

# UK Tax Round Up

October 2023

**Welcome to the October edition of the UK Tax Round Up. This month has seen the Supreme Court's judgment on the operation of the employment-related securities deeming provision, the Court of Appeal's decision on what constitutes receipt of profits in a fiduciary capacity in the latest BlueCrest case, a number of interesting VAT cases and a policy paper and draft legislation confirming how EU law will remain relevant to the UK's VAT law.**

## UK Case Law Developments

### Scope of the employment-related securities deeming provisions

In *Vermilion Holdings Ltd v HMRC*, the Supreme Court (SC) has considered the longstanding question of how broad the employment-related securities option deeming provision in section 471(3) ITEPA 2003 is (or how literally should it be read). The terms of Section 471(3) are the same as those in section 421B(3) ITEPA which apply to employment related securities generally.

The case involved the exercise of an option to acquire shares which had been granted to Mr Noble when he became a director of Vermilion Holdings Ltd's (Vermilion's) subsidiary Vermilion Software Ltd (VSL). Mr Noble had acquired an option over Vermilion shares in 2006 as part payment for providing advisory services in respect of an equity finance raise by VSL. By 2007, it was apparent that VSL required emergency funding. As a condition to the provision of that finance, the terms of the 2006 options were amended to reduce their entitlement and Mr Noble became executive chairman of Vermilion. The change to the 2006 option was effected through a cancellation of the existing option and the grant of a new option. When the option was exercised in 2016, HMRC argued that it was an "employment-related securities option", and that Mr Noble's gain was subject to employment tax (for Vermilion) under Chapter 5 Part 7 ITEPA.

In order to be an employment related securities option, it must be the case (under section 471(1) and 421B(1) ITEPA) that the option is acquired by the holder in circumstances where the right or opportunity to acquire it is available by reason of an employment (including a directorship) of the holder or any other person (the factual test).

However, under section 471(3) (and 421B(3)) ITEPA, a right or opportunity to acquire a securities option made available by a person's employer or a person connected with it is to be regarded as made available by reason of the employment (the deeming test). The question for the SC to consider was to what extent section 471(3) should be read in the context of section 471(1) or to what extent it was a standalone, self-explanatory provision.

The earlier decisions of the First-tier Tribunal (FTT), Upper Tribunal (UT) and the Inner House of the Court of Session (IHCS) had come to different conclusions. The FTT decided that Mr Noble did not acquire the 2007 option by reason of his employment (or directorship) as a factual matter and that section 471(3) was subordinate to section 471(1), should not give a result that was inconsistent with section 471(1) and that the option was not "made available" by Vermilion but by Mr Noble's 2006 option. The UT decided that Mr Noble had acquired the 2007 option "by reason of his employment" applying section 471(1) because it was a condition of receiving it that he became a director. The UT did not consider section 471(3) as a consequence. The IHCS (by majority) found in favour of Vermilion, stating in respect of section 471(3) that it was "an error to categorise [section 471(3)] as a separate and distinct route to taxation which is available even if it has been established that [section 471(1)] has no application" and that it would be "anomalous, absurd and unjust" to treat the 2007 option as having been made available to Mr Noble by his employer when the answer to the factual question was that Mr Noble had acquired the 2007 option because of the 2006 option".

These decisions show how difficult the courts have found it to assess the scope of the deeming provision in section 471(3) (and section 421B(3)) notwithstanding their importance to many questions about whether securities and securities options are "employment related" for the purposes of Part 7 ITEPA.

The SC stated that it did not need to consider whether the factual test was satisfied because the appeal turned on whether the deeming test in section 471(3) was met. The SC noted, as stated by the dissenting voice in the IHCS, that the factual test requires a careful examination of fact to assess the causal connection between employment and the grant of the option. This analysis can be difficult and causes disagreement between judges (as shown by this case). Section 471(3), therefore, was introduced by Parliament to create a straightforward test to avoid these difficulties. That test is that, if a person's employer (or a person connected to the person's employer) provides (or makes available) the right or opportunity to acquire a securities option, that right or opportunity is conclusively treated as having been made available by reason of the employment of that person. Turning the order of section 471 on its head, the SC stated that it was only if the clear terms of the deeming test were not met that there was a requirement to consider the more difficult application of the factual test. While it was accepted that there are limits to the application of deeming provisions (as set out in *Marshall v Kerr*) and that deeming provisions should be given their natural consequences, but not so as to give an absurd or unjust result, it was not the case that, applying section 471(3), concluding that the 2007 option was acquired by reason of Mr Noble's employment was an absurd or unjust conclusion. Rather, Parliament had taken the perfectly rational approach of specifying that a securities option (or securities) was always within the scope of employment tax as a result of being treated as made available by reason of employment when it was made available by the person's employer.

The case is significant as the SC has definitively confirmed that the deeming test is a standalone basis on which to determine whether securities or securities options are within the scope of Part 7 ITEPA and employment tax even if, on an examination of the causal link between the employment and the grant of options or acquisition of securities, the conclusion would be that they were acquired for reasons other than employment. While the case considered the deeming test in the context of securities options, it can be taken that the conclusion applies equally to the equivalent test in section 421B(3) ITEPA in respect of employment related securities.

### **General partner did not receive income in a fiduciary capacity**

In *BCM Cayman LP and another company v HMRC*, the Court of Appeal (CA) has dismissed BlueCrest's appeal against the FTT's and the UT's decisions on (i) the tax treatment of profit allocations of a multi-level partnership and (ii) the deductibility of finance costs for acquiring an interest in a partnership. The UT's decision was previously covered in our [August 2022 UK Tax Round Up](#) which also summarises the factual background.

By way of summary, BlueCrest Capital Management LP (BCM LP) was an English limited partnership that carried on a trade of providing investment management services to hedge funds. As part of a partner succession plan, a number of the partners wished to sell their partnership interests in BCM LP and the remaining partners agreed to acquire those interests.

In order to fund the purchase of the BCM LP interests, BlueCrest established a Cayman incorporated and tax resident company (BCMCL) (the second appellant) as a subsidiary of another Cayman company (Cayman Holdco). BCMCL became the general partner of a new Cayman limited partnership, BCM Cayman LP (Cayman LP) (the first appellant). BCMCL then took out a loan of \$200 million from the Royal Bank of Scotland (RBS) and issued \$165 million in loan notes to the sellers. BCMCL then contributed the partnership interests in BCM LP to Cayman LP, which became a partner in BCM LP as a result. Because Cayman LP had no separate legal personality, the registered partner in BCM LP was BCMCL acting in its capacity as general partner of Cayman LP. Cayman LP (or BCMCL as the limited partner in BCM LP) was entitled to a profit allocation from BCM LP sufficient to pay the interest on BCMCL's loan from RBS and the interest on the loan notes it issued to acquire the BCM LP partnership interests. Under BCM LP's partnership agreement, BCMCL was also entitled to an additional amount if BCM LP generated a "superprofit". Under the Cayman LP partnership agreement, BCMCL was entitled to the Cayman LP receipt equal to interest payments on the RBS loan and the loan notes.

RBS became a corporate limited partner in Cayman LP and was entitled to any of the “superprofit” that Cayman LP received from BCM LP. RBS entered into a total return swap (the TRS) with Cayman Holdco under which RBS would pay to Cayman Holdco an amount equal to whatever RBS received from Cayman LP as “superprofit” less a fee for its involvement in the arrangement. Cayman Holdco contributed any amount received under the TRS to BCMCL as capital and BCMCL used it to repay the loan notes. RBS later assigned its interest in Cayman LP to an entity called Fyled Limited (Fyled), a Morgan Stanley group company, which entered into arrangements similar to and with the same overall effect as the TRS.

In 2008 and 2009 (after RBS had transferred its interest in Cayman LP to Fyled), BCM LP made “superprofits”. BCM LP paid those profits to BCMCL (as general partner of Cayman LP and limited partner of record in BCM LP), BCMCL paid them to Fyled as limited partner in Cayman LP and Fyled paid most of them to Cayman Holdco under the TRS.

The arrangement overall was intended to result in the superprofit not being subject to UK tax because it was allocated by Cayman LP to Fyled and Fyled would claim a deduction in respect of it (or nearly all of it) for its payment obligations under the TRS. In addition, BCMCL claimed a UK corporation tax deduction for its interest expense on the RBS loan as a trading loan relationship debit because, it claimed, the loan was used to acquire an interest in BCM LP and, therefore, for the purposes of BCM LP’s trade that Cayman LP was treated as conducting as a partner in BCM LP.

The two issues that were considered by the CA were whether:

1. BCMCL was liable to corporation tax on the superprofits allocated to Cayman LP by BCM LP notwithstanding that those amounts were allocated to Fyled under Cayman LP’s limited partnership agreement (the profit allocation issue); and
2. BCMCL was entitled to relief on the interest on its loan from RBS used to acquire the interests in BCM LP on the basis that the interest related to a trading loan relationship (the interest deductibility issue).

BlueCrest had lost on both points in front of the FTT and the UT, although for different reasons to the CA decision. In this hearing, HMRC had raised the new argument that the UT's decision on the profit allocation issue should be upheld on the basis that the arrangements, viewed realistically, were caught by the relevant legislation, construed purposively, applying a *Ramsay* approach on the basis that the TRS arrangement meant that BCMCL, and not Fyled, was entitled to the superprofit from of Cayman LP.

The profit allocation issue

The first question before the CA was to assess whether all the partners in the Cayman LP became members in BCM LP (and its successor vehicle BlueCrest Capital Management LLP). If Fyled was a partner in BCM LP, the superprofit could be allocated by BCM LP to Fyled directly as a partner (rather than it passing through Cayman LP/BCMCL).

BlueCrest sought to apply the findings in the *Major v Brodie* case to argue that the partners in the top level of stacked partnerships became partners of the bottom, operating partnership. The FTT and UT (for different reasons) came to the conclusion that the partners in the Cayman LP were not partners in BCM LP and/or members of BCM LLP. They distinguished this case from *Major v Brodie* on the basis that each participant in the latter case was aware that the two partners in the top partnership were participating in the business of the bottom partnership whereas, in this case, the individual partners in BCM LP were not aware of and had not consented to Fyled (or any other partner in Cayman LP other than BCMCL) becoming partners in BCM LP (or members in BCM LLP) and the requirements of the BCM LP partnership agreement had not been followed to allow them to become partners in it.

The CA agreed with HMRC (and the FTT and UT) that Fyled did not become a partner in BCM LP simply by virtue of its membership of Cayman LP. The CA also rejected the alternative argument that, as a matter of substance and reality, Fyled became a partner in BCM LP. Thus, the superprofits were allocated to Cayman LP, acting through its general partner BCMCL, and not to each partner in Cayman LP.

Having decided that only BCMCL, as general partner of Cayman LP, was entitled to the superprofit allocation from BCM LP, the CA then had to consider whether BCMCL was subject to UK corporation tax on those profits or whether Fyled was subject to tax on the profit because of its entitlement to them under the Cayman LP partnership agreement.

The starting point was that BCMCL, as the partner in BCM LP, was subject to corporation tax on the profits under section 5(2) CTA 2009 as a result of being treated as carrying on BCM LP's trade through its UK permanent establishment. BlueCrest argued, however, that BCMCL was not subject to corporation tax on the profits because it received them in a "fiduciary or representative capacity" so that section 6 CTA 2009 applied.

HMRC submitted, firstly, that a partner does not act as a fiduciary for another partner when receiving profits or income belonging to the partnership (with no discussion on whether the general partner of a limited partnership had any special status in this regard). Secondly, and alternatively, HMRC argued that BCMCL should be treated as receiving the profit in other than a fiduciary or representative capacity applying a *Ramsay* approach to the overall arrangement, including the TRS between Fyled and Cayman Holdco and the arrangement for Cayman Holdco to contribute any amount received by it under the TRS to BCMCL. Under these arrangements, HMRC argued, the superprofit paid to BCMCL and then paid to Fyled was, through the sequence of preordained transactions, returned to BCMCL minus only the fee retained by Fyled for its participation in the arrangement. In reality, BCMCL was the entity entitled to the superprofit and, therefore, could not rely on the fiduciary exception.

The CA found little difficulty in agreeing to this second, alternative approach and the requirement to examine the totality of the transactions, including the financing arrangements, when deciding the capacity in which BCMCL received the profit from BCM LP. Adopting this approach, the CA held that BCMCL received the profit from BCM LP in other than a fiduciary or representative capacity and so was subject to corporation tax on it applying section 5(2) CTA 2009.

While the CA did not consider in detail the status of a general partner of a limited partnership in particular and whether it acts in a fiduciary capacity in general terms, it did disagree with the UT's approach to the profit allocation issue, which was simply to say that section 1259 CTA 2009 stated that a non-UK resident partner was subject to UK tax on the profits allocated to it by a partnership to the extent that it would be had it carried on the partnership's trade and that this was sufficient to charge BCMCL, as the registered partner in BCM LP, to corporation tax on the profits allocated to it. The CA agreed with BlueCrest that section 1259 was, itself, merely a computational provision and that the relevant charging provision(s) (sections 5 and 6 CTA 2009) must be applied to determine the actual tax on the profits allocated to the non-UK resident partner. By then accepting that section 6 CTA 2009 was potentially relevant to BCMCL's tax, and determining that it did not apply adopting a purposive construction to the arrangements as a whole, there is a strong implication that, in ordinary circumstances, the non-UK general partner of a limited partnership that was a partner in a partnership conducting a trade in the UK would not be subject to corporation tax on profits allocated from the bottom partnership because, in those circumstances, the general partner would receive its profit allocation in a fiduciary or representative capacity.

The interest deduction issue

The second point considered was whether BCMCL was entitled to a deduction for its interest expense on the loan from RBS as a trading loan relationship debit because it had borrowed the money "for the purpose of [its] trade", being BCM LP's trade that it was treated as conducting as a partner in BCM LP. HMRC argued that BCMCL was not entitled to a trading loan relationship deduction because the money borrowed from RBS had not been used for the purpose of BCM LP's trade but for the purpose of Cayman LP's separate investment activity of becoming a partner in BCM LP. *Major v Brodie* was again distinguished on the basis that, in that case, the amount borrowed by the top partnership was used directly for the purpose of the activity of the bottom partnership.

The CA had little difficulty in concluding that BCMCL was not entitled to a trading loan relationship deduction for the interest on the loan from RBS because the purpose of the loan was to acquire the capital in BCM LP and not for the purposes of the trade of asset management carried on by BCM LP.



Given the attempt to apply principles from *Major v Brodie* to a wholly different set of facts and this case involving such a structured arrangement, it is not surprising that BlueCrest lost on the interest deduction point, although it might be considered that the *Ramsay* approach to the profit allocation issue is sweeping given that BCMCL was the partner in BCM LP only in its capacity as general partner of Cayman LP.

## **Consideration not reduced for target company loan repayment**

In *McEnroe and another v HMRC*, the UT has upheld the decision of the FTT against Ms McEnroe and Ms Newman, the two shareholders in Kingly Care Partnership (Kingly), that the consideration stated in the share purchase agreement (SPA) under which they sold their shares in Kingly should be reduced because some of it was actually used to repay a debt owed by Kingly to Allied Irish Bank (AIB).

In circumstances similar to those in the old *Spectros* case, the SPA stated that the consideration for the sale of the shares was £8 million plus an earn out and subject to a working capital adjustment that would increase or decrease the £8 million. Kingly had an outstanding debt to AIB of just under £1.1 million. On completion of the transaction, the buyer paid £6.9 million to the appellants and £1.1 million to AIB in discharge of Kingly's debt.

In their self-assessment returns, the appellants each declared their gain as half of £6.9 million (plus a working capital adjustment of about £145,000 in their favour and the earn out payment that they received later). HMRC disputed this amount and assessed them on the amount of consideration as stated in the SPA (i.e. £4 million each plus the working capital increase and the earn out). The appellants appealed to the FTT on the grounds that HMRC's assessment was incorrect as they had not received the amount of the proceeds that was paid to AIB on behalf of Kingly, and later sought to have the SPA rectified to correctly reflect the intention of the parties that the consideration was £6.9 million and the buyer agreed to procure that Kingly would repay AIB (this request was refused on the basis that it was out of time although the UT noted in passing that the terms of the SPA probably did not reflect the intention of the parties). The FTT agreed with HMRC, finding that there was no ambiguity in the terms of the SPA and that it didn't support the view that the contract was for the sale of the shares and the procurement that Kingly would repay its loan.

In this appeal, the appellants claimed that the FTT should have considered the completion accounts clause which included the working capital adjustment and that this should have taken Kingly's debt to AIB into account to reduce the consideration payable under the SPA to £6.9 million. The UT rejected this argument and found that the FTT made no error of law in not assessing this point as neither party had put it forward to the FTT.

The UT agreed with HMRC that the appellants were in effect mounting a disguised challenge to the FTT's factual findings and that they did not have basis to do so because the FTT had been entitled to ignore consideration adjustment terms in the SPA which the parties had not argued for. Accordingly, the UT dismissed the appeal and agreed with HMRC that the appellants' CGT liability should be based on the £8 million consideration stated on the face of the SPA.

The case highlights the importance of clearly stating in a SPA what the consideration actually due to the sellers is and how the buyer will discharge, or will procure the discharge of, any liabilities of the target that need to be paid on completion or around completion and how the consideration might be adjusted for any liabilities that will remain in place.

## **Self-invested pension plan services not exempt from VAT as insurance transactions**

In *Intelligent Money Limited v HMRC*, the UT has upheld the FTT's decision that services in respect of the provision, operation and administration of self-invested pension plans (SIPPs) for the SIPP holders were not exempt from VAT as insurance transactions.

The case concerned the provision by Intelligent Money Ltd (IML) of services related to the setting up and administration of SIPPs. Until 2014, IML charged and accounted for VAT on services it provided to members but, following a review, it subsequently changed its position and claimed that it had incorrectly accounted for VAT on these supplies and that these services should be exempt from VAT under the provision of insurance exemption in Group 2 Schedule 9 VATA 1994. IML sought to recover the VAT from HMRC. HMRC rejected the claim and IML appealed to the FTT.

IML submitted that the supplies made by it were insurance transactions as all the relevant elements of an insurance transaction had been established by reference to EU case law, namely that (i) the insurer was defined by reference to the transaction, (ii) the annual fees, charges and some contributions were paid in advance and represented the premiums paid, (iii) IML agreed to provide a service (the payment of life and death benefits) and (iv) the service was to be provided on the materialisation of risk covered (for instance, the payment on the death of a SIPP holder).

HMRC submitted that what was needed for an insurance transaction was that the insurer provided the insured with some sort of protection against a known risk. The FTT summarised the requirement for the purposes of the VAT exemption, as determined by the CJEU, as being that “the insurer undertakes in return for prior payment of the premium, to provide the insured, in the event of materialisation of the risk covered, with a service agreed when the contract was concluded”. HMRC argued that the members of the SIPP did not pay a premium and that their contributions were not consideration for any supply. The only payments that the members of the SIPP made in advance were annual fees, which HMRC argued were paid for a continuing service and not for the provision of the benefits on the materialisation of a risk. HMRC also submitted that IML did not undertake to provide life and death benefits but was making payments as trustee of the fund from the members’ own accumulated pension pots and that IML’s SIPP did not cover any “risk” since all that the SIPP members were entitled to was the return on the investments that they had funded. Accordingly, the FTT had held that it was clear from case law that the VAT exemption for insurance requires the insurer to take on risk in return for the payment of premiums and found that IML’s SIPP was an investment product and not an insurance product.

In this case, the UT examined the CJEU authority in detail and identified that for an “insurance transaction” to exist for VAT purposes the essential features are for the insurer to undertake, in return for prior payment of a premium, to provide the insured, in the event of the materialisation of the risk covered, with the service agreed when the contract was concluded.

In dismissing the appeal, the UT found that the arrangements in the IML SIPP were such that the cost of life and death benefits provided to the member were borne by each member's own fund and were, therefore, outside the scope of the insurance exemption. Furthermore, the payments made by the members were not prior payments of a premium, the annual fees were simply paid for the annual operational services and the contributions themselves were not in consideration for any supply.

The decision is not surprising given the recent decisions of the CJEU, which highlight that the definition of "insurance" for the purposes of the VAT exemption is narrower than the general definition used for regulatory purposes that IML tried to rely upon. While previous HMRC guidance (in VAT Notice 701/36) had suggested that the wider definition of insurance should be accepted, this guidance was updated in August 2023 to correspond with the prevailing CJEU approach and that taken by the UT.

## **Loan administration services not exempt from VAT**

In *Target Group Ltd v HMRC*, the SC has unanimously upheld the CA's decision (and FTT's and UT's decisions) that loan administration services that Target Group Ltd (Target) provided to a bank were not exempt from VAT.

In summary, Shawbrook Bank Limited (Shawbrook) was in the business of making loans and outsourced the management of the loans to Target. Target was responsible for a range of activities including setting up direct debits, issuing instructions for the movement of funds between bank accounts belonging to Shawbrook and calculating interest payment and principal loan repayment amounts. Target claimed that the entirety of the services that it provided to Shawbrook constituted a single supply that fell within the financial services VAT exemption as "transactions ... concerning ... payments, transfers, debts ... but excluding debt collection". In particular, Target relied on the assertion that it procured payments from borrowers' bank accounts to Shawbrook's bank accounts by giving instructions for payment which were then automatically carried out through the BACS system and input entries into the borrowers' loan accounts with Shawbrook.

HMRC argued that the finance exemption did not apply as prior CJEU decisions had made it clear that it required the execution of an order for the transfer or payment and to change a party's legal and financial position. HMRC said that giving instructions for payment is a prior step to execution rather than being part of the process of execution.

Target contended that its services fell under the financial services exemption as it gave instructions for money to move from the borrower's account to Shawbrook's accounts (the payments/transfers issue), and because it input entries into the borrower's loan accounts (the loan accounts issue). The SC rejected this argument, holding that, in interpreting the words of the provision strictly as was required for an exemption, the giving of instructions is not enough even if the instructions inevitably result in a payment or transfer. The SC held that it is necessary for Target to be involved in carrying out or executing the transfer or payment. In other words, Target must be involved in the "materialisation" of the transaction. On this basis, the SC found that the element missing in Target's activities was the functional participation and performance in the money transfers.

Target also suggested that making accounting entries is the standard modern means of effecting movements of money and was enough to effect a payment or transfer. It said that its role of debiting and crediting the borrower loan accounts with Shawbrook had made changes to the financial and legal position of the parties, which was sufficient to fall within the VAT exemption. The SC rejected this argument and, drawing on the FTT's factual findings, noted that the entries made in ledgers were of "expected payments" which were "assumed to be made" rather than actually effecting payments. The SC said that such an entry could not effect a payment or transfer or result in a change in the legal or financial position of the parties.

The decision has confirmed how closely a person must be involved with the actual payment or transfer to be able to apply the VAT exemption.

## **Other UK Tax Developments**

### **Interaction between EU VAT law and the Retained EU Law (Revocation and Reform) Act**

HMRC has published a [policy paper](#) and [draft legislation](#) dealing with how the interpretation of UK VAT and excise law that relies on EU law will remain after the introduction of the Retained EU Law (Revocation and Reform) Act 2023 (REUL) which will repeal the supremacy and direct effect of EU law in the UK.

HMRC's policy paper and draft legislation is intended to clarify the application of EU law in interpreting UK VAT and excise law and states that the government is taking a bespoke approach so that these laws can still be interpreted as Parliament intended. Broadly, the approach to be taken is that EU law and interpretation will still apply to UK VAT and excise law unless it is disapplied by UK legislation enacted after the introduction of REUL so providing continued certainty to the application of UK VAT law.

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