Proskauer

UK Tax Round Up

January 2021

UK COVID-19 Developments

Extension of support for retail, leisure and hospitality businesses

Further to the extension of the Coronavirus Job Retention Scheme (or furlough scheme), reported in the November issue of our UK Tax Round Up as well as extensions to other COVID-19 related government support, the government has announced one-off top up grants for retail, hospitality and leisure businesses.

Following the Prime Minister's recent announcement that businesses within these three sectors will be required to remain closed, perhaps until May, the Chancellor has announced an additional £4.6 billion will be made available to these businesses in the form of lockdown grants. The grants will be available to those businesses legally required to close that cannot effectively operate remotely and will range in value from £4,000 to £9,000, depending on a business's rateable value.

For more detailed information on the lockdown grants, as well as other COVID-19 support available to businesses please see the "Business Support" section of the government's Coronavirus (COVID-19) website.

HMRC clarifies position on late filing of self-assessment

CIOT, together with other professional bodies, had requested prior to the Christmas break that HMRC waive any late filing penalties for self-assessment returns filed before 1 March 2021. A deferral of the 31 January 2021 deadline was not requested as CIOT considered, after consultation with members, that this could lead to further complication and recognised the benefits in continuing to encourage filings by 31 January 2021 where possible.

HMRC has now confirmed that taxpayers who are unable to meet the 31 January deadline will not be subject to late filing penalties if they file online by 28 February 2021. HMRC had previously confirmed that penalties would not be imposed where an individual could not file on time due to the impact of COVID-19. Similarly HMRC will accept COVID-19 related personal or business disruption as a reasonable excuse as well as delays on the part of an agent where those delays are due to the pandemic. The penalty appeal period will also be extended by 3 months. Taxpayers are still required to pay their tax bills by 31 January 2021.

UK Case Law Developments

Compounding fixed rate preference shares are ordinary shares

In a further development on the long running and important question of whether the rights attaching to preference shares mean that they are or are not ordinary shares for tax purposes (including what was entrepreneurs' relief and is now business asset disposal relief), the Upper Tribunal (UT) have dismissed HMRC's appeal and confirmed the First-Tier Tribunal's (FTT's) decision that dividends paid in respect of cumulative and compounding fixed rate preference shares were ordinary shares.

In *Warshaw v HMRC*, the FTT held that cumulative fixed rate preference shares under which the fixed rate was also applied to the unpaid dividend (so the fixed rate dividend compounded) *were* ordinary share capital for entrepreneurs' relief purposes (so the taxpayer in this case was entitled to entrepreneurs' relief). It should be noted, however, that while the taxpayer benefited from the decision in this case, there will also be many cases in which shares that were thought not to be ordinary shares but will, on the basis of this decision, be ordinary shares will lead to adverse consequences for the taxpayer.

In this case, the taxpayer held shares that carried the right to a fixed rate dividend (10%) calculated on a compounding basis (on the sum of the subscription price and the aggregate of any unpaid dividends from previous years). Therefore, if profits were not available in a certain year or the dividend was not paid for any other reason, the fixed rate of 10% would be calculated on an increased amount in subsequent years.

The definition of "ordinary share capital" in section 989 Income Tax Act 2007 (ITA) is all of a company's issued share capital except for those shares which carry a right to "a dividend at a fixed rate" with "no other right to share in the company's profits".

In this case, HMRC, in line with its published view at the time, argued that the shares were not ordinary share capital as the rate of the dividend remained fixed. However, the FTT accepted the taxpayer's argument that the fixed rate requirement looked at not only the rate but also the amount that it applied to (here an indeterminate amount depending on whether dividends were or were not paid in a particular year).

The UT dismissed HMRC's appeal stating that the dividend ascribed to the preference shares could not be labelled as 'fixed' due to the compounding element, meaning that the amount by reference to which the dividend percentage applied was variable. The UT noted that section 989 ITA should operate as a "bright dividing line" between shares that are ordinary share capital and shares that are not and stating that "[we] see no principled basis for distinction between a dividend expressed as a fixed percentage of profits and the dividend on the Preference Shares", concluding that a 'fixed rate' involved a relationship between two variables and, as the rights attached to these preference shares related to more than two variables, there was no 'fixed rate'.

Following the earlier FTT decision, HMRC updated its guidance on what constitutes "ordinary share capital" with examples of shares carrying a range of rights. The guidance includes reference to fixed rate preference shares where the dividend compounds over time or where a rate of accretion is added if a dividend is unpaid. HMRC states that such shares would be "borderline" in respect of whether or not they are ordinary share capital. Although this guidance was welcome in providing some clarity given the lack of detail in HMRC's previous guidance and examples, there remains an unfortunate lack of certainty for taxpayers on the potentially significant tax consequences for them depending on subtle nuances in the rights attaching the shares that they and others hold.

It remains to be seen whether HMRC will amend its guidance given this decision.

Taxpayers expecting to rely on the terms of their shares to give particular tax results should check the position given this decision.

Transfer of assets abroad (TOAA) rules considered by the Upper Tribunal

In *HMRC v Rialas*, the UT has given its decision on when an individual should be treated as a transferor for the purposes of the TOAA rules but stopped short of answering the question of whether the imposition of an income tax charge under the TOAA rules would infringe on an individual's EU rights to free movement of capital.

The key question in this case was when an individual should be treated as a transferor for the purposes of the TOAA where they have not personally made the transfer. On this, the UT has upheld the FTT's decision that the taxpayer was not a transferor or quasi-transferor under the TOAA rules, even when the taxpayer was closely involved in conceiving the structure that was used.

Mr Rialas (R) was UK tax resident. He owned a UK fund management company (Argo) 50:50 with his business partner, Mr Cressman (C). R wanted to buy C's 50% stake in Argo (with a view to then selling 100% of Argo to a third party fund manager). A non-UK (Cypriot) trust, of which R and certain immediate family members were beneficiaries, was set up. The trust was the sole shareholder of Farkland Ventures Inc (Farkland), which entered into a loan agreement with a Greek company, Magnetic Corp, to finance the acquisition by Farkland of C's shares in Argo. Following the sale of C's shares in Argo to Farkland, dividends were paid to each R and Farkland. Subsequently, each of R and Farkland sold their 50% stake in Argo to the third party fund manager.

HMRC alleged that R had made a "transfer" for TOAA purposes in respect of the Farkland arrangements.

In the original case, the FTT determined that the £10 that R used to set up Farkland should not be regarded as a "transfer" for TOAA purposes, on the basis that the TOAA rules were intended to deter UK residents from transferring income-producing assets already owned (and not income-producing assets being set up). This part of the judgement might, depending on the facts, provide some comfort to private fund managers establishing non-UK general partner, management or advisory structures using small amounts of set-up capital.

As a separate point, the FTT also noted that in "exceptional" cases there could, in principle, be a transfer for TOAA purposes where a UK resident "procures" a transfer (even if the individual is not itself making a transfer). HMRC's argument in this case was that R had procured the Farkland structure, having effectively negotiated the arrangements himself. Although this argument was rejected by the FTT, on the basis that there were commercial reasons for using a non-UK acquisition company and it could not be said that R procured C's decision to sell his 50% stake in Argo to Farkland, this should act as a warning that the TOAA rules cannot, in principle, be completely circumnavigated by the use of intermediary structures.

The UT agreed with the FTT's approach, referring to the position taken in *Fisher and others v HMRC*, where the key question was the same, and the answer that involvement by a taxpayer in a transferor's decision making process in a sale and purchase of assets does not mean that the taxpayer is itself treated as having made the transfer. Ultimately Mr Rialas had no control over whether the third party sold the shares.

The UT declined to opine on whether the FTT was correct or not in determining that the application of an income tax charge under the TOAA rules would infringe Mr Rialas's EU rights to free movement of capital.

In upholding the FTT's position and linking this case to the *Fisher* case, the UT has effectively enabled HMRC to pursue a joint appeal for both cases, as the core issue in dispute is the same and we can expect to see such an appeal made.

FTT rules against loss creation scheme, applying the *Ramsay* principle

The FTT has shown that the *Ramsay* principle to structured tax avoidance arrangements is still very much alive, applying it to counter a loss creation scheme viewed by the FTT as creating a circular and self-cancelling transaction.

The *Ramsay* principle is an anti-avoidance doctrine that has evolved through case law and, in essence, is that one should, in appropriate circumstances, look at the effect of a composite transaction as a whole, and not each transaction step in isolation, in light of the purpose of the relevant legislation when determining the tax consequences of the transaction. The *Ramsay* principle is now recognised to simply involve the application of a purposive construction of the relevant law to a realistic view of the facts surrounding a particular transaction to determine the correct tax treatment.

In *Padfield and Others v HMRC*, the FTT found that "trades" (and the related underlying transactions) between the taxpayers and Shroders (the Bank) as part of a "volatility investment strategy" should be considered together and not as separate components. Consequently, they amounted to self-cancelling composite transactions giving rise to neither a gain nor a deductible loss. Furthermore, the FTT found that any capital losses that did result from the arrangement would not have been allowable losses as the main purpose of the arrangement was tax avoidance, meaning the losses would be caught by the capital losses anti-avoidance rule in section 16A Taxation of Chargeable Gains Act (TCGA).

The arrangement entered into by the taxpayers had been designed to produce either capital losses or income losses (as chosen by the taxpayer) which would then be set against the taxpayer's capital gains or relevant categories of taxable income. The taxpayer entered into a forward purchase contract to purchase securities from the Bank and simultaneously entered into a forward sale contract to sell securities to the Bank. The two contracts together equated to the "trade".

The terms of the contracts meant that any gains from the arrangement would always result from the sale of gilts (and be tax exempt) and any losses would result from the sale of shares or certificates of deposit (and generate allowable losses) which could then be set against the taxpayer's capital gains or certain taxable income.

The FTT held that the losses could not be deductible and should be disallowed. The transactions underlying the loss-making trades could and should be considered together since it was clear that the trades were circular, self-cancelling, composite transactions giving rise to no economic gain or loss, and under the *Ramsay* principle the taxpayers' appeal should be ignored for tax purposes.

Further, the FTT found that the capital losses would not have been allowed in any event under the capital loss anti-avoidance rule in section 16A of the TCGA which prevents losses being claimed where the main purpose of the arrangement giving rise to them is tax avoidance.

It will come as welcome news to HMRC that the *Ramsay* principle will still be applied in this way. The case is a reminder for taxpayers of the potential risk for those involved in structured tax avoidance arrangements, that the courts may well defeat their tax objectives through a realistic view of the transaction as a whole and purposive approach to the relevant tax rules.

Other UK Developments

Use of "dummy" UTRs restricted for UK partnerships with a non-UK GP

HMRC has clarified (to some extent) their position on the use of "dummy" unique taxpayer reference numbers (UTRs), limiting their use for UK partnerships with a non-UK general partner (GP) which is based in a Common Reporting Standards (CRS) jurisdiction and which does not file a CRS/FATCA return with HMRC.

As reported in our Tax Talks Blog in January, the Finance Act 2018 introduced a number of changes to the information required to be provided in partnership returns. The purpose of the legislation was to address concerns around the administrative burden being imposed on UK investment partnerships.

Among the proposed changes was a welcome change to the position on UTRs. Investment partnerships would no longer have to provide UTRs for non-UK resident partners who are not subject to UK tax on partnership profits where the partnership reports information about them under the CRS.

However, HMRC have now clarified that these “dummy” UTRs will not be available to UK partnerships with a non-UK resident GP where the GP is already under an obligation to file a CRS/FATCA return with a tax authority other than HMRC, i.e. a GP resident in a non-UK CRS jurisdiction. The consequence of this clarification is that partnerships of this kind will now be required to obtain UTRs for all non-resident partners.

As is clear, this could represent a large and additional administrative burden for such investment partnerships, with multiple non-resident investors requiring UTRs. To this point, HMRC are considering processes that would (a) allow relevant partners to obtain UTRs and (b) prevent filing notices from being issued to these partners.

Given the timing of this announcement, HMRC will still accept 2019/20 partnership tax returns using the “dummy” UTR for non-resident partners that HMRC has permitted. It should be noted, however, that once HMRC confirms and communicates a process for obtaining UTRs, it will be expected that these UTRs are applied for, and that the partnership refiles with the issued UTRs included.

HMRC is continuing to consult with tax bodies and discuss the issues this causes as well as potential processes to alleviate the administrative burden for investment partnerships and their limited partners.

HMRC delays changes to the VAT treatment of fees and compensation for early termination of contracts

HMRC has granted a temporary cessation of its revised policy on the VAT treatment of fees and compensation payments on early termination of contracts.

In light of the European Court of Justice's (ECJ's) rulings in Meo-Serviços de Comunicações e Multimédia SA v Autoridade Tributária e Aduaneira and Vodafone Portugal - Comunicações Pessoais SA v Autoridade Tributária e Aduaneira, HMRC has updated its guidance, stating in the Revenue and Customs Brief 12 (2020) (the Brief) that payments arising out of early contract termination will now be treated as consideration for the supply that the contract relates to and therefore subject to VAT where the supply is subject to VAT. This marks a significant change from HMRC's previous position that early termination payments described as compensation payments would ordinarily not be subject to VAT.

HMRC has now published an update to the Brief, stating that the revised position above will now apply from a yet to be determined future date. A further update is expected to provide taxpayers who changed their VAT treatment on the basis of the guidance in the Brief with further guidance.

In the intervening time, taxpayers can choose to take one of two approaches and either (a) follow the guidance in the Brief and treat fees and compensation for early termination of contracts as further consideration for the contracted supply or (b) take the approach previously taken by HMRC and, if this was the approach utilised by the taxpayer prior to the publication of the Brief, treat such fees as outside the scope of VAT.

HM Treasury looks to improve the UK's position as an attractive location for investment funds

HM Treasury have asked key stakeholders to input on possible regulatory and tax reforms to the UK's fund regime with a view to increasing the attractiveness of the UK as a location for investment funds and preventing (or slowing down) the movement of those funds to jurisdictions such as Luxembourg, Jersey and Guernsey. The request is for input on both the substance of reforms as well as on how any such reforms should be prioritised.

With this backdrop, the government wants to be clear that any proposals for tax reforms must be within the government's policy towards tax avoidance and evasion as well as consistent with their international commitments.

The deadline for comments on the request for evidence is 20 April 2021. Following a review of responses, the government will then consult on more specific proposals for reform.

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