

UK Tax Round Up

March 2024

Welcome to March's edition of our UK Tax Round Up. This month has seen a number of interesting cases covering a range of issues, from the deductibility of costs against employment income to the place of effective management of a Mauritian trust. In addition, the Chancellor announced significant changes to the UK's so called "non dom" rules in the Spring Budget and the new Finance Bill has been published.

UK Case Law Developments

***Ramsay* principle applied to dividend replacement scheme**

In *Clipperton v HMRC*, the Court of Appeal (CA) has agreed with the Upper Tribunal (UT) and First tier Tribunal (FTT) that a "dividend replacement scheme" was ineffective.

The scheme in question was designed to allow individual shareholders to extract profits from their companies with no liability to income tax. In this case, the two owners and shareholders of Winn & Co (Yorkshire) Ltd (the Company), an accounting firm, implemented the "Aikido" scheme in order to extract £200,000 of distributable reserves. In prior years they had paid themselves dividends subject to income tax.

The scheme involved the Company setting up a wholly owned subsidiary (the Subsidiary) with two shares, an A share held by the Company and a B share issued to RT Corporate Trustee Ltd (the Trustee) which held it as nominee for the Company. The A share was entitled to vote and to receive assets upon a winding up and other distributions. The B share was entitled only to distributions. Different distributions could be paid on the A and B shares. The Company settled its rights from the B share on a trust which, subject to other minor interests, entitled the Company's two shareholders to the benefit of any income arising in the 18 month period from establishment and entitled the Company to any income from the B share after that time.

Following establishment of the trust, the Company subscribed £200,001 for a new A share in the Subsidiary. The Subsidiary reduced its capital (including share premium) by £200,000 and paid that amount as a dividend on the B share to the Trustee, which paid the large majority of it to the Company's shareholders as beneficiaries of the trust.

The shareholders argued that they were not subject to income tax on the receipt from the trust because the settlements legislation in sections 624 and 625 ITTOIA applied to impose tax only on the Company, which had a small interest in the B share dividend under the trust, as the settlor of a settlor interested trust. In addition, the shareholders argued that they were not subject to tax on their receipt under section 353 ITTOIA because they did not receive and were not entitled to a distribution “in respect of” the B shares.

The FTT and UT had rejected these arguments and held that the shareholders were subject to income tax on their distributions from the trust under section 353 ITTOIA applying the *Ramsay* principle to say that the shareholders did receive their distribution “in respect of” the B shares because, notwithstanding that they weren’t the holders of the B shares, the shares were the source of their receipt through a highly structured tax avoidance arrangement. In addition, the FTT agreed with HMRC that the shareholders, and not the Company, were the settlors of the trust as the guiding minds behind the whole arrangement. The UT agreed on both points.

The shareholders appealed and, in particular, referred to the recent CA case of *Khan v HMRC* (discussed in our [May 2021 UK Tax Round](#)) to support the argument that section 353 ITTOIA did not apply to the shareholders. The CA considered the arguments both in the absence of and applying the *Khan* decision.

Ignoring it, the CA had no difficulty, applying the general *Ramsay* principle of purposive application of the statute to a realistic view of the facts, in agreeing with the FTT and the UT that the shareholders had received a distribution in respect of the shares that they held in the Company. The courts were entitled to ignore steps planned in advance as part of a tax avoidance scheme and to view the scheme as a whole, which led to the conclusion that the Company had paid out its distributable reserves (actually used to purchase the additional A share in the Subsidiary) to the shareholders “in respect of” their shares in the Company. The reality was that, as shareholders, they wanted to secure a dividend from the Company and did receive the amount that would otherwise have been paid as a dividend. The CA described it as a “paradigm case for the application of the *Ramsay* principle”.

Applying *Khan*, the CA came to the same conclusion. In *Khan*, the taxpayer (Mr Khan), who acquired shares in a company just before a number of the shares were repurchased by the company and then paid the amount received for the repurchase to the previous owners of the shares as consideration, was taxed on this distribution having argued that the *Ramsay* principle should be applied to treat the sellers as receiving or entitled to it. The CA in *Khan* held that Mr Khan did receive and was entitled to the distribution notwithstanding his obligation to pay the same amount to the share sellers and not retain the economic benefit from it.

In the current case, the CA held that the *Khan* decision was not relevant as it was only concerned with whether Mr Khan received or was entitled what was accepted to be a distribution in respect of the shares that he held. The question in this case was what is a “distribution in respect of shares”.

The case highlights both how the *Ramsay* principle can be applied to consider the overall effect of closely articulated arrangements with intended tax consequences that might be considered divergent from the overall economic consequences and how dangerous it can be to try to rely on conclusions from other cases without a very clear understanding of exactly what those cases decided and why.

Footballer’s agent fees not deductible from employment income

In *Niasse v HMRC*, the FTT has held that fees paid to his agent by a professional footballer when he was moving clubs were not deductible from his employment income. While unsurprising, the case is a useful reminder of how restrictive the deduction from employment income rule is and how it differs from the less restrictive deduction from trading income provision.

Mr Niasse was transferred from Lokomotiv Moscow to Everton in 2016. Prior to the move, he entered into a Standard Representation Contract with an agent to negotiate and agree to the transfer. Mr Niasse, the agent and Everton then entered into a tripartite contract and Mr Niasse entered into a Premier League Contract with Everton. The agent was entitled to 10% of Mr Niasse’s basic gross income. Mr Niasse claimed a deduction for the agent’s fee under section 336 or, alternatively, 352 ITEPA 2003.

Under section 336 ITEPA, an employee can claim a deduction against their earnings for an amount that the employee “is obliged to incur and pay as holder of the employment” where the amount is incurred “wholly, exclusively and necessarily in the performance of the duties of the employment”.

Mr Niasse’s claim was based on the fact that, in accordance with the terms of the Premier League Contact which he had to comply with to sign for Everton, he was requested to act in accordance with Everton’s lawful instructions. Everton required him to engage an agent. HMRC argued that his duties as a player for Everton did not oblige him to incur the agent’s fees and that the tripartite contract was not part of the contractual framework for his employment.

The FTT considered the relevant case law, which supported a very narrow approach to what was deductible. In respect of the obligation to incur the expense in section 336(1)(a) ITEPA, the person must be obliged “by the very fact that [he/she] holds that office and has to perform its duties”. In addition, it is not a question of whether the employer requires the expense to be incurred but whether the duties do. It follows from this that an expense incurred to obtain an employment is not deductible. Applying this test, and rejecting Mr Niasse’s argument that the terms of the tripartite agreement were part of the contractual framework of his employment with Everton, the FTT held he was not obliged to incur the agent’s fee as holder of his employment.

In respect of the second, “wholly and exclusively”, limb in section 336(1)(b) ITEPA, the FTT noted that the duties in respect of which the expense is incurred are those that are “intrinsic” to the employment rather than anything “collateral” to it. In the *Madeley* case, it was stated that the expense incurred in engaging an agent to negotiate terms of employment will not ordinarily be deductible as the services are not used in performing the duties of employment. Accordingly, the FTT decided that the agent’s fees were not incurred by Mr Niasse “wholly and exclusively and necessarily in the performance of [his] duties” for much the same reason as applied to the “obligation” to pay the fees under section 336(1)(a) and because the work of the agent was not an integral element of this continuing employment.

As a secondary matter, Mr Niasse argued that he could claim the deduction under section 352 ITEPA as an agency fee included by “an entertainer”. The FTT rejected this also on the basis that entertainer was defined as “an actor, dancer, musician or theatrical artist” and that this did not cover a professional footballer as, although his job was in general terms to entertain, he was not a “theatrical artist”.

The case provides an interesting reminder of how closely linked expenditure must be to actual performance of duties of employment for it to be deductible from earnings.

Place of effective management of a Mauritian trust in the UK

In *Howarth v HMRC*, the UT considered where the place of effective management (POEM) of a trust established for a tax avoidance scheme was for the purpose of the UK/Mauritius double tax treaty. The UT agreed with the FTT’s decision that it was in the UK and not in Mauritius.

The case involved a so called “round the world” scheme, in which the taxpayers transferred assets to a trust which they wanted to be treated as managed in Mauritius to avoid capital gains tax on the disposal of the assets. In order to achieve this, the taxpayer replaced the Jersey trustees of certain family trusts with trustees resident in Mauritius, the trusts then sold some shares that they held and the Mauritian trustees retired and were replaced by English trustees. The taxpayers claimed that the gain was not subject to capital gains tax because the trust was resident in Mauritius for the purpose of the UK/Mauritius double tax treaty which reserves the right to tax on capital gains on the sale of shares to Mauritius.

The appeal from the FTT’s decision was on the basis that the FTT had applied the wrong test in determining the trusts’ POEM. The taxpayers argued that it should have applied to UK’s “central management and control” (CMC) tool applied by the CA in *Wood v Holden*, which held that a non-UK board of directors deciding to implement a scheme devised and recommended by people in the UK had its CMC outside the UK, where the directors took their decision. The CA held that the place of CMC would only be outside the jurisdiction in which the directors took their position if the decision making process of the company in question had been “usurped” by a person or persons in a different jurisdiction. This contrasted with the approach taken by the CA in the later *Smallwood* case that involved a similar scheme to that in the present case.

The basic tax position, ignoring UK/Mauritius tax treaty, was that because the trust had UK resident settlors who had an interest in the trust and the trust had UK resident trustees for part of the tax year in question, the settlors were subject to UK capital gains tax on the gain realised by the trust selling the shares. The objective behind the scheme was to make the trustees of the trusts Mauritian resident at the time of the share sale and use Article 13 of the UK/Mauritius double tax treaty which states that only the jurisdiction in which the seller is resident can tax the capital gain. Article 4 of the treaty states that the trusts are resident in the jurisdiction in which their “place of effective management” is situated where they could be resident in both the UK and Mauritius.

The UT then discussed in detail the test of POEM and the CA’s decisions in *Wood v Holden* and *Smallwood*. While accepting that the test for POEM was, in substance, the same as the test for CMC, the UT placed emphasis on the test for the trust being where the POEM of the trustees as a continuing body was. Applying the approach that it considered the CA in *Smallwood* had taken, it stated that the relevant period for assessing the POEM of the trusts was not simply the date on which the trustees took the decision to sell the shares but was the longer period over which the wider scheme was devised and implemented. The UT accepted that the FTT had been entitled to reach the conclusion that the POEM of the trusts was the UK and not Mauritius on the basis applied in *Smallwood* that the period over which to make the assessment was the period over which the scheme was devised and implemented and not the date on which the decision to sell the shares was taken.

The case provides a useful reminder of the dangers in applying a concept (or principle) from one case to another where the concepts are highly fact, and context, specific and in seeking to apply the relevant principle to a snapshot in time when a more realistic approach might be to consider the circumstances of a wider transaction.

Contract not created by reference to intentions of one party

In *Delaney v HMRC*, the FTT has held that the taxpayer was not entitled to claim entrepreneurs’ relief (ER) on the sale of shares because the date of disposal was later than that claimed.

Ms Delaney ran a nursery school business as a sole trader which she transferred, along with the goodwill of the business, to a company that she owned, Miss Delaney's Nursery Schools Limited (MDNSL). She claimed ER on the gain that she realised on transferring the business.

The case related to the date on which she transferred her beneficial interest in the business since an anti-avoidance rule was introduced in respect of transfers made after 3 December 2014 which meant that ER could not be claimed on a transfer to a company connected with the transferor (in section 169L TCGA 1992).

Ms Delaney claimed that she had entered into an oral agreement to sell the business prior to 3 December 2014 and that, applying section 28 TCGA, the date of disposal was the date that the unconditional contract was entered into. While the effect of section 28 was not in question if there had been an unconditional contract to sell, HMRC argued that no such contract was entered into under September 2015. Following HMRC's assessment, it was for Ms Delaney to prove that an enforceable contract was in place.

Ms Delaney ran two nursery schools from church property which she licensed. The licences were in her name. In 2011 she was advised that she should consider incorporating the business to protect herself from personal liability and with an eye on a possible future sale. The licences for the nurseries were due for renewal in August 2014. The intention to transfer the business to MDNSL at some time was raised as part of the discussion around renewing the licences as, if and when the business was transferred, the licences with Ms Delaney would have to be replaced with leases with MDNSL. There was evidence that discussion around the business incorporation had taken place between 2011 and 2014. This included a letter from October 2013 from Ms Delaney's legal advisers stating that they had been instructed to incorporate the business. In order to minimise costs, no business transfer agreement was prepared since it was considered that there would be no disagreement between Ms Delaney and MDNSL. In addition, the lawyers did not ultimately incorporate the second company that was proposed to hold the second nursery business, prepare an employment contract for Ms Delaney, prepare standard employment terms for the business's employees or prepare a licence agreement for the use of the "Miss Delaney" name by MDNSL as was envisaged in the letter of 23 October 2013. The FTT noted that the trademark "Miss Delaney's" was registered in Ms Delaney's name in March 2014 but was not formally licensed to MDNSL.

MDNSL was incorporated in November 2013, at which time Ms Delaney informed the church that she intended to transfer the business to it and sought to enter into leases for the two sites with MDNSL. However, one of the sites would not agree to enter into a lease and would only agree to extend Ms Delaney's personal licence. This led to some protracted negotiation and attempt by Ms Delaney to find alternative premises, but, in August 2014, when Ms Delaney was very keen to fix the arrangements so that she could be sure of having premises for the next year, she entered into renewed personal licences. Ms Delaney then continued to prepare MDNSL to be in a position to operate the schools, including applying for the required OFSTED registration. This was obtained in September 2015, with the schools having operated using Ms Delaney's personal licences for the school year 2014/15.

On the basis of all of the evidence, the FTT decided that there had not been a formal agreement between Ms Delaney and MDNSL that amounted to an intention by both parties to contract for the sale and purchase of the goodwill and any other assets of the business until sometime after December 2014, when MDNSL was in a position to operate the schools, had received planning permission to operate a school from a new, leased premise, had completed its OFSTED application and, importantly, had agreed a consideration to be paid for the business.

This is one of those cases in which the date that an enforceable, unconditional contract is entered into is crucial and highlights the importance of clear documentary evidence of the intention of the parties to support any claim that such a contract was in place at the right time.

Distribution out of share premium of Jersey company a dividend

In *Beard v HMRC*, the UT has agreed with the FTT that a distribution made out of share premium by a Jersey incorporated company was subject to income tax as a "dividend" paid by the company and was not exempted from income tax as a "dividend of a capital nature".

Mr Beard was a shareholder in Glencore PLC (Glencore), a Jersey incorporated and Swiss domiciled company. Mr Beard received cash distributions in the tax years 2011-12 to 2015-16 and in the tax year 2015-16 received a distribution in specie of shares in a subsidiary of Glencore (together the Distributions). All of the Distributions were paid out of Glencore's share premium HMRC assessed Mr Beard to income tax on all of the Distributions pursuant to section 402 ITTOIA 2005. Mr Beard claimed that the Distributions were not subject to income tax because they were "dividends of a capital nature" as referred to in section 402(4). The UT also agreed to consider a claim by Mr Beard that the distribution in specie of the subsidiary shares was a dividend of a capital nature even if the cash distributions were not.

The UT provide a thorough analysis of the law in determining whether or not a payment by a non-UK company is income or capital in nature. Following the decision on *Rae v Lazard* and other cases, the requirement is to determine whether under the relevant law of the entity in question the mechanism used for the distribution means that the corpus of the asset (here the Glencore shares or the capital attached to the shares) is left intact or is eroded. The UT also explained how Jersey company law had been changed in 2002 to allow the distribution of share premium subject to the provision of a solvency statement by the company's directors and how the Jersey company law, as amended in 2002, included a mechanism for making distributions, including out of share premium account as well as more stringent provisions for the reduction of share capital. Glencore had used the general distribution mechanism to pay the Distributions. In relation to the income or capital question, the UT stated that the question was not what the source of the distribution was but what the machinery used to make it was.

Having considered the UK law in respect of distributions by non-UK companies and the relevant Jersey law and mechanism used to make the Distributions, the UT concluded that the Distributions were dividends and were of an income, rather than a capital, nature since they were paid out of a reserve that Jersey law stated was not protected as share capital and was paid using the standard mechanism for paying dividends by a Jersey company.

The UT then considered briefly Mr Beard's contention that the distribution in specie of the subsidiary shares was in the nature of capital. The UT disagreed stating that there was no reason to distinguish it from the cash distributions and that if it were the case that an in specie distribution were, by nature, capital then companies could simply turn cash into assets before distributing them.

The case provides a useful reminder of the process required to try to determine whether distributions by non-UK companies are income or capital in nature and the requirement to fully understand the local law mechanism used for the distribution.

VAT on services treated as supplied after recipient left VAT group

In *Prudential Assurance Company Limited v HMRC*, the CA has upheld the decision of the UT that services which were actually supplied to a recipient in a VAT group but which were invoiced after it had left the group, were subject to VAT because the invoice fixed the time of supply. We discussed the UT's decision in our March 2023 edition of *UK Tax Round Up* [ADD LINK].

In broad summary, the facts of the case were that Prudential had received services from an investment management company that was in its VAT group at the time that the services were actually supplied. The fees for the services included two elements, an annual management fee and a contingent performance fee. There was no dispute over the VAT treatment of the first element, which was invoiced each year while the investment manager was in the Prudential VAT group. The performance fees, however, were not invoiced until after the investment manager had left the VAT group.

The question to be considered by the CA was whether section 43 VATA 1994, which treats all services supplied by one VAT group member to another as supplied by and to the representative member of the VAT group and so not a service for VAT purposes, should be applied at the time that the service is actually supplied or at the time that it is deemed to be supplied under the Value Added Tax Regulations 1995, which treat continuous supplies as supplied when they are invoiced or paid for.

The FTT had allowed Prudential's appeal on the basis of the decision in *B J Rice & Associates v Customs & Excise Commissioners*, which involved services supplied and invoiced by a supplier which was not VAT registered which were paid for after the supplier became VAT registered. The CA determined in that case that the time of supply determined "when" a taxable supply was made but not "whether" one was made and the reality of the supply was that it was made when the supplier was not registered for VAT.

The UT had overturned that decision on the basis that it was bound by a number of House of Lords cases that had held that the time of supply rules did operate to fix the time at which the circumstances relevant to assessing the VAT treatment of the supply should be considered. In each of *Thorn*, *Svenska* and *RSA*, the House of Lords had determined, on a slightly different issue to the one in question here, that the time of supply rules fixed the time at which the circumstances relevant to the VAT provision in question should be applied. By majority, the CA considered that it was bound by those decisions, so that the question of whether section 43 VATA applied to the performance fees, and the service in respect of which they were paid, had to be tested at the time that the fees were invoiced. At that time, the investment manager was not in the Prudential VAT group, so the fees were subject to VAT.

In addition to the technical point and the effect of the time of supply rules and their reach through the VAT rules as a deeming provision, the case is interesting in its discussion of precedence and how tightly the lower courts are bound by decisions of the higher courts, and how different judges might have the leeway to take different decisions on that presented with the same cases because the facts of the precedent cases will always vary to some extent from the case in question.

Other UK Tax Developments

Announcement of changes to "non dom" rules

In his Budget speech on 6 March, the Chancellor announced changes to the UK's rules for taxing non-UK domiciled individuals (the non dom rules) to be introduced from April 2025.

The proposed changes are summarised in our [TaxTalks article](#).

In broad summary, the new rules will, from April 2025, replace the current non dom remittance basis tax regime with a “foreign income and gains” (or FIG) regime that will exempt non-UK source income and capital gains arising to individuals who become UK resident after a period of at least 10 years of non UK residence for four years following becoming UK resident. After that four year period, the individuals will be subject to UK income and capital gains tax on their worldwide income and gains, as is the case currently for UK resident and domiciled individuals. There are also transitional rules applying to individuals who are currently taxed under the non dom remittance basis or who have been UK resident for less than four years following a period of at least 10 years of non residence.

The changes will also lead to the repeal of the concept of non-UK domicile and changes to the current non-UK trust and inheritance tax rules.

Individuals who might be affected by the new rules should seek specialist advice as the proposal is relatively detailed and wide ranging.

Publication of the Finance (No 2) Bill 2024

On 13 March, the new Finance Bill was published including the draft legislation for the various tax proposals announced in the Spring Budget. At 22 pages, it is relatively short.

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