

UK Tax Round Up

April 2023

Welcome to April's edition of our UK Tax Round Up. This month has seen a number of interesting cases highlighting the need for taxpayers and HMRC alike to apply a realistic approach to the facts in assessing the tax consequences of uncommon arrangements and also saw HMRC publish its proposals for modernising elements of the tax system in its Tax administration and maintenance publications, including a consultation on stamp taxes on shares.

Tax administration and maintenance proposals – stamp taxes on shares

HMRC has published its latest set of proposals for modernising the tax system. Most notably this includes a [consultation on stamp taxes on shares](#) which is seeking responses from interested parties by 22 June 2023.

The main recommendation to be considered is that the current rules under which both stamp duty and stamp duty reserve tax (SDRT) apply to transfers (and agreements to transfer) shares should be replaced by a single system equivalent to SDRT which would be operated both through CREST for dematerialised shares (as is the case now for SDRT) and also through online reporting and payment for materialised shares (replacing the document-based stamp duty that applies now). The new tax would be payable by the purchaser of the shares and would be self-assessed (in contrast to the way in which stamp duty and, to some extent, SDRT operates now).

The consultation considers issues including the geographical extent of the tax (the suggestion is that it would only apply to shares and certain securities issued by UK companies as is the case with SDRT), its administration, the extent of reliefs, the trigger point for the tax and other issues such as how to tax deferred and unascertainable consideration.

In very general terms, the proposal seeks to retain the tax base that exists today in respect of the transfer of shares (mainly collected through CREST) and to bring it into a single, self assessed, online regime. It does, however, raise possible new issues, such as proposing that the tax point for all share transfers should be when the contract for sale becomes unconditional rather than when the transfer completes. This is, broadly, the case for SDRT now, which works efficiently since the transactions are generally processed through CREST, but might well lead to new and unattractive complications for transfers of unlisted shares in respect of which stamp duty is generally paid on execution of a stock transfer form on completion of the transfer. Other areas of possible complexity are the proposal to move from the current regime in respect of unascertainable consideration (subject to SDRT on a money's worth best estimate basis and not subject to stamp duty) to that applying to stamp duty land tax which can result in multiple payments becoming due.

One attractive suggestion for the funds industry is a suggestion that stamp tax might be abolished on transfers of partnership interests, although there is reference to possible anti avoidance provisions and it is not clear whether this would be a complete abolition of tax on transfers of interests in partnerships which owned shares or whether a specific set of rules would apply to such transfers.

While modernisation of the regime would be welcomed it would be unhelpful if the changes raised new complexities and administrative costs.

Responses can be sent to HMRC until 22 June.

UK Case Law Developments

Successful discovery assessment against EBT loan arrangement

In *Sheth v HMRC*, the First-tier Tribunal (FTT) dismissed an appeal from the taxpayer, finding that the income received between 2009 and 2011 from two schemes under which income from a UK employer was converted into loans from two offshore trusts (the EBTs) was taxable as employment income. HMRC had assessed the taxpayer to additional income tax following service of a discovery assessment despite the fact that the scheme had been disclosed to HMRC under the Disclosure of Tax Avoidance Schemes (DoTAS) rules and that the taxpayer had included the DoTAS scheme reference number on his tax return for the relevant years.

The scheme in question involved the taxpayer providing services to a UK employer via a contract of employment with the EBT. The UK employer made payment to the EBT. The EBT paid the employee a modest salary which was paid subject to withholding of income tax and NICs in the ordinary way. The balance (and far greater proportion) of the income attributable to the taxpayer's services was then advanced to the taxpayer by the EBT by way of a loan at a discounted interest rate. The discounted interest rate on the loan was disclosed in the taxpayer's return as a benefit in kind, and tax was paid in respect of it, but the loan itself was not declared as taxable income.

The decision of the FTT that this type of arrangement was a tax avoidance scheme and that the loans were subject to income tax as earnings is not surprising as arrangements like this have been investigated and challenged by HMRC since the mid-2000s (and it is unlikely that this type of arrangement would be put in place to today in light of the disguised remuneration rules introduced in 2011).

Having said this, the interesting point in this case was that HMRC had assessed the taxpayer by issuing a discovery assessment because it was out of time to make the assessment using its standard enquiry process. Generally, a discovery assessment can be made within four years of the submission of a tax return whereas an ordinary enquiry must be made within twelve months but only where HMRC discovers new facts that are relevant to the tax insufficiency.

As stated above, the promoters of the EBT scheme had disclosed it under the DoTAS rules in 2008 and they were given a DoTAS scheme reference number. The taxpayer included the scheme reference number in his tax returns for the years in question. Despite this, HMRC successfully argued that the information made available in the returns, which did not reflect the receipt of the amount advanced to the taxpayer under the EBT loans, could not reasonably be expected to make a hypothetical HMRC officer aware that additional income tax should be payable (in accordance with section 29(5) of the Taxes Management Act 1970 which sets out this "hypothetical officer" condition). Applying this test, the FTT held that HMRC was entitled to make the discovery assessments on the facts on the basis that the information provided in the tax returns did not disclose that there was a loss of tax or how the scheme worked in sufficient detail.

The decision was reached despite the fact that, for these purposes, the hypothetical HMRC officer is imputed a reasonable knowledge and understanding of the law and must apply such knowledge to the facts presented. Further, the scheme in question was reasonably straightforward and was the sort of arrangement which HMRC had experience investigating. The FTT also recognised that the hypothetical officer might well have been put on notice that an enquiry may be warranted given that it was clear from the tax return that the taxpayer was being lent roughly eight times his stated salary for that tax year, which was unusual, but this was not enough to prevent discovery as it did not highlight the actual tax insufficiency.

Regarding the DoTAS disclosure made by the scheme promoter, the FTT noted that this was a typically disingenuous and misleading disclosure which was designed to prevent a discovery assessment if HMRC missed the standard enquiry closure window while at the same time providing insufficient information to alert HMRC to the fact that it should open an enquiry. In the circumstances, the FTT noted that the level of disclosure required to be made on the taxpayer's tax return to alert the officer to the insufficient level of income tax declared was quite low, but that it had not been met in the circumstances.

What is surprising in this decision is that simply notifying HMRC that a taxpayer has used a tax avoidance scheme disclosed under DoTAS is not sufficient to alert HMRC to the fact that an enquiry might be warranted when the whole point of the DoTAS reporting regime was to accelerate the time at which HMRC became aware of schemes to allow it to counteract them more efficiently. The decision seems to give HMRC a wide power both to require the early notification that a DoTAS reported scheme has been used and an extended period to ignore the taxpayer's disclosure of the use of the scheme and then raise a discovery. It also, however, highlights that the courts will generally look unfavourably on the use of tax avoidance schemes and that full disclosure on a taxpayer's tax return is advisable if the taxpayer wants certainty that his or her tax affairs can be closed once the standard enquiry window has passed.

FTT dismisses taxpayer appeal in respect of contributions to a “sham” remuneration trust

In *Northwood v HMRC*, the FTT dismissed the taxpayer's appeal against an HMRC assessment that contributions made to a remuneration trust established by the taxpayer were not deductible from the income of the taxpayer's dentistry business. As with the *Sheth* case discussed above, the decision itself is not surprising, but the FTT found, not only that the scheme did not achieve its intended tax consequences as a general matter, but also that the documents used to set up the arrangement were a sham which is a relatively rare conclusion.

The remuneration trust was set up in accordance with professional wealth management advice which the taxpayer received with the stated (purported) purpose of furthering the taxpayer's business by providing benefits to its suppliers, customers or future employees. The scheme then involved the taxpayer's business contributing a large proportion of its income to the remuneration trust. The only use that the trust made of the amounts contributed to it was to lend the money to the taxpayer.

The FTT identified four issues in assessing whether the payments to the trust (together with the associated implementation fee) were deductible:

1. whether contributions to the remuneration trust should have been recognised as an expense in the accounts of the dentistry business under UK GAAP;
2. if the answer to (1) was yes, whether the expense was incurred;
3. if the answer to (2) was yes, whether contributions were incurred wholly and exclusively for the purposes of the trade; and
4. whether a deduction for the associated fees could be claimed.

In addition, the FTT considered whether the taxpayer intended to make things appear other than they were such that the sham doctrine could be applied to determine what the arrangement actually achieved.

The FTT found that the contributions to the remuneration trust did not give rise to an expense under GAAP and, therefore, did not give rise to an income tax deduction in accordance with section 25(1) ITTOIA 2005. In coming to this conclusion, the FTT agreed with HMRC that Mr Northwood's accounts were not prepared in accordance with GAAP and accepted HMRC's expert accounting evidence on the correct accounting treatment. Regarding the issue of whether the expense had been "incurred" for the purposes of section 34 ITTOIA 2005, the FTT found that Mr Northwood retained future economic benefit from the assets transferred to the trust and, as such, the payments did not remove the money from his personal control and could not be considered to be properly incurred on that basis.

On whether the contributions were incurred wholly and exclusively for the purposes of the taxpayer's trade, as opposed to having at least a dual purpose of benefiting the trade and something else, the FTT held that Mr Northwood's intention to benefit suppliers by improving his business and its turnover was not supported by the evidence and that he had never intended for the money to be paid out to suppliers. Rather, it was held that Mr Northwood's subjective intentions at the time of making the payments to the trust was to benefit himself and his family by accessing the money in a manner that would provide tax advantages, including inheritance tax planning. The FTT did note that the mere fact that an arrangement is influenced by its tax consequences does not necessarily mean that there is a duality of purpose in making a payment but that, on the facts of this case, the expense was incurred for the non-trade purpose of securing a tax advantage for Mr Northwood. Accordingly, neither the payments nor the related fees were deductible.

Overriding the various elements of the decision was the application of the sham doctrine. The sham doctrine applies to circumstances where an arrangement is created with the intention of deceiving or making things appear other than as they are. HMRC argued that the remuneration trust and the terms set out in the documents used to establish it were a sham that were intended to make things appear different from their reality of providing the business's funds to Mr Northwood without the normal tax consequences.

Both parties referred to the decision in *Hockin*, which clarified that a finding of sham requires the court to be satisfied that there is an intention to deceive or to make things appear other than as they are. It was also noted that a finding of sham does not necessarily imply dishonesty in the ordinary meaning of the word.

The FTT found, after examining the evidence and considering the parties' arguments, that there was a common intention to make things appear other than as they were in relation to the remuneration trust by dressing up the documentation relating to the trust as if the trust was established to deliver business benefits to the taxpayer's business when, in fact, it was established to achieve a tax benefit and there was no intention for the money to be used in the manner described in the documents. As a result, the FTT concluded that the documentation and the arrangement was a sham.

Despite this finding, the FTT noted that the sham did not amount to evasion or dishonesty as there was no attempt to conceal what actually happened despite the attempts to dress up the arrangement as having a purpose which it did not. So, although not required as the basis for upholding HMRC's assessment, it is interesting that the sham doctrine was successfully applied to what was a highly structured (albeit relatively simple) arrangement that relied to an extent on the taxpayer having a commercial purpose which, in reality, was not accepted as existing and was not supported by the evidence.

Place of supply of sports agency services outside the UK

In *Sports Invest UK Limited v HMRC*, the FTT considered the VAT treatment of a €4 million payment received by the Sports Invest from Italian football Club Internazionale Milano SpA (Inter) relating to the transfer of a Portuguese player from Portuguese club Sporting Clube de Portugal (Sporting) to Inter in August 2016. The issue in question was where the supply by Sports Invest had been made for VAT purposes, which depended on what supplies were made and whether Sports Invest supplied services to both Inter and the player or just to Inter. This was because if Sports Invest supplied its services only to Inter then the services would be treated as made outside the UK and no UK VAT would be due on Sports Invest's fee whereas if the supply was to the player then, as the player was not himself a "business" person for VAT purposes, the supply would be treated as made in the UK and UK VAT would apply.

HMRC argued that the services were supplied to both Inter and the player as, under a contract with the player, Sports Invest was entitled to a fee of 10% of the player's gross salary, although it was agreed that Sports Invest would not seek to recover any of that amount from the player and, rather, would receive it, if at all, from Inter. HMRC's position was that the payment by Inter amounted to third party consideration for the services rendered to the player and, accordingly, VAT was due on the payment.

Conversely, the appellant contended that all of the consideration payable by Inter, including the 10% figure, was consideration for services provided by the appellant to Inter and so the place of supply for VAT purposes was Italy and no UK VAT was due on the payment.

The FTT concluded, based on a consideration of several factors implied by the contracts entered into between Sports Invest, Inter and the player, that Sports Invest's services were supplied only to Inter and that the €4 million payment by Inter to Sports Invest was for those services and was not a third party payment in respect of services supplied to the player.

Although there was a contract between Sports Invest and the player, there was nothing in the agreement between Sports Invest and Inter to suggest that the payment by Inter was in respect of any of the services provided to the player. The FTT acknowledged that Sports Invest provided services to both the player and Inter and noted HMRC's concern that it was inconceivable that Sports Invest, as a commercial organisation, would have provided services to the player without being paid for it. However, the FTT accepted Sports Invest's explanation that it was common practice in the sports agency business for contracts to be framed in the way that they were and to include the possibility for a payment from the player to the agent, both to comply with the Football Association's standard contractual terms and to protect Sports Invest against the player using a different agent for the transfer and that Sports Invest did not intend to charge the player, that the fee waiver letter between the player and Sports Invest was real and that Inter agreed to pay and paid the €4 million purely in respect of the services supplied by Sports Invest to Inter. It also noted that the evidence was that, although Sports Invest provided services to the player, no consideration was payable in respect of those services and the contracts reflected the economic and commercial reality of the overall arrangement.

Based on these findings, the tribunal held that there was no indication that the payment was made for anything other than services supplied to Inter. Consequently, the place of supply for VAT purposes was determined to be Italy, not the UK.

The case highlights how technical a tax VAT is and how it is important that contracts are analysed extremely carefully when seeking to determine exactly where and how such VAT might be due from an analysis of exactly what services are being supplied to which customer for what consideration.

Special dividend from US company part capital

In *John Buckingham v HMRC*, the key issue between the parties was whether a special dividend paid to a shareholder, Mr Buckingham, who held shares in Dr Pepper Snapple Group (Dr Pepper) in connection with a merger between Dr Pepper and Keurig Green Mountain Inc was income, capital or both in nature for UK tax purposes.

The basic facts were that Dr Pepper merged with Keurig using a new merger company (Dr Pepper and the new company both being Delaware companies) in 2018 with Keurig paying \$18 billion for an 87% stake in the new company and the Dr Pepper shareholders owning 13%. In addition, Mr Buckingham (and the other shareholders) received a special dividend of \$103.75 per share from Dr Pepper immediately prior to the merger. Of the \$103.75 special dividend received by the Dr Pepper shareholders it was accepted that \$29.50 was paid out of Dr Pepper's earnings and profits in the way that a standard dividend would be. It was also accepted that the remaining \$74.25 was funded by Keurig (or its shareholders). The details are not explained, but it was presumably through the Keurig shareholders taking a disproportionately large stake in the new company since the value of the Dr Pepper shareholders' interest in the merged company was reduced significantly. This was all reflected in the documents filed with the IRS and sent to shareholders in respect of the merger which, although referring to the declaration and payment of a cash dividend of \$103.75 per share, also stated that, for US tax purposes, only the portion of the dividend that was paid out of earnings and profits would be subject to income tax as a dividend and that the rest would reduce the shareholder's tax basis in their shares. Mr Buckingham also received a US Form 1042-S "foreign person's US Source Income Subject to Withholding" from the new merger company which stated that the \$29.50 per share receipt was a "dividend" which was paid subject to US withholding tax (as it was) and that the \$74.25 per share was a "return of capital".

Initially, Mr Buckingham had not reflected any of the special dividend as subject to income tax. HMRC raised an enquiry that sought to tax the \$29.50 per share as a dividend. HMRC then amended this assessment under a discovery assessment and sought to charge the entire special dividend to income tax. Mr Buckingham accepted that the \$29.50 per share was a dividend but challenged the assessment on the remaining \$74.25 per share.

In its analysis, the FTT referred to the case law that has been built up over years to determine the nature of distributions from overseas companies, noting that under section 402 ITTOIA 2005 only dividends (rather than dividends and other distributions) of a non-UK company are subject to income tax and that dividends expressly does not include “dividends of a capital nature”. The case law (recently discussed in detail in the *First Nationwide* case) states, broadly, that in assessing how a distribution of an overseas company should be characterised as income or capital, one must assess the form of the payment applying the relevant overseas company law. Applying that test, the characterisation of the payment for US tax purposes and as set out in the Form 1042-S provided to Mr Buckingham and the fact that the capital value of his shares in the merged company was significantly less than the capital value of his pre-merger Dr Pepper shares, the FTT held that only the \$29.50 of the special dividend was income and that the rest was capital.

HMRC’s assessment of the whole of the special dividend as income was severely criticised by the FTT. HMRC had seemingly looked only at the company statement that referred to the declaration and payment of a cash dividend of \$103.75 per share as part of the demerger and had not considered the other documentation and statements in respect of the US tax treatment of the payment. HMRC had claimed that the US tax treatment was irrelevant and had also seemingly ignored its own guidance on the exclusion of “capital dividends” from income tax in its published manuals (at SAIM5210) which states that, “Whether a dividend is income or capital in nature is determined by reference to the mechanism of distribution under the constitutive law of the territory where the company is incorporated or registered and its implications for the company making the distribution. The question is whether or not the ‘corpus of the asset’ is left intact after the distribution. If not, the receipt will be a capital receipt; if it is, the payment will be chargeable as income”.

The FTT clearly considered that HMRC had not considered the details of the merger and how it was effected under Delaware law sufficiently before amending its assessment.

Other UK Tax Developments

HMRC to close DAC6 reporting on 31 May

HMRC has announced that the DAC6 reporting service will close on 31 May 2023. This follows the replacement of the UK's implementation of the EU's cross-border tax avoidance arrangement disclosure rules (known as DAC6) with the new reporting rules introduced by the International Tax Enforcement (Disclosable Arrangements) Regulations 2023 complying with the OECD's mandatory disclosure rules (MDR) which entered into force on 28 March. These new rules broadly align with the UK's restricted application of DAC6 that was introduced from 1 January 2021 following the UK's exit from the EU, but with different administrative and reporting processes.

The DAC6 reporting service can be used for arrangements which became reportable before 28 March 2023 and to update previously submitted disclosures until 31 May. Users wishing to tell HMRC about reportable arrangements from 28 March 2023 will need to use the new MDR reporting service.

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