games were not employees of the PGMO. Under the arrangements with the PGMO, a large number of individuals are contracted to act as referees in lower league football games. They are then allocated to particular games on an as need basis, but there is no requirement either for the PGMO to find games for them to officiate at or for them to agree to officiate at any particular game.

The FTT rejected the PGMO's argument that there was no contractual relationship between themselves and the individuals or that it was relevant to the employment relationship that the PGMO did not actually make payment to the individuals but that these were made directly by the clubs playing in the relevant matches.

The FTT then considered the general employment criteria as set out in *Ready Mixed Concrete* to determine whether the rights and obligations between the PGMO and the individuals created an employment relationship. They decided that they did not because the relevant arrangements did not create a legal obligation to provide work or accept work on either side. In addition, they decided that the PGMO did not have any control over how the individuals performed their duties during matches since 'the referee's decision is final'.

The fact that the referees officiated wholly or substantially for a single engager (the PGMO) was, in this case, outweighed by the other factors pointing to self-employment.

Other UK Developments

Clarification on the definition of ordinary share capital

The CIOT has, with HMRC's permission, published a document setting out HMRC's initial view on whether particular rights attached to shares mean that the shares would or would not be 'ordinary share capital' for the purposes of ER (among other things).

One of the conditions for ER to be claimed is that the relevant individual holds not less than 5% of the company's 'ordinary share capital'. Ordinary shares are all shares other than shares which, broadly, carry a right only to a dividend at a fixed rate and no other right to share in the profits of the company. The question of whether shares are or are not ordinary share capital for ER purposes has been considered twice by the courts in recent years in relation to shares with no right to receive a dividend. In those two cases, the FTT decided in one case that the shares were ordinary share capital and in another that they were not. This discrepancy has since been clarified by the Upper Tribunal, which decided that shares with no dividend rights are ordinary share capital on the basis that a right to no dividend is not a right to a dividend at a 'fixed rate' of zero.

The list made available by the CIOT sets out HMRC's current view on whether shares carrying particular rights are or are not ordinary share capital. Since this distinction can be critical for numerous tax purposes, people should think very carefully about the rights attaching to shares when it is important whether they are or are not ordinary share capital. For instance, according to HMRC, a share with a right to a dividend at a fixed rate that is cumulative is not ordinary share capital but a share with a right to a dividend at a fixed rate that is not cumulative is.

Particular care should be taken in this regard where share rights are to be changed or new shares are to be issued with the intention that they are, or are not, ordinary share capital.

HMRC's success using its CEST tool for establishing employment status

HMRC has published a list of recent cases relating to employment or self-employed status where the decision of the FTT was tested against the conclusion of its Check Employment Status for Tax (CEST) digital service. They state that in 22 of the 24 test cases tested, the CEST outcome concurred with the FTT's decision. In the two cases in which the CEST returned a different conclusion to the FTT, it was acknowledged that one case was finally balanced and commentators expressed surprise at the result of the other.

Given this success rate, taxpayers considering whether certain individuals should be treated as employees or self-employed might consider using the CEST tool to assist them in that decision.

Government announces that it will not abolish Class 2 NICs

On 6 September, the Government announced that it will not proceed with the abolition of self-employed Class 2 NICs during the current Parliament, in contrast to its previously stated intention in this regard.

This change in approach results from representation indicating that a significant number of low-earning self-employed individuals would become subject to higher voluntary contributions in order to maintain access to the State Pension. The Government states that having listened to those likely to be affected by the change they have concluded that it would not be right to proceed at the moment. The Government also states that it remains committed to simplifying the tax system for the self-employed, so that the issue will be kept under review and this might result in changes in the future.

Developments Outside the UK

Attorney General opinion on VAT recovery on aborted sale of shares

In *C&D Foods Acquisition ApS v Skatteministeriet*, the Attorney General (AG) has opined that VAT incurred on fees for assistance with preparing a share sale agreement for the (aborted) sale of the shares in the taxpayer's subsidiary was not recoverable.

In the case, the taxpayer holding company provided financial, management and IT services to its group trading companies and charged a fee plus VAT to them. It incurred fees on the preparation of a SPA for an expected disposal of two companies in a group, but no purchaser was found and the disposal was abandoned. The Danish tax authorities refused to allow recovery of the VAT on the fees because, among other things, there was no direct and immediate link between the fees incurred and the holding company's VATable activities of providing (or ceasing to provide) services to its subsidiaries. While the AG recognised that ceasing to provide VATable services could itself constitute an economic activity for VAT purposes and the fact that the sale had not completed was not relevant to the ability to recover VAT, the AG also stated that the VAT input costs would not be recoverable to the extent that there was a direct and immediate link between incurring the legal fees and the disposal of shares, since the disposal of the shares itself was an exempt activity. The AG sent the matter back to the Danish court to decide whether there was such a direct and immediate link between the fees and the sale of the shares in the subsidiaries.

While there have been a number of recent cases and developments that have made it more likely that VAT occurred on legal fees on the acquisition of companies to which the acquirer intends to provide management will be recoverable, this is the first decision in a while considering the recoverability of VAT related to the disposal of shares in a subsidiary. It shows that it is more likely that VAT recovery will be denied on the fees incurred in selling a company than on those incurred in buying it, since it is more likely that the fees incurred will be directly related to the disposal of the shares rather than to ceasing the whole or part of the holding company's business of providing management services.

European Commission decides McDonald's not given illegal State Aid

The European Commission (EC) has decided that McDonald's' Luxembourg operating company was not given illegal State Aid by the Luxembourg tax authorities when they agreed in 2009 that the Luxembourg company was not subject to tax in Luxembourg because its profits were attributable to the company's US permanent establishment and so only subject to US tax under the Luxembourg-US double tax treaty, notwithstanding that the profits were also not taxable in the US under the US's domestic treatment of the arrangements.

State Aid arises where, among other things, a person is given a 'selective' advantage not available to others in similar circumstances. The EC concluded that this was not the case and that, rather, the tax ruling given to McDonald's would be available to any Luxembourg taxpayer in similar circumstances and the tax advantage arose because of the different general application of tax law in Luxembourg and the US.

As a result of this case, the Luxembourg government has now put forward proposed changes to its determination of when a non-Luxembourg permanent establishment will be recognised to avoid this sort of non taxation in the future. Among other things, the Luxembourg authorities will require proof that the permanent establishment is subject to tax on its profits outside Luxembourg.

This is the first of a number of high profile State Aid infringement cases brought by the EC to be decided, and it will be interesting to see what approach is taken in those other cases.

Ireland publishes corporation tax roadmap

The Irish government has published a roadmap setting out expected future changes to its corporation tax regime in order to comply with the EU's Anti-Tax Avoidance Directive (ATAD) and the OECD's BEPS initiative. In order to do this, the government says that it will bring forward legislation in 2019 to strengthen Ireland's transfer pricing regime to bring it into line with the OECD's best practice and latest transfer pricing guidelines and to introduce anti-hybrid mismatch rules, although it states that its new rules will adopt the relevant measures in line with ATAD and the BEPS recommendations but not go beyond those requirements.

In addition, the government has confirmed its intention to retain Ireland's 12.5% corporation tax rate to maintain its competitiveness.

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