RPC

Tax update

July 2016

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Project Blue Ltd v HMRC – taxpayer victory in SDLT sub-sale case

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Any comments or queries

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About this update

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

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

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News items

Revised corporate interest deductibility rules – consultation document issued

HMRC has issued a consultation on the design of the new corporate interest deductibility rules which are to have effect from 1 April 2017.

The new regime is intended to restrict the deductibility of interest payments by applying a fixed ratio of 30% of a UK group's tax EBITDA. The changes are also intended to replace the current debt-cap rules with new rules placing limits on deductible interest to net accounting finance expenses. These changes are significant and there is concern over the lack of grandfathering provisions and absence of draft legislation. Taxpayers will have relatively little time to adapt and the administrative burden is likely to be significant for those corporates which will have to comply with the new rules.

The consultation documentation is available to view here.

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Company taxation manual – updated for transactions in securities

HMRC's has updated the transactions in securities section of its company taxation manual. The manual has been rewritten to update it for the revised transactions in securities rules that apply in relation to income tax from 24 March 2010. Changes contained in the Finance Bill 2016, are not reflected in the updated manual.

The revised guidance deals with, amongst other things, circumstances where a tax advantage may be said to arise and where clearance may be given.

The new guidance is available to view here.

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Off-payroll working and IR35 – consultation document issued

HMRC has issued a consultation on the amendment of the IR35 legislation in order to deal with workers who provide services to a public sector engager through an intermediary. The proposed new rules will make the public sector engager, or if a third party is involved, that third party, rather than the intermediary, responsible for deciding whether the IR35 rules apply and if they do, for calculating, reporting and paying the relevant tax and NICs to HMRC. The changes are to take effect from April 2017. The government estimates that these changes will generate an additional £555 million by the end of 2020/21. Whilst these changes will not apply to the private sector, it can only be a matter of time before they are extended to the private sector.

The consultation documentation is available to view here.

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Case reports

Gray v HMRC – appeal fails as trade not conducted on a commercial basis

In *Gray v HMRC*[1], the First-tier Tribunal (FTT) has held that a taxpayer conducting promotional activities for his musician wife was not entitled to set losses from those activities against profits from his legal business.

Although those activities were sufficiently organised to constitute a trade, they were insufficiently planned or organised to be viewed as being conducted on a commercial basis or with a view to realising profits.

Background

If a person accrues a trade loss for income tax purposes in a tax year, he can make a claim for the loss to be deducted from his net income for that tax year or the previous year. Furthermore, an individual who accrues a trade loss in any of the first four years of trading may make a claim for the loss to be deducted from net income for the three tax years preceding that in which the loss arises. The use of such losses in this way is known as "sideways relief".

In order for sideways relief to be available the following two conditions must be satisfied:

- the loss must arise from a "trade" and
- the trade must be "commercial", meaning that it is carried on throughout the relevant period on a commercial basis and with a view to realising profits (section 66(1) and (2), Income Tax Act 2007).

The taxpayer, a UK resident lawyer specialising in international tax law, was married to a well-regarded concert pianist. Before 2010, he had tried to help his wife with her career by sponsoring and underwriting her concerts and musical recordings. By the end of 2010, he had decided to enter into a separate business of promoting his wife and approached an agent with a view to the agent representing his wife. The agent declined the invitation and the taxpayer agreed to engage the agent as a paid consultant, paying the agent a monthly fee. The taxpayer was to provide marketing materials and spent a large amount of his free time on promotional activities, but he was of the view that the consultancy arrangement was needed due to the industry being something of a 'closed shop' and the agent had the necessary contacts within the industry.

The taxpayer agreed orally with his wife that he would retain any money generated until he had recouped his outlay, from which point they would divide the income from her activities equally. In giving evidence before the FTT, the taxpayer said that he had expected to at least break even after the first year and to make a profit in the second year. However, the volume and cost of the required marketing materials spiralled.

The taxpayer acknowledged that his motivation was not only profit he also wished to support his wife.

The taxpayer did not separate out the earnings and expenses from his legal practice and those from his promotional activities in his tax return. HMRC denied his claim for relief for the losses he had incurred from his promotional activities on the basis that those activities did not constitute a trade conducted on a commercial basis with a view to realising profits. Accordingly,

1. [2016] UKFTT 0379 (TC).

sideways relief was not available.

The taxpayer appealed to the FTT.

FTT's decision
The FTT dismissed the appeal, concluding that the promotional activities did not constitute a commercial trade and, therefore, the taxpayer was not entitled to sideways relief.

Was there a trade?
The FTT held that the taxpayer's activities did constitute a trade.

The FTT considered the case to be marginal and took into account the taxpayer's relationship with his wife (following *Murtagh v HMRC*[2]), as motivation is a relevant factor in determining whether there was a trade. However, the FTT considered that the activities were sufficiently organised to amount to a venture in the nature of a trade.

Was the trade commercial?
Although the taxpayer was carrying on a trade, the FTT concluded that the trade was not commercial. The FTT stressed that the issue of commerciality involved two separate questions. Firstly, was the trade carried on on a commercial basis, and, secondly, was the trade carried on with a view to realising profit.

It was not disputed that the first question involved an objective analysis. The FTT considered that, applying *Rowbottom v HMRC*[3], although there was a subjective element to the second test, there was a need for objective evidence demonstrating an "appropriate basis" for the trader taking a particular view. The FTT concluded that the answer to the first question was, on balance, that the trade was not conducted on a commercial basis and that this was sufficient to determine the appeal.

As a result of several factors, including a lack of financial forecasts or budgeting information, the FTT concluded that the success, or otherwise, of the taxpayer's venture depended entirely on the work and ability of the agent and the taxpayer's wife, with no provision being made for the taxpayer's efforts proving fruitless. Although there had been sufficient organisation for the promotional activities to constitute a trade, there was less organisation and planning than would be appropriate or expected for a commercial business in the nature of the taxpayer's trade.

Comment
The FTT stressed that the question of whether there is a commercial trade is one of fact, and as a consequence previous decisions can only be of limited assistance in determining this issue. The decision illustrates the need for taxpayers wishing to benefit from sideways relief to be able to clearly demonstrate the commercial nature of their activities. The existence of a trade, on its own, might entitle the trader to carry forward losses from that trade and set them off against profits of the same trade in future periods, but the requirement of a commercial nature imposes an extra hurdle, and requires further analysis, if sideways relief is sought.

The decision is available to view here.

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Tottenham Hotspur Ltd v HMRC – football club secures win against HMRC

2. [2013] UKFTT 352 (TC).
3. [2016] UKFTT 009 (TC).

over player termination fees

In *Tottenham Hotspur Ltd v HMRC*[4], the FTT has allowed the taxpayer's appeals and concluded that the transfer fees paid in respect of two football players were not payments made "from" the players' employment and therefore were not subject to income tax or national insurance contributions (NICs) under section 9, Income Tax (Earnings and Pensions) Act 2003 and section 6, Social Security Contributions and Benefits Act 1992, respectively.

Background

The case concerned the transfer of two football players, Peter Crouch and Wilson Palacios (the Players), from Tottenham Hotspur Football & Athletic Co Ltd (Tottenham) to Stoke City Football Club (Stoke). The Players were employed by Tottenham on fixed term employment contracts. The contracts contained a provision for early termination, either if certain circumstances arose (none of which were found to have arisen in this case), or by mutual agreement between the Players and the club.

In 2011, Tottenham wished to transfer the Players to another club and had identified Stoke as a possible destination. However, the Players were reluctant to move and for that reason Tottenham made payments to them as part of the agreement to terminate their contracts early.

HMRC considered that the payments made to the Players were earnings because the terms of the Players' employment contracts expressly envisaged, and provided for, termination by mutual consent and any payment received in consequence of implementing those terms was therefore "from" their employment. As such, the payments were subject to income tax and NICs.

Tottenham argued that the payments were compensation for the early termination of the Players' contracts and were not made pursuant to any provision of those contracts. Accordingly, the payments were made in return for the Players giving up their rights to be employed until the expiry of the fixed term set out in their employment contracts and, as such, were not "from" their respective employments.

On 10 December 2014, HMRC issued determinations under Regulation 80 of the Income Tax (PAYE) Regulations 2003 and decisions under section 8, Social Security Contributions (Transfer of Functions etc) Act 1999, for recovery of the tax and NICs allegedly due on the payments made to the Players.

Tottenham appealed against the determinations and decisions.

FTT's decision

The parties agreed that the relevant question to be decided by the FTT was whether the payments made to the Players as part of the termination arrangements were "from" the Players' employments.

The FTT did not accept that the degree of the employee's involvement in the termination of the employment was relevant, citing the Court of Appeal's decision in *Henley v Murray*[5]. In *Henley*, as in the present case, the relevant payment was made following a compromise of a potential dispute that the parties agreed between themselves. The FTT drew a distinction between the "receipt of remuneration or profits in respect of the office" and "sums paid in consideration of the surrender by the recipient of rights in respect of the office".

4. [2016] UKFTT 0389 (TC).
5. [1950] 1 All ER 908.

HMRC relied on the Court of Appeal's decision in *EMI Group Electronics Ltd v Coldicott*[6], where a payment made in pursuance of a contractual provision, agreed at the outset of the employment, which enabled the employer to terminate the employment on making that payment, was held to be remuneration in respect of the employment even though it was made in conjunction with the termination of the employment. Such a payment is not paid in consideration of the recipient's "surrender of rights" under the contract because the recipient is receiving what was bargained for under that contract.

However, this was contrasted with the Players' employment contracts which did not specifically provide for the payments. In such a situation, where a contract contains an express provision permitting early termination by mutual consent and the parties agree that, on the employer making a payment, the contract will be terminated, the FTT did not consider that the employee is receiving "the security, or continuity, of salary which he required as an inducement to enter the employment".

In the FTT's view, *Henley*, did not set out whether a breach of contract is necessary in order for a payment to be regarded as consideration for the surrender of rights. Whilst the High Court, in *Richardson v Delaney*[7], had envisaged that a breach of contract would be required in order for a payment to amount to consideration for the surrender of rights, the Upper Tribunal, in *Martin v Revenue & Customs Commissioners*[8], had reached a different conclusion.

As employers and employees may take a pragmatic decision to enter into a compromise agreement in order to avoid the time and expense of determining whether there has been a breach of contract, the FTT did not think it would be a desirable state of affairs if it was nevertheless necessary to determine whether a breach had taken place in order to ascertain the correct tax position. The FTT therefore concluded that there does not need to be a breach of contract for payments such as those in issue not to be "from" the Players' employments.

At the time the agreements were made to end the Players' employment contracts early, the only operative right of termination conferred under the contracts was the right to terminate early by mutual agreement. The payments were accordingly made in return for the surrender of the Players' rights under the contracts. The FTT therefore allowed Tottenham's appeal, concluding that the payments did not derive "from" the Players' employments and consequently were outside the scope of NICs and were only subject to income tax above the £30,000 threshold.

Comment

As the contracts were not terminated following a breach of contract, the termination was by mutual agreement, however, the payments made following such mutual agreement were not within the scope of the principle enunciated in *EMI Group Electronics*, as the contracts had not specifically provided for the payments. In the view of the FTT, it followed that applying *Henley*, the payments did not derive "from" the Players' employments.

Whilst this decision will no doubt be welcomed by Tottenham, the benefit to other taxpayers is likely to be short-lived following the government's recent announcement that from April 2018 all taxable termination payments will be subject to employer NICs.

The decision is available to view here.

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6. [1999] STC 803.
7. [2001] STC 1328.
8. [2015] STC 478.

Project Blue Ltd v HMRC – taxpayer victory in SDLT sub-sale case

In *Project Blue Ltd v HMRC*[9], the Court of Appeal has allowed the taxpayer's appeal and dismissed HMRC's cross-appeal.

The court found that section 75A, Finance Act 2003 (FA 2003) did not apply because the sub-sale to the financier was not exempt from charge to stamp duty land tax (SDLT) under section 71A, FA 2003.

Unless otherwise stated, all statutory references below are to FA 2003.

Background

SDLT is chargeable under section 42(1) on "land transactions" meaning "any acquisition of a chargeable interest in land" (section 43(1)), however "the acquisition is effected" (section 43(2)).

A "chargeable interest", is defined in section 48(1) as:

"(a) an estate, interest, right or power in or over land in the United Kingdom or

(b) the benefit of an obligation, restriction or condition affecting the value of any such estate, interest, right or power,

other than an exempt interest."

Exempt interests include "any security interest", which in most cases will mean a mortgage. Put another way, there is no SDLT to pay if the property is held only for the purposes of securing the payment of money. The charge instead will fall to the mortgagor.

Ordinarily the person acquiring a property with a mortgage will acquire the property free from a charge once the loan, interest and costs have been paid back to the mortgagee. This conventional arrangement, familiar to many individuals purchasing property with the use of a mortgage, is not permitted under Sharia law which places prohibitions on usury. Such transactions require a different form of arrangement.

The case concerned the purchase of Chelsea Barracks from the Ministry of Defence (MOD) and Project Blue Limited (PBL), an entity controlled by the Sovereign Wealth Fund of Qatar. The sale cost was £959m. It would not have been possible for PBL to utilise a conventional loan and interest arrangement for the purchase, instead, PBL contracted to sell the property to Masraf al Rayan (MAR) a Qatari bank for £1.25bn. The difference between the purchase and sale costs being the costs of redeveloping the site and SDLT.

On the day of completion, MAR granted to PBL a 999 year lease and agreed various other options which would enable PBL to re-acquire the freehold. Accordingly, this transaction did not involve a loan. Instead, PBL and MAR were parties to a lease and put option agreement.

Court of Appeal judgment

Superficially there appeared to be two transactions which may be land transactions for the purposes of section 43: the sale between the MOD and PBL and the sale by PBL to MAR, the latter not being exempt under section 48 because of the absence of a security interest. Under section 48, however, the completion of the contracts between the parties had the effect of engaging sections 44-45, which relate to "sub-sale" agreements. The consequence being that the two transactions were treated as a single land transaction for SDLT purposes.

9. [2016] EWCA Civ 485.

Following the Court of Appeal decision in *DV3 RS LP v HMRC*[10], the Court was obliged to disregard PBL's acquisition from the MOD for SDLT purposes. Accordingly, for the purposes of SDLT, MAR was to be treated as acquiring an interest in land directly from the MOD and it was on MAR that the liability for SDLT fell.

The Court considered the effect of section 71A, which applies to alternative forms of financing arrangements. Specifically, it covers circumstances where a financial institution acquires a "major interest in land" and then provides a leasing arrangement to a person with an option for acquisition. In such cases, the institution will be exempt from SDLT. The parties accepted that section 71A covered arrangements which complied with Sharia law.

HMRC argued that section 71A had the effect of shifting any liability for SDLT from MAR to PBL. The Court found, however, that the exemption from the charge only applied in circumstances where the "vendor" was the person making the financial arrangements with the financial institution. In this case, because of the effect of the decision in *DV3*, the "vendor" could not be regarded as PBL, as the transaction between MAR and PBL had to be disregarded under sections 44-45. Rather, the vendor was MOD. Accordingly, in the view of the Court, the exemption to SDLT contained in section 71A did not apply to MAR and SDLT remained payable by MAR.

The Court dismissed HMRC's arguments on the application of the anti-avoidance provisions contained in section 75A, on the basis that, if the rules applied at all, a necessary precondition of their application was not met in that the notional SDLT payable was not less than the amount that would otherwise be payable on HMRC's notional reconstruction of the transaction.

Comment

This is an important case in the context of SDLT. Although SDLT was payable, HMRC's decision to close its enquiries into MAR's land transaction return was a significant mistake costing the Exchequer some £50m in lost SDLT.

Many tax advisers will be disappointed by the Court's obiter comment that the Upper Tribunal was correct in its view that a tax avoidance motive is not necessary in order for section 75A to apply.

It is understood that having been refused permission to appeal by the Court of Appeal HMRC has applied to the Supreme Court for permission to appeal.

The decision is available to view here.

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10. [2013] EWCA Civ 907.

About RPC

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