UK Tax Round Up

December 2024

Welcome to the December 2024 edition of our UK Tax Round Up. This month has seen interesting decisions on the basis for rescission of an arrangement with adverse tax consequences, the treatment of a loan from an EBT, the tax status of a payment relating to resignation as a director and the meaning of interest in the context of a redress payment.

UK Case Law Developments

High Court allows rescission of EBT sub?trust arrangement

In *JTC Employer Solutions Trustee Ltd and others v Garnett and another*, the High Court (HC) considered the request for rescission of an arrangement involving sub-trusts in a number of employee benefit trusts (EBTs) established by the Janus Henderson group. The HC granted the request for rescission on the basis that the sub-trusts had been established under a mistake as to the tax consequences of setting them up and that the other requirements for rescission were satisfied.

The Janus Henderson group had established a number of EBTs with JTC Employer Solutions Trustee Ltd (JTC) as their trustee. The EBTs had been set up so as to fall within the scope of section 86 IHTA 1984 (section 86) and to benefit from the inheritance tax advantages provided by it. It was accepted that the EBTs did satisfy the requirements in section 86 as they were established on terms that allowed the EBT assets to be applied only for the benefit of Janus Henderson group employees as a class and the potential beneficiaries included all or most of the group’s employees.

The terms of the EBTs allowed Janus Henderson and JTC to set up sub-trusts under each EBT with trust assets linked to the sub-trusts and each sub-trust only benefiting a named employee or their family members. Certain sub-trusts were set up with EBT assets allocated to them. HMRC argued that the existence and use of the sub-trusts meant that the sub-trusts and the assets allocated to them did not qualify under section 86 because those assets were not available to the entire class of Janus Henderson group employees. This was reflected in HMRC's published guidance and a 2012 published response to frequently asked questions as part of a broader EBT settlement process that was being entered into.

In 2015, Janus Henderson entered into a settlement agreement with HMRC in respect of income tax and national insurance contribution liabilities triggered by the sub-trusts but did not agree the inheritance tax position.

JTC and the relevant Janus Henderson group companies applied to the HC for rescission of the sub-trust arrangements so that the EBTs would continue to benefit from section 86. In a case for rescission that might result in a loss of tax revenue, HMRC is entitled to join the proceedings and put its case for the rescission to be denied. In this case, HMRC did not join the proceedings but did send a letter setting out why it considered that the request for rescission should not be granted. The main reasons were that (i) granting rescission would prejudice the wide range of taxpayers by reducing the tax revenue from these arrangements and (ii) Janus Henderson had entered into a "complex tax avoidance arrangement" with the EBTs and the sub-trusts and was seeking relief from their tax consequences through the rescission. The HC considered and rejected these as reasons to refuse the request for rescission because HMRC should have joined the proceedings if it wished to make these points that were outside the scope of the evidence before the HC and, in respect of the "complex tax avoidance arrangement", there was no question that the EBTs would have qualified under section 86 IHTA but for the sub-trust arrangements and all that the HC had to consider was whether that arrangement could be rescinded.

As a general matter, the HC has the power to rescind "voluntary dispositions" made under a mistake. The HC accepted that the establishment and funding of the EBTs and the allocation of assets to the sub-trusts was a voluntary disposition and so capable of rescission.

The HC set out the requirements for rescission to be granted as summarised by the Supreme Court (SC) in *Pitt v Holt* and reiterated by the HC in *Kennedy v Kennedy*. These are that there is a distinct mistake, rather than mere ignorance (although such ignorance can lead to a misconception which amounts to a mistake), the mistake may be due to carelessness unless the evidence shows that the person making the disposition deliberately ran the risk of being wrong, the mistake must be sufficiently significant to make it unconscionable for the recipient of the disposition to retain the property (which will generally only be the case where there is a mistake either as to the legal nature of a transaction or as to some matter of fact or law which is basic to the transaction) and the injustice (or unfairness or unconscionableness) of leaving the mistaken disposition uncorrected must be evaluated objectively by the court.

The first question that the HC considered was the basis for the claim of rescission and the nature of the operative mistake that had been made. HMRC had argued that the sub-trusts meant that section 86 did not apply to them but Janus Henderson had not agreed on that point. Janus Henderson did, however, say that they would accept it if doing so meant that the rescission could be granted. Given that the only practical way of determining that question would be to adjourn the proceedings to allow HMRC to finish its enquiry into the arrangements, and that would involve more delay and additional cost, the HC stated that it was entitled to proceed on the basis that HMRC was correct and that a mistake had been made.

The HC then considered the other elements required to grant rescission. In that regard there was plenty of contemporaneous evidence from when the EBTs were stablished, the terms allowing for the sub-trusts and the use of the sub-trusts that the claimants expected that the EBTs (and the sub-trusts) would be within section 86. This was enough for the HC to accept that the sub-trust arrangements had been made under an operative mistake as to their tax consequences. The HC then stated that it did not consider that the use of the sub-trusts amounted to aggressive tax planning so as to mean that Janus Henderson had taken the risk that section 86 would not apply to the sub-trusts. Rather, HMRC did not argue that section 86 would have applied absent the sub-trusts and there was no evidence that Janus Henderson had considered the inclusion of the sub-trusts as risking that result.

The next question was whether the mistake was sufficiently grave to make it unconscionable to leave the sub-trust arrangements in place with the assumed effect that the sub-trusts would not qualify for section 86 relief. The HC decided that it was given the material inheritance tax liabilities that would have arisen had the sub-trusts not qualified for section 86 relief.

The final point was that there had to be an issue capable of being contested between the parties for the rescission to be granted. The parties were JTC and the Janus Henderson companies as claimants and certain of the beneficiaries of the sub-trusts as defendants. HMRC was not a party although the consequence of the mistake was that tax would be due to HMRC. In *Racal*, the court stated that "the court will not order rectification of a document as between the parties or as between a grantor or covenantor and an intended beneficiary, if their rights will be unaffected and if the only effect of the order will be to secure a fiscal benefit". The HC decided, however, that, had the sub-trusts not qualified for section 86 relief and inheritance tax been due, there might have been questions between JTC as trustee of the EBTs and the beneficiaries as to who was liable and how the inheritance tax should be funded. JTC might have claimed that money distributed to the beneficiaries should be returned to it and/or a dispute might arise as between the wider class of beneficiaries of the EBT as to how the inheritance tax should be borne. HMRC argued that rescission should not be granted because JTC and the other claimants had indicated that they would not reclaim the amounts allocated to or distributed to the defendants under the relevant sub-trusts so that rescission would not affect the positions of the parties. The HC decided that this was not necessary and it was sufficient that there had been a mistake as to the satisfaction of the section 86 requirements and that the mistake led to material consequences that might lead to a dispute between the parties and/or the wide class of beneficiaries and, consequently, granted rescission of the sub-trust arrangements.

The case is the latest granting rescission of arrangements because of a mistake as to the tax consequences and provides a useful summary of the requirements for rescission to be granted and an illustration of how the HC might apply its discretion in granting rescission and that, in the required circumstance, rescission might present an effective method of relief from unexpected adverse tax consequences.

Repayable loan from EBT not earnings

In *MR Currell Ltd v HMRC*, the Upper Tribunal (UT) has allowed an appeal against the decision of the First-tier Tribunal (FTT) and accepted that a repayable loan from an EBT to the principal owner of the company establishing and funding the EBT was not earnings under section 62 ITEPA 2003 (noting that the loan was made before the disguised remuneration rules in Part 7A ITEPA were introduced).

Mr Currell (MC) was the principal shareholder in and a director of MR Currell Ltd (MRCL). MC’s wife (KC) was the other shareholder and director. MRCL (and its business previously conducted by MC as a sole trader and with KC in partnership) was successful and generated significant profits over a number of years. During that time MC and KC took small salaries from MRCL (and the business prior to its incorporation) with the majority reinvested or retained. In November 2010, MRCL established an EBT and agreed to fund it with £800,000. The EBT had the discretion to make loans to employees. MC requested a loan of £800,000 from the EBT and the EBT made the loan. The loan was fully repayable. MC used the £800,000 to acquire shares in MRCL from KC. MC provided security over his shares in MRCL to the EBT. It was accepted that this wider transaction was anticipated when the EBT was established and that MC understood his obligation to repay the loan to MRCL if requested and had the resources to do so. It was also accepted that MRCL would not have paid £800,000 to MC as remuneration had the EBT not been established.

HMRC had assessed MRCL to income tax and national insurance contributions on the basis that the payment by MRCL to the EBT was “earnings” of MC under section 62 ITEPA. Section 62 applies to a payment that is (i) wages, salary or fee, (ii) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth or (iii) anything else that constitutes an emolument of employment.

HMRC had argued that the payment by MRCL to the EBT, inevitably linked to the loan from the EBT to MC, fell within section 62(2)(b) ITEPA as giving rise to a benefit obtained by MC. The FTT agreed and stated that “it was inevitable, at the time at which the [payment by MRCL to the EBT] was made by the company to the EBT, that it would be paid by the Trustee to MC by way of the Loan. We have also found that it was more likely than not that the Loan was paid to MC as a reward for the services which he had provided to the company. In our view there is no legal principle which prevents a genuine money loan on commercial terms with a real repayment obligation from being a reward or benefit”.

MRCL appealed the decision of the FTT on the basis that it had erred in law by concluding that the payment by MRCL to the EBT constituted earnings under section 62 ITEPA and that the loan from the EBT to MC constituted a “reward or benefit” for MC within the meaning of section 62(2)(b) ITEPA.

The FTT had decided that it was possible for a repayable loan to constitute earnings, that the payment by MRCL to the EBT had been made in contemplation of the loan from the EBT to MC, that the loan conferred a benefit on MC in a broad sense and that the reason for the loan was to reward MC for his past services to MRCL.

As part of its appeal, MRCL had referred to the provisions in Chapter 7 Part 3 ITEPA relating to employment related loans (in particular, section 188 ITEPA that treated the amount of any such loan released or waived as earnings) and in Chapter 3 Part 10 CTA 2010 relating to loans to participators and argued that these provisions would not be required if the principal amount of loans made to employees or directors were taxable as earnings as a matter of course.

The UT considered the basis on which the FTT had come to its decision and concluded that, viewing the facts realistically, neither the payment by MRCL to the EBT nor the loan from the EBT to MC constituted earnings and stated that “Here, MC has an obligation to repay the Loan, and even when taking account of the findings of fact made by the FTT as to the arrangements being prewired (which included the purchase of the [shares in MRCL] and the loan by KC to the Appellant) and the finding that the loan from KC to the Appellant was repayable to her whenever she wanted, and the FTT’s conclusion that this could be used for their “mutual benefit”, the position remains that MC owns the [shares in MRCL] and has a liability to the [trustee of the EBT]. The money lent to him was not placed unreservedly at his disposal”.

Accordingly, the UT held that the making of the loan to MC was not a payment of earnings to him and that the FTT made an error of law in concluding that “in the vast majority of cases in practice a loan will confer a “benefit” on the borrower”, that the loan from the EBT to MC conferred a benefit on him and that its payment to MC was potentially earnings.

The case highlights the careful analysis of the facts required to determine the nature of a payment made by a company to one of its employees or directors and the limits on the ability of HMRC to simply assume that any such payment (or benefit) should be subject to tax as earnings even when it might be considered unlikely that, if made by way of loan, the amount will be repaid or recovered.

Settlement payment was earnings outside the ambit of £30,000 tax exemption

In *Simrajsar Ltd and Achilles Products Ltd v HMRC*, the FTT has held that a number of payments made to directors of the appellants on their resignation were fully taxable as earnings under section 62 ITEPA and did not fall within the scope of section 401 ITEPA so that the £30,000 tax exemption in section 403 ITEPA did not apply to them.

The case involved a number of payments made by the appellant companies to their directors in the tax years 2015/16, 2016/17, 2017/18 and 2018/19. The relevant recipients were all members of a limited liability partnership, Redbox Tax Associates LLP (Redbox), from which they received profit shares. They were also directors of one or both of the appellant companies which were commercially connected to Redbox and from which they received minimal, if any, remuneration. Each of the directors resigned and was paid £30,000 stated to be "in consideration for loss of office". There were no written termination contracts and the reason for the £30,000 was stated to be only that "the directors took into account the number of years [the relevant individual] was a director of the company, the profitable position of the company and limited any payment to an amount which was fiscally efficient". None of the directors included the payments on their tax returns and they said that was because they thought that it was tax free under section 403 ITEPA.

In order to be exempt under section 403 ITEPA, the payment has to fall within section 401 ITEPA. That section applies to a payment made "in consideration or in consequence of, or otherwise in connection with (a) the termination of a person's employment, (b) a change in the duties of a person's employment or (c) a change in the earnings from a person's employment". Section 401(3) states that section 401 "does not apply to any payment or other benefit chargeable to income tax apart from [section 401]".

HMRC argued that the payments were general earnings taxable under section 62 rather than specifically payments made “in consideration or in consequence of, or otherwise in connection with” the individuals’ resignations.

The FTT agreed with HMRC having assessed the facts around the individuals’ engagements as directors, payments received from Redbox and the lack of documentation in respect of their directorships or their resignations. In particular, HMRC noted that there were no contracts of termination and that one of the directors had agreed that “I confirm that I have no claim against the Company nor against any other person, firm or company, for loss of office or at common law or under statute or (without limitation) on any other account and that there is no agreement or arrangement, whether performed or executory, under which the Company might be or become liable to me on any account” and that the £30,000 payment was not awarded to her until after her resignation so that it could not have been paid in respect of any loss resulting from such resignation.

The FTT stated that it was not satisfied that that the payments could properly be described as compensation for loss of office, so the question was “what were the payments for?”. The FTT decided, on the basis of the evidence provided, that “the payments were gratuitous lump sums paid in recognition of the past service of the respective directors. In other words, each payment was a “gratuity or other profit … obtained by the employee” within section 62(2)(b) ITEPA. The payments were derived, in Lord Templeman’s words, “from being an employee” and were not “attributable to something else””. Accordingly, the payments were emoluments of the directors’ employments and so “earnings” subject to income tax under section 62 ITEPA.

The FTT also considered whether the appellant companies had been careless in treating the payments as exempt under section 403 ITEPA. The individuals (or one of them) told the FTT that the appellant companies had not taken advice on the tax treatment of the payments and that “a Mr Drury”, who became the sole director of Achilles Products Ltd, and who was a Chartered Tax Advisor, “worked with Redbox” although it was unclear in what capacity. Achilles also said it was a “small office” and that Mr Drury was aware of the payments and had not raised any issues. The FTT noted that Redbox’s, and the appellant companies’, business was tax related and that the directors would have been aware that tax was rarely straightforward and that tax reliefs are usually subject to conditions. A reasonable taxpayer in the position of the appellant companies would have taken some advice about the tax treatment of the payments, even if they thought they were tax free, in order to check that was the case. Accordingly, the appellant companies had been careless in treating the payments as exempt from tax under section 4013 ITEPA.

The case highlights that more is required than that a payment is made at the same time as a resignation or loss of office for it to fall within section 401 ITEPA and that there has to be some compensatory element to the payment linked to the termination of employment or loss of office for section 401, and so the £30,000 exemption in section 403 ITEPA, to apply.

Time related element of redress payment taxable as interest

In *NHS Mid and South Essex ICB and others v HMRC*, the FTT has held that part of certain redress payments made by NHS integrated care boards (ICBs) calculated by reference to the time between the failure by the ICBs that triggered the redress payments and when the redress payments were made were “interest” and “yearly interest” and, accordingly, subject to income tax and withholding tax obligations.

The case related to payments made by the appellant ICBs to individuals to whom the ICBs had failed to award “continuing healthcare” (CHC) funding in respect of primary health care (e.g. care home) needs. As a result, the individuals had financed their own care. The Health Service Commissioner (ombudsman) had reviewed the decision making of the ICBs and concluded that, as a result of the maladministration by both the Department of Health and local health authorities, a significant group of patients might have been wrongly made to pay for their care in a home and that redress payments should be made and that those payments should include an element of “interest” by reason of the recipients having been denied the payments when they should have been awarded.

HMRC argued that the element of the redress payments that were calculated by reference to the period between the time that the payments should have been awarded and the time that they were made should be treated as interest and was subject to withholding tax under section 874 ITA 2007 as “yearly interest” or as “a payment of interest which is payable to an individual by way of compensation”.

The ICBs argued that no amount of the redress payment was interest, in particular because the relevant statutory rules stated that no amount was payable until the determination of eligibility for CHC funding had been completed and that had not happened until the decision to make the redress payments, so there was no “debt” in existence at the time that the determination should have been made. The amount in question was, however, described in the relevant Department of Health documents as being an “interest” element of compensation that should be calculated using the retail price index (RPI) and template letters to individual recipients stated “To ensure that you are reimbursed correctly, and within Department of Health guidelines I have performed a calculation that adds inflation value to the basic sum due based on the movement in the Retail Price Index over the period from when the costs were originally incurred to the final date of payment by the NHS”. Further, the NHS Continuing Healthcare Refreshed Redress Guidance of 1 April 2015 states under the heading “Interest” that “Redress is about placing individuals in the position they would have been in had NHS Continuing Healthcare been awarded at the appropriate time and not about the NHS or the public profiting from public funds” and “CCGs are advised to apply the Retail Price Index for calculation of compound interest when considering redress cases. The index is calculated monthly, with an average for each calendar year. CCGs are advised to apply the average rate for the year for which care costs are being reimbursed”.

The ICBs argued that the amounts stated as compensation by reference to the time that the recipients were out of pocket was not “interest” because it was not payment calculated by reference to a principal sum outstanding and, in particular, because the recipients had no entitlement to anything until the determination that the CHC funding was due had been made.

HMRC argued that the element of the redress payment referred to as “interest” was compensation for the time value of the money that the recipients had been made to expend. HMRC also argued that it was standard practice for interest to be awarded as part of statutory awards or damages claims and that in those cases there is no debt due until the award was made.

The FTT then considered the case law relevant to the meaning of interest and referred to the statement in *Pike v HMRC* summarising the characteristics of interest as “First, it is calculated by reference to an underlying debt. Second, it is a payment made according to time, by way of compensation for the use of money. Third, the sum payable accrues from day to day or at other periodic intervals. Fourth, whilst the payment so accrues, it does not, in order for it to be interest, have to be paid at any intervals: it is possible for interest not to become payable until the principal becomes payable. Fifth, what the payment is called is not determinative; the question must always be one as to its true nature. Sixth, the fact that an interest payment may be aggregated with a payment of a different nature does not ‘denature’ the interest payment”. This was further summarised in *Wilkinson v HMRC* as meaning that “(i) if a payment constitutes "interest" properly so called, it will not cease to be such merely because it is included in a greater aggregate sum of money, (ii) in order for a payment to be "interest" properly so called, there needs to be a sum of money by reference to which the payment was ascertained and that sum of money needs to be due to the person entitled to the payment and (iii) it is not necessary for the sum of money in respect of which the payment has been calculated to be known to be due on the date on which the payment starts to accrue. It is possible to determine with the benefit of hindsight that the relevant sum should have been due on a particular date and then to calculate the payment on the relevant sum from that date”.

The question was, therefore, whether the amount described broadly as interest was just an integral element of the overall redress payment or whether it could be separated as a separate element that was specifically compensating the recipients for the time value of the money that they had wrongly been made to expend. The FTT held that the true nature of the element of the payment calculated by reference to the amount expended, the timing of that payment (or those payments) and the RPI was “payments by time for the use of money and not payments by time for non-performance of an obligation to reach a correct decision on eligibility [for the CHC payments]” and that those payments were “interest”.

The FTT then concluded that the payments were both “yearly interest” and “a payment of interest which is payable to an individual by way of compensation”.

The case provides a useful summary of the factors that should be assessed when seeking to determine whether an element of a settlement, redress or damages payment might be interest and so subject to the specific tax rules applicable to interest as opposed to the general compensatory element of the underlying payment.

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