RPC

Tax update

December 2018

In this month's update we report on (1) the published response to the consultation on creating a "fund structure" within the Enterprise Investment Scheme for investment in innovative knowledge-intensive companies; (2) the published response to the consultation on extending the IR35 rules to the private sector; and (3) the published response to HMRC's tax abuse and insolvency discussion document. We also comment on three recent decisions relating to (1) penalties attaching to employment intermediaries returns (2); penalties for failing to file tax returns; and (3) CGT holdover relief where the transferor was a foreign controller of the transferee.

News items

Enterprise Investment Scheme knowledge-intensive fund consultation

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Off-payroll working in the private sector

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Tax abuse and insolvency discussion document

On 7 November 2018, HMRC published a summary of responses to the tax abuse and insolvency discussion document it released earlier this year. more›

Case reports

Thornton – identifiable HMRC officer must determine penalties

In *Robert, Adam and Dorothy Thornton (trading as A* Education) v HMRC* [2018] UKFTT 568 (TC), the First-tier Tribunal (FTT) has held that penalties for failure to file employment intermediaries returns (EIRs) were invalidly issued as they had not been made by an identifiable officer of HMRC under section 100, Taxes Management Act 1970 (TMA). more›

Any comments or queries

Adam Craggs
Partner
+44 20 3060 6421
adam.craggs@rpc.co.uk

Robert Waterson
Legal Director
+44 20 3060 6245
robert.waterson@rpc.co.uk

Michelle Sloane
Senior Associate
+44 20 3060 6255
michelle.sloane@rpc.co.uk

About this update

Our Tax update is published on the first Thursday of every month, and is written by members of RPC's Tax team.

We also publish a VAT update on the final Thursday of every month, and a weekly blog, RPC's Tax Take.

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Griffiths – appeal against HMRC penalties allowed as notice to file was invalid

In *Griffiths v HMRC* [2018] UKFTT 0527 (TC), the FTT has allowed the taxpayer's appeal against penalties imposed by HMRC as its notice to file a tax return was invalidly issued and in any event the taxpayer had a reasonable excuse for failing to submit his return. more>

Reeves – CGT holdover relief available where transferor is foreign controller of transferee

In *Reeves v HMRC* [2018] UKUT 293 (TCC), the Upper Tribunal (UT) has held that a non-resident taxpayer was entitled to holdover relief from capital gains tax (CGT) on a disposal he had made when he gifted his interest in a limited liability partnership to a UK-resident company of which he was the sole shareholder. more>

News items

Enterprise Investment Scheme knowledge-intensive fund consultation

On 30 October 2018, the Treasury published the response to its consultation on creating a "fund structure" within the Enterprise Investment Scheme for investment in innovative knowledge-intensive companies.

Conclusions from the consultation are that:

- it would be helpful to provide a more straightforward and attractive fund structure for investors to place money in knowledge-intensive companies (KIC) and there was general support for the idea of a new KIC fund structure
- respondents did not support a dividend tax relief element, as this might push KICs to issue dividends early on, rather than focusing on growth, and
- respondents suggested the most valuable changes would include reducing the current administrative burden on investors in current approved funds.

In light of the responses to the consultation, the government has decided to take forward its proposals to introduce a new approved EIS fund structure, improving on the existing structure through:

- focusing on KIC – a minimum of 80% of funds raised must be invested in KICs, reducing the risk of inadvertent non-compliant investment threatening approved fund status
- flexibility for managers – funds will have two years to deploy capital, with at least 50% of each raise to be invested within the first 12 months, with monies not yet invested held in cash (this improves on previous rules where 90% of each raise had to be deployed within the first 12 months)
- clearer timings for tax relief – investors will be allowed to set their relief against income tax liabilities in the year before the fund closes (previously this was only permitted in the same year the fund closes).

The new approved fund structure will be rolled out in April 2020 at the same time the current approved fund structure is withdrawn.

A copy of the consultation response document can be viewed here.

Back to contents>

Off-payroll working in the private sector

On 30 October 2018, a joint Treasury and HMRC publication was published summarising the responses to the consultation on the best way to tackle non-compliance with the off-payroll working rules (IR35) in the private sector.

Despite repeated calls from a number of industry bodies and professionals to proceed with caution, the government, in the recent Budget, indicated that it intends to introduce rules, similar to the April 2017 public sector off-payroll working reform, to the private sector.

A copy of the consultation response document can be viewed here.

Back to contents>

Tax abuse and insolvency discussion document

On 7 November 2018, HMRC published a summary of responses to the tax abuse and insolvency discussion document it released earlier this year. As announced in the recent Budget, the government intends to introduce legislation to:

- extend joint and several liability to directors, company officers and other relevant related parties in cases of "tax avoidance", evasion and repeated non-payment of tax (including so-called "phoenixism"); and
- to apply joint and several liability to facilitators of tax avoidance arrangements (and evasion) who are penalised, but seek to avoid such penalties by moving into insolvency.

A copy of the response document can be viewed here.

Back to contents>

Case reports

Thornton – identifiable HMRC officer must determine penalties

In *Robert, Adam and Dorothy Thornton (trading as A* Education) v HMRC* [2018] UKFTT 568 (TC), the First-tier Tribunal (FTT) has held that penalties for failure to file employment intermediaries returns (EIRs) were invalidly issued as they had not been made by an identifiable officer of HMRC under section 100, Taxes Management Act 1970 (TMA).

Background

A* Education (the taxpayer) locates and provides supply teachers to schools. It issues invoices to the schools for the supply of such teachers and then remunerates the teachers net of PAYE and NICs.

The taxpayer supplied two self-employed teachers to schools. Unwittingly, the taxpayer had become an employment intermediary for the relevant periods as it satisfied the statutory criteria set out in Regulation 84E of The Income Tax (Pay As You Earn) (Amendment No. 2) Regulations 2015 (the Regulations). The taxpayer should, therefore, have submitted EIRs for the relevant quarters.

In February 2017, the taxpayer, having spoken with HMRC, discovered that it should have filed EIRs in relation to the periods it supplied the self-employed teachers and subsequently made a late filing.

HMRC issued computerised late filing penalties in the total sum of £1,750, under section 98(1)(b), TMA, for the three tax quarters ending 5 July 2016 (£250), 5 October 2016 (£500) and 5 January 2017 (£1,000).

The taxpayer's appeal to HMRC was unsuccessful and it appealed to the FTT.

FTT decision

The appeal was allowed.

The FTT considered that it had jurisdiction to consider the validity of the penalty notices and considered that issue first. The FTT noted that whilst the penalties were issued under section 98, TMA, they were in fact governed by section 100, TMA, which imposes a requirement that an officer of the board must authorise a penalty notice.

HMRC was unable to supply the name of the authorising officer because the process was automated. The FTT therefore found, as a fact, that no officer of the board had made the relevant determinations and accordingly it concluded that the penalty notices were invalid.

Comment

The FTT's decision is consistent with *Donaldson v HMRC* [2016] EWCA Civ 761. Penalties issued under section 100, TMA, require a decision by an actual officer of HMRC and it is not sufficient for the process to be automated without the involvement of an actual officer. This decision, together with the decisions in *Groves v HMRC* [2018] UKFTT 0311 (TC) and Rogers v HMRC [2018] UKFTT 0312 (TC), expands the situations in which penalty notices have to be issued by individual HMRC officers.

Given the wider ramifications of this decision for HMRC, it would not be surprising if HMRC sought to appeal this decision.

A copy to the decision can be viewed here.

Back to contents>

Griffiths – appeal against HMRC penalties allowed as notice to file was invalid

In *Griffiths v HMRC* [2018] UKFTT 0527 (TC), the FTT has allowed the taxpayer's appeal against penalties imposed by HMRC as its notice to file a tax return was invalidly issued and in any event the taxpayer had a reasonable excuse for failing to submit his return.

Background

On 31 May 2014, HMRC sent Mr Griffiths (the taxpayer) a PAYE tax calculation for the tax year 2013/14. The calculation showed an overpayment of tax by the taxpayer of £579.80. This was incorrect, as it only took into account one of the taxpayer's two employments.

On 1 June 2014, HMRC issued a payable order in respect of the "overpayment" which was paid to the taxpayer on 3 June 2014.

On 2 June 2014, before the repayment had been made, HMRC sent a revised PAYE calculation to the taxpayer showing an underpayment of tax of £581.60 (the taxpayer had underpaid tax of £0.80). Shortly after receiving the revised PAYE calculation, the taxpayer telephoned HMRC and was informed that the underpayment would be collected through a change in his PAYE tax code. HMRC claimed to have no record of this telephone call. The taxpayer heard nothing from HMRC for over eight months and assumed the matter had been dealt with.

HMRC accepted that normally such an underpayment would have been "coded out" through the taxpayer's PAYE tax code, but claimed that the taxpayer's income at the time was insufficient to enable HMRC to do this. Instead, on 25 January 2015, HMRC sent the taxpayer an unpaid income tax letter or "voluntary payment letter". This letter stated that if the taxpayer did not pay, HMRC would consider collecting the amount through the self-assessment system and he would have to fill in a tax return.

On 2 February 2015, the taxpayer telephoned HMRC again. On this occasion the telephone call was recorded. The taxpayer was assured that the underpaid tax would be collected through an adjustment to his tax code.

A further voluntary payment letter, in the same generic form as the earlier one, was sent to the taxpayer on 19 April 2015. Given the two telephone conversations he had had with HMRC, the taxpayer did not respond to this letter. Nothing happened for ten months, until HMRC sent a further voluntary payment letter to the taxpayer on 1 February 2016.

HMRC then sent a notice to file a tax return to the taxpayer on 28 July 2016. As this was outside the normal self-assessment cycle, the filing date for both an online and a paper return was 4 November 2016.

The taxpayer took no further action and after he received a letter from HMRC informing him that his tax return was late and penalties were accruing, he instructed an agent in April 2017. The agent submitted the taxpayer's self-assessment tax return for 2013/14, on 8 June 2017.

The taxpayer appealed against the penalties that HMRC imposed under Schedule 55, Finance Act 2009, for his alleged failure to submit his 2013/14 return on time.

FTT decision
The appeal was allowed.

In arriving at its decision, the FTT considered the following two issues:

1. was HMRC's notice to the taxpayer to file a tax return validly issued pursuant to section 8, TMA, and
2. if it was validly issued, did the taxpayer have a reasonable excuse for failing to submit his tax return in time?

In relation to the first issue, the FTT held that the notice to file was not validly issued because it was not issued for the statutory purpose of establishing the taxpayer's liability to income tax, pursuant to section 8, TMA. HMRC already knew the taxpayer's liability at the time the notice to file was issued. The purpose of issuing the notice to file was simply to create a tax debt. This was ultra vires and accordingly the notice to file was invalid. As the taxpayer had not been validly required to submit a tax return, he had no obligation to do so and had not failed to submit a tax return. It followed that no penalties were due.

In relation to the second issue, the FTT said that even if it had concluded that the notice to file was validly issued, the taxpayer had a reasonable excuse for failing to submit his tax return in time for the following reasons:

- the taxpayer's experience and knowledge of the tax system was very limited, having had little interaction with HMRC as he had always paid income tax through the PAYE system
- the taxpayer received limited help when he contacted HMRC and was informed on more than one occasion that the underpaid tax would be collected through his notice of coding, and
- the lengthy delays by HMRC between communications with the taxpayer lead him to believe that everything had been dealt with; he did not appreciate that he needed to complete a tax return.

Comment
This decision follows the recent decision of *Groves v HMRC* [20188] UKFTT 311 (TC), in which the taxpayer was also successful in his appeal against penalties issued by HMRC pursuant to Schedule 55, Finance Act 2009, for the late filing of a tax return, as the notice to file in that case had not been signed by an "Officer of the Board" and in any event the notice was invalid as it was not given by HMRC for the purpose set out in section 8, TMA.

A copy of the decision can be viewed here.

Back to contents>

Reeves – CGT holdover relief available where transferor is foreign controller of transferee

In *Reeves v HMRC* [2018] UKUT 293 (TCC), the Upper Tribunal (UT) has held that a non-resident taxpayer was entitled to holdover relief from capital gains tax (CGT) on a disposal he had made when he gifted his interest in a limited liability partnership to a UK-resident company of which he was the sole shareholder.

Background
The issue in the appeal was whether William Reeves (the taxpayer) was entitled, as a non-resident, to claim holdover relief pursuant to section 165, Taxation of Chargeable Gains Act 1992 (TCGA), in relation to a disposal that he made when he gifted his interest in Blue Crest LLP (Blue Crest) to WHR Ltd (WHR), a UK-resident company, of which he was the sole shareholder.

Blue Crest operated a hedge fund business. At the time of the disposal, the taxpayer was resident in the US and was a non-UK resident for tax purposes. A capital gain of some £33.6 million arose on the disposal of the taxpayer's interest in WHR. The gain was chargeable to CGT in the UK as a result of the application of sections 10 and 17, TCGA. The issue was whether holdover relief was available to the taxpayer under section 165, TCGA. The gift had been made in anticipation of the emigration of Blue Crest from the UK to Guernsey in order to avoid the charge which would otherwise have been triggered under section 25, TCGA (deemed disposal by non-resident).

The taxpayer claimed that the gain should be held over and if and when the transferee company disposed of its interest in Blue Crest, it might then have to pay CGT on the capital gain.

Section 167(2), TCGA, dis-applies the entitlement to holdover relief under section 165, where the transferee company is controlled by a person who is neither resident nor ordinarily resident in the UK and is connected with the person making the disposal.

HMRC considered that section 167(2) should be read as including the situation where the transferee company was controlled by a person who was non-resident and who made the disposal. It also argued that the taxpayer's rights could be attributed to his non-resident wife under section 416(2) and (6), Income and Corporation Taxes Act 1988 (ICTA) (since repealed), which provided a definition of "associated company" and "control".

In the taxpayer's view, in considering section 167(2), it was not permissible to attribute his rights and powers to his non-resident wife. To do so would lead to an absurd result as it would make the application of section 167(2) dependent on whether the transferor had non-resident associates.

In the alternative, the taxpayer relied on Article 1, Protocol 1, European Convention on Human Rights (ECHR) (the right to property).

The taxpayer's appeal to the FTT was dismissed and he appealed to the UT.

UT decision
The appeal was allowed.

HMRC's case on construction
HMRC submitted that an unintended loophole existed in section 167(2) because the provision only applied when the non-resident controller of the transferee company was a person connected with the transferor, not where the controller was the transferor himself, as in the present case. This, it said, must be a mistake which should be remedied by including additional wording in section 167(2), so that it read:

"A company is within this subsection if it is controlled by a person who, or by persons each of whom, (a) is neither resident nor ordinarily resident in the United Kingdom, and (b) [is the person making the disposal or] is connected with the person making the disposal".

The UT, like the FTT, rejected HMRC's attempt to re-write the legislation, commenting that:

"In our judgment, applying the three-stage test in [*Inco Europe Ltd v First Choice Distribution (a firm)* [2000] 2 All ER 109], we cannot be abundantly sure what Parliament intended to do about a taxpayer in [the taxpayer's] position, namely one who is a non-resident transferor and who also controls the resident transferee company".

The UT agreed with the taxpayer that section 167(2) was enacted to put an end to the so-called "envelope trick", which was a widely used arrangement by which UK residents could avoid CGT by gifting their assets to a company controlled by non-resident associates. In the view of the UT, it was not permissible for it to close a different "loophole" which the provision was clearly not drafted to address.

Section 416 ICTA
Section 288, TCGA, imports the definition of "control", provided in section 416, into TCGA for all purposes, "unless the context otherwise requires". The first issue raised by the taxpayer was whether the context in which the term "control" is used in section 167(2), TCGA, did require it to be defined in a different way. In agreeing with the taxpayer, the UT concluded that the associate attribution rule in section 416(6) did not have the breadth for which HMRC contended, and the need to draft anti-avoidance provisions widely did not mean that Parliament intended for taxpayers in the taxpayer's situation to be denied holdover relief.

In order to correct the statutory anomaly, the UT said that the modification required was to construe section 167(2) as including the words that were included in section 167(3). It commented:

"We therefore hold that the context of [section 167(2), TCGA] requires that pursuant to [section 288, TCGA], the artificial assumptions to be made ... by the attributions of interests between associates within [section 416, ICTA] are limited to connected persons who control the transferee by virtue of holding assets relating to that or any other company".

Human Rights Act 1998 (HRA)
The taxpayer relied on his rights under the ECHR in the event that the UT decided that HMRC's interpretation of section 167(2) was correct and that holdover relief should be denied. It was common ground that Article 1, Protocol 1, ECHR was engaged.

The UT considered whether the provisions in TCGA were discriminatory in treating the taxpayer differently, as a result of his wife and children being non-resident, from how he would be treated if his wife and children were resident in the UK. The UT was of the view that there was clear discrimination on the basis of the taxpayer's status as a person with a non-resident wife and children as compared with a person with a resident wife and children.

HMRC argued that the result in this particular case was not irrational because the taxpayer himself was non-resident and he should not benefit from holdover relief because he was non-resident. The UT gave this argument short shrift and said:

"We do not regard that as a legitimate point to raise. [The taxpayer], like every other person whether resident or non-resident, is entitled to insist on being taxed only in accordance with the law, including in accordance with his rights under the [ECHR]. It is accepted that [the taxpayer] is properly a 'victim' of the legislation and that the legislation itself does not treat as relevant the status of the transferor; it is only concerned with the residence of those controlling the transferee. One must look at the effect of the legislation more generally not simply in the context of the particular facts of the [taxpayer]".

With regard to whether HMRC had shown that the discriminatory treatment was justified and proportionate, the UT said:

"We accept that although tax avoidance in a broad sense is a legitimate aim of the provision, the literal interpretation of [section 167(2), TCGA] fails on proportionality grounds because of the anomalous position it creates ... In our judgment, it is impossible to justify the application of TCGA 1992, s 167(2) by reference to the residence or non-residence of a spouse who holds no interest in the company to which the gift is being transferred. Indeed, the application of the provision in circumstances where the taxpayer happens to have a relative living abroad strikes us as precisely the kind of provision at which Article 14 in conjunction with [Article 1, Protocol 1, ECHR] is aimed".

In the UT's view, section 167(2) could be read down, pursuant to section 3, HRA, in order to prevent any interference with the taxpayer's rights under the ECHR.

Comment

Although cases of this nature tend to be fact-specific, the way the UT construed the relevant statutory provisions so as to avoid what it considered to be an absurdity arising from a literal interpretation is significant and may have implications for other taxpayers in comparable circumstances. Rather than adopt a literal interpretation, the UT chose to reconstruct the provisions to give effect to what it considered must have been their intended meaning, which was different from the meaning for which HMRC contended.

The UT's decision in respect of the application of human rights law is also significant. It found that the legislation deprived the taxpayer of his possessions, namely, the CGT that he would have to pay if he was unable to claim holdover relief under section 165, TCGA, on a discriminatory basis as his claim for holdover relief would be denied simply because his wife and children were non-UK resident. In the view of the UT, such discrimination was unjustified and disproportionate in circumstances where the taxpayer's wife and children had no interest in the asset being transferred.

A copy of the decision can be viewed here.

Back to contents>

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18715

Tower Bridge House
St Katharine's Way
London E1W 1AA
T +44 20 3060 6000

Temple Circus
Temple Way
Bristol BS1 6LW
T +44 20 3060 6000

11/F Three Exchange Square
8 Connaught Place
Central Hong Kong
T +852 2216 7000

12 Marina Boulevard
#38-04 Marina Bay Financial Centre Tower 3
Singapore 018982
T +65 6422 3000

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