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UK Tax Round Up

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UK Case Law Developments

EIS relief not available for shares carrying preferential rights

The Upper Tribunal (UT) in *Foojit v HMRC* dismissed the taxpayer's appeal against the First-tier Tribunal's (FTT's) decision (as reported in our November 2019 UK Tax Round Up) and agreed with the FTT that enterprise investment scheme (EIS) relief was not available for a class of shares owing to the mechanics in the company's articles of association for paying out dividends. This case shows the importance of careful drafting of share rights if EIS relief is intended.

EIS relief is not available in respect of shares which carry a preferential right to dividends where the amount or timing of the dividends payable pursuant to that right depends on a decision of the company, the shareholder or any other person.

In this case, the UT found that, looking at the company's articles of association as a whole, the preferential dividends on the shares would only become payable following a decision of the company. This was on the basis that the company's articles stated the preferential dividend was payable if a dividend was declared and the declaration of any dividend required a decision of the company's board. The company argued that because it intended that the shares should qualify for EIS relief, the court should apply a construction to the terms of the shares that assisted that objective. The UT declined to take this approach, and simply construed the words in the articles. Accordingly, EIS relief was not capable of applying to this class of shares.

This case is another example of how strictly the complex and detailed requirements for EIS relief to be available will be scrutinised and applied by HMRC and that the courts will also support a prescriptive approach to the rules. As such, taxpayer companies looking to benefit from EIS relief should seek detailed advice on the application of the rules in their specific case and attention should be paid to the detail of the drafting of the relevant documents.

It is also another example, alongside the recent decision on whether shares were "ordinary" in *Warshaw v HMRC* (reported in our January UK Tax Round Up), of just how carefully taxpayers (and their advisers) should consider all of the terms of shares when they are intended to meet specific requirements of relevant tax legislation and what significant adverse consequences can arise if the detailed requirements of the legislation are not reflected in the terms.

FTT applies *Ramsay* principle to defeat tax avoidance scheme

In *Clipperton v HMRC*, the FTT applied the *Ramsay* principle to a series of steps designed to result in a payment of profits from a company to its shareholders which did not attract an income tax charge as a dividend.

The FTT, taking a purposive approach, concluded that the series of steps in question did not detract from the nature of the receipt in the shareholders' hands, and held that the receipt was taxable on those shareholders as a dividend.

The basic facts of the case were that the company was owned by its two founders who had received substantial dividends in prior years. Instead of paying profits out as a dividend the shareholders decided to use a structured arrangement that sought to apply the settlements legislation to attribute the receipt to the trustee of a trust of which they were beneficiaries.

The FTT took a broad approach to the meaning of distribution in section 383 ITTOIA 2003 and which includes any "distribution out of assets of a company in respect of shares in the company" under section 1000 CTA 2010 and concluded that it encompassed any reduction in the assets of a company in a manner which benefited its shareholders in their capacity as shareholders. That construction of distribution included the amounts paid out by the company and ultimately received by the shareholders under their trust arrangements.

This is another example of the willingness of the courts to apply the *Ramsay* anti-avoidance doctrine to tax avoidance arrangements in a broad manner, particularly where the relevant statutory terms are open to wide construction. For example, as reported in last month's UK Tax Round Up, the FTT recently applied the *Ramsay* principle to structured tax avoidance arrangements in the case of *Padfield and Others v HMRC*. As noted in that UK Tax Round Up, the *Ramsay* principle is an anti-avoidance doctrine that has evolved through case law. The doctrine, 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.

The *Clipperton* decision once again reminds taxpayers that the principle provides HMRC and the courts with a powerful tool in seeking to defeat structured tax avoidance arrangements.

Other UK Tax Developments

IR35 off-payroll working April 2021 changes – HMRC publications

HMRC has updated its taxpayer guidance on the changes for off-payroll working which will come into effect from 6 April 2021. HMRC has also published an issue briefing policy paper which includes information on the approach it will take to compliance activity following these changes. These publications will be of interest to organisations which engage individuals through personal service companies or other intermediaries and which are preparing for the upcoming changes in the off-payroll working rules.

In short, the April 2021 changes will see the responsibility for determining whether the off-payroll working rules (generally referred to as IR35) apply move from the individual's personal service company to the client organisation (except in the case of clients which are small private sector organisations). Similarly, where the client contracts with a contractor's personal service company directly and the client/contractor relationship is one of deemed employment, it will be the client organisation rather than the contractor's personal service company which will be responsible for accounting for employment taxes and national insurance.

Companies and other organisations preparing for these changes may find the guidance in these publications helpful. In particular, the issue briefing confirms previous statements that HMRC will not seek penalties for inaccuracies in applying the new rules in the first 12 months of the rules applying, unless there is evidence of deliberate non-compliance.

GAAR panel opinion on loan to participator scheme released

The GAAR Advisory Panel published its most recent decision of 16 December 2020. The panel concluded that arrangements put in place to prevent a charge arising under the close company loans to participators rules were not a reasonable course of action having regard to the relevant tax provision and were, therefore, susceptible to counteraction under the GAAR.

The decision is not surprising, given the facts, and is a useful reminder that the GAAR panel is unlikely to be sympathetic to arrangements designed to circumvent tax rules by which owners of closely-held companies are taxed on extracting profits from those companies. In this case, the panel were giving their opinion despite the taxpayer's advisers having conceded, after HMRC referred the case to the panel,that the arrangements were ineffective and a tax charge under the loans to participators rules had arisen.

In summary, the case involved a loan from a close company taxpayer to a participator which the taxpayer claimed was not within the corporation tax loans to participators rules because the loan had been repaid within the relevant nine-month period. However, the repayment of the loan took the form of transferring shares in a newly established company (Newco) to the close company in order to repay the debt. Newco had been established by the participator with £1,000 of paid-up share capital and nearly £2 million of share capital uncalled with the obligation to pay up capital called on the shares remaining with the participator. The taxpayers claimed that Newco was worth £2 million because of its right to call for payment of the unpaid capital.

The panel found that, although satisfying a debt by transferring an asset is not objectionable, there were contrived or abnormal steps (one of the features set out in the GAAR legislation as indicative of arrangements being abusive) in leaving nearly £2 million of capital uncalled with the obligation to pay up that amount remaining with the original shareholder. The panel also suggested that the very short period of time (around ten days) between the steps being suggested in a letter from the taxpayers' advisers and steps being completed as suggested was indicative of the contrived nature of the arrangements. The panel also found that if this kind of repayment were found not to trigger the loans to participators rules, this would be exploiting a shortcoming in the legislation

This is another example of a case where the GAAR panel appears to have had little difficulty in determining that a structured tax avoidance scheme was within the scope of the GAAR and might be encouraging to HMRC in broadening the sort of transaction that it refers to the panel for consideration

EU Tax Developments

Extension of European Commission's state aid temporary framework for COVID-19

The European Commission's temporary framework for state aid, originally adopted on 19 March 2020, has been extended to 31 December 2021. This framework was adopted in the context of the COVID-19 pandemic and was due to be in place until 30 June 2021 with certain measures being allowed until 30 September 2021. The framework is now being extended in light of the persistence and evolution of the pandemic. The extension allows EU Member States to continue supporting businesses by providing for various types of aid, including elective tax advantages. In addition the limits for some of the support measures have been increased.

European Commission announces consultation on VAT rules for financial and insurance services

The European Commission has announced a consultation, closing on 3 May 2021, into the functioning of current EU VAT rules on financial and insurance services. The consultation is part of process begun in October 2020 and seeks stakeholder views on the functioning of these rules which will feed into a wider review of the EU VAT Directive and contribute to a possible future legislative proposal.

The Commission acknowledges that the current rules are criticised as being complex, difficult to apply and not having kept pace with the development of new services in the sector and that this may have led to legal uncertainty and high administrative and regulatory costs for businesses, as well as a lack of VAT neutrality. It is also noted that the rules are interpreted and applied inconsistently by Member States.

This process is in early stages but is something to keep an eye on as it becomes clearer what, if any, changes are proposed to EU VAT rules as a result.

Other Developments

OECD COVID-19 guidance on residence and permanent establishments updated

As covered in more detail in our recent Tax Talks post, the OECD has updated its guidance on the impact of COVID-19 on double tax treaties (DTTs), including in relation to tax residence, tie breakers and permanent establishments, to reflect the pandemic's persistence and the risk that some measures taken in response to the pandemic may no longer be described as temporary.

The guidance reaffirms the OECD's position of April 2020 and should offer some comfort to businesses and individuals concerned about changes in residence and permanent establishment risk arising from COVID-19 and the associated travel restrictions.

However, taxpayers should be cautious in their approach to these matters given that it is for the relevant tax authorities to determine these questions. In particular, taxpayers would be advised to take a cautious approach if setting up new non-UK entities or businesses and assuming that they can be managed from the UK during the remainder of the COVID-19-related travel restrictions. In those cases, we would recommend that people should ensure that relevant decisions are taken in the local jurisdictions and not rely on decisions being taken temporarily in the UK, since the relevant entities will have no track record of overseas management to fall back on.

OECD/G20 inclusive framework public meeting

A public meeting of the OECD was held on 27/28 January 2021 to provide an update on the OECD/G20 inclusive framework on the digitalisation of the economy and the Pillar One and Pillar Two blueprints (see our October 2020 UK Tax Round Up for more background).

It is widely reported that at the meeting the UK chancellor, Rishi Sunak, indicated that the UK intends to withdraw the UK's digital services tax once a global consensus is reached on these points.

On the project more generally, it is understood that the intention is to reach agreement on the proposals before 9/10 July 2021, when the G20 finance ministers meet.

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