RPC

Corporate tax update

May 2019

Welcome to the latest edition of our Corporate Tax Update, written by members of RPC's tax team. This month's report includes a summary of a recent decision of interest for those taxpayers using, or considering, offshore UK property holding structures. There are also case summaries on the topics of entrepreneurs' relief, employment-related securities options and the application of the dreaded "IR35" regime.

Warshaw and entrepreneurs' relief: when is a fixed rate not a fixed rate?

On 24 April 2019, the First-tier Tribunal held that a cumulative preference share fell within the definition of "ordinary share capital" (OSC) for entrepreneurs' relief (ER) purposes. more›

Entrepreneurs' Relief – new guidance for revised "personal company" conditions

HMRC has updated its CGT manual following the amendments made to the definition of a "personal company" for the purposes of disposals made on or after 29 October 2018. more›

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IR35 – Tribunal decisions come thick and fast

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First-tier Tribunal – option granted to director not "employment related" under deeming provision

On 8 April 2019, the First-tier Tribunal held that an option granted to a company director was not an employment-related securities option (ERSO) under the deeming provision of ITEPA 2003. more›

European Commission: pre-2019 CFC rules amounted to illegal state aid

On 2 April 2019, the European Commission (EC) announced that the UK's controlled foreign company (CFC) regime exemption for certain finance income amounted (in part) to illegal state aid. Then, on 25 April 2019, the EC published its full decision in this case. more›

Any comments or queries?

Ben Roberts
Senior Associate
+44 20 3060 6184
ben.roberts@rpc.co.uk

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

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

UK's chargeable gains group relief rules contrary to EU law – First-tier Tribunal

On 25 March 2019, the First-tier Tribunal held that the denial of intra-group transfer relief (section 171 TCGA 1992) for transfers to a non-UK EU parent was contrary to the right to freedom of establishment. more>

AG opines that provision and maintenance of cashpoints not exempt from VAT

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Warshaw and entrepreneurs' relief: when is a fixed rate not a fixed rate?

On 24 April 2019, the First-tier Tribunal[1] held that a cumulative preference share fell within the definition of "ordinary share capital" (OSC) for entrepreneurs' relief (ER) purposes.

The decision is of vital importance to Mr Warshaw as it means he held 5.777%[2] of the OSC of the company in question at the time of disposal and therefore would qualify for ER treatment. The CGT at stake was over £1.1m.

The definition of OSC for these purposes is to be found at section 989 of the Income Tax Act 2007. The sole issue in the case was whether the preference shares in question had a right to dividends at a "fixed rate". In order for Mr Warshaw's appeal to succeed, he needed to convince the Tribunal that the preference shares did **not** carry a right to dividends at a fixed rate.

The Articles of the company in question provided that the preference shares had a right to a "fixed cumulative preferential dividend" at the rate of 10% per annum "on the aggregate of (i) the subscription price of such Preference Share and (ii) the aggregate amount of Preference Dividend that has previously compounded and not yet paid".

Mr Warshaw's position was that as the rate of the dividend on the preference shares was calculated by reference to any previous unpaid dividends, they did not carry a right to a dividend at a "fixed rate". HMRC's position was that as the 10% was fixed, it made no difference (for the purposes of the definition of OSC) that the compounded element varied.

The Tribunal "on balance" sided with Mr Warshaw and held that it was necessary, for the purposes of identifying OSC, to consider both (i) the percentage rate (which, in this case, was fixed at 10%) and (ii) the amount to which it is applied (which, in this case, varied).

HMRC has only relatively recently made public its views on cumulative preference shares (see our earlier blog here. As this decision goes against HMRC's published view, HMRC might be expected to appeal against the decision.

Although in this particular case the decision amounted to a taxpayer win, this decision could have adverse implications in other cases (for example, it could have the effect of diluting below the 5% threshold the OSC held by management shareholders in private equity-backed companies).

The decision can be viewed here.

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Entrepreneurs' Relief – new guidance for revised "personal company" conditions

HMRC has updated its CGT manual following the amendments made to the definition of a "personal company" for the purposes of disposals made on or after 29 October 2018.

The updated guidance now reflects the further amendments made over the Christmas period to the new economic interest requirement for entrepreneurs' relief (ER) on share sales introduced by the Finance Act 2019, such that – in order to access ER – as well as holding 5% of the ordinary share capital and 5% of the voting rights the shareholder must **either**:

- be beneficially entitled to at least 5% of the company's distributable profits, and 5% of its assets available for distribution to "equity holders" in a winding up, or

1. In *Warshaw v HMRC* [2019] UKFTT 268 (TC).
2. Compared with 3.5% of the ordinary share capital, if the preference shares were not "ordinary share capital".

- in the event of a disposal of the ordinary share capital of the company, be beneficially entitled to 5% of the disposal proceeds.

The revised HMRC guidance can be viewed here and here.

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SDLT avoidance and corporate property deals – the importance of timing!

On 18 April 2019, the First-tier Tribunal[3], caused something of a stir for clients and advisors familiar with the well-trodden (and, usually, tax-efficient) use of offshore unit trusts to hold UK property.

In the *Hannover* case the Tribunal held that the SDLT anti-avoidance rule (s.75A) applied to a series of transactions that included the SDLT-free sale of units in a Guernsey property unit trust (GPUT). None of these transactions, by themselves, gave rise to a significant SDLT charge. The effect of the Tribunal's decision, however, is that additional SDLT of £5.49m is payable.

Crucially on the facts of this particular case, a transaction effected as part of the pre-ordained series of sale steps took place **before** the transfer of the GPUT units. The decision serves as a timely reminder to carefully consider the nature and timing of all transactions that could be considered to take place "in connection" with a sale of UK property, even where there is no SDLT avoidance motive behind those steps. Acquisition steps undertaken for commercial reasons can have unintended SDLT consequences.

Structure

A fairly typical investment ownership structure had been put in place in 2006 to acquire the UK property (Property) in question.

The GPUT in this case was the sole limited partner in an English limited partnership (LP). Profits of the LP were allocated as to 99% to the GPUT and 1% to the LP's general partner. Units in the GPUT were held as to 99.7% by another limited partnership and 0.3% by an offshore company.

The LP acquired the Property in 2006, and the overall UK tax effect of the structure was, in broad summary, that (1) a small amount of UK corporation tax would be payable on net rental income received by the general partner of the LP and the minority unit-holder in the GPUT, (2) net rental income allocated to partners in the partnership holding 99.7% of the GPUT units would be taxed according to their UK residence status, (3) on sale by the LP of the Property the general partner would incur a charge to UK tax on its share of any gain, but no UK tax would be payable by the GPUT[4], and (4) no UK stamp duty nor SDLT would arise on sale of the GPUT units.

The 2011 sale to Hannover

In early 2011 the German fund Hannover offered to buy the Property. Initially, Hannover was not aware of the existing ownership structure. Ultimately it offered to buy the Property either (1) by way of direct acquisition of the freehold, for £133.6m or (2) by way of acquisition of the GPUT units for £138.8m. The higher price offered for the GPUT units recognised the SDLT saving that the parties believed would be available, but stipulated that post-sale the GPUT structure would be collapsed and the Property distributed to the Hannover purchasing entity.

3. In *Hannover Leasing Wachstumswerte Europa Beteiligungsgesellschaft MbH and another v HMRC* [2019] UKFTT 0262 (TC).
4. Under UK tax law as at the relevant time.

Hannover's structuring preferences were driven by a number of factors:

- its preference was to acquire properties directly, so as to be more marketable to German retail investors and in order to more readily obtain approval from BaFin (the German regulatory body)
- their supervisory board took a conservative approach and would be concerned at the prospect of acquiring the GPUT with the LP (and potential historic liabilities) sat below it
- however, Hannover realised that pursuing an SDLT-efficient structure would enable it to table a more competitive purchase price.

The acquisition took place by way of a number of steps, each of which together formed "a single plan, which had to be completed in full…in sequence". In summary:

- the Property was transferred from the LP to the GPUT. The consideration was £138.8m but the application of the SDLT rules for transfers out of partnerships to partners meant that SDLT of only £55,540 was paid
- a conditional sale of the GPUT units to Hannover was agreed. The conditions included that the GPUT's interest in the LP be transferred to the sellers of the units. The consideration was again £138.8m but, under the SDLT rules, no tax was due on transfer of the units
- the GPUT was terminated and the Property transferred out to Hannover. No SDLT was paid as the consideration for the transfer was below the SDLT threshold.

Tribunal decision and comment

At the end of the Tribunal hearing the Supreme Court released its decision in the long-running *Project Blue*[5] case. Although the details of the *Project Blue* case were somewhat different, the Supreme Court in its judgment in that case confirmed that s.75A does not require a taxpayer to have a tax avoidance motive (despite being an "anti-avoidance" provision). Rather, s.75A "self-defines" SDLT avoidance; if the transactions put in place by the parties mean that less SDLT is payable than would have been paid (on a "notional" land transaction from the original owner to the ultimate purchaser), then s.75A is engaged.

Following the *Project Blue* decision the Tribunal held that s.75A applied so that there was a "notional" land transaction from the LP to the Hannover purchasing entity. The consideration for this notional transaction was £138.8m resulting in SDLT of £5.55m (with credit given for the £55,540 already paid on the first step noted above).

The Tribunal acknowledged that had the first step been the transfer of the GPUT units to Hannover, s.75A may well not have been engaged. It seems odd that this anti-avoidance provision can be switched on or off solely by virtue of the order in which the parties choose to carry out the acquisition steps. Whether the transfer of units is the "first" step for s.75A purposes may not always be clear, particularly where acquisition-related loans are being put in place.

It seems highly possible that the decision will be appealed but, at least until then, this decision will add to uncertainty around SDLT on complex "corporate wrapper" acquisitions.

The decision can be viewed here.

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5. [2018] UKSC 30.

IR35 – Tribunal decisions come thick and fast

Hot on the heels of the First-tier Tribunal's decision in *Albatel*[6] (the "Lorraine Kelly" case) two more IR35 decisions were handed down in April.

Firstly, in *Big Bad Wolff Limited*[7] the Upper Tribunal upheld the First-tier's decision that an actor who provided services through his personal services company was caught by IR35 for national insurance contributions (NICs) purposes (even though it was accepted that IR35 did not in this case impose an income tax charge). The Upper Tribunal held that the relevant NICs rules[8] had the effect that the actor was **deemed** to be employed for NICs purposes. This was the case despite the fact that he was not considered to be an employee under general law purposes. The decision can be viewed here.

Secondly, in *Atholl House*[9] the First-tier Tribunal held that IR35 did not apply in the case of another well-known presenter (this time Kaye Adams of *Loose Women* fame).

The appellant was Ms Adams' personal service company (PSC). HMRC determined that Ms Adams was a BBC employee for two tax years, primarily due to her work presenting a BBC Radio Scotland programme (running for three hours, each weekday morning). In addition to her BBC work, Ms Adams also appeared on ITV's *Loose Women* and Sky's *Newspaper Review*, wrote columns for a number of newspapers and magazines, hosted a number of corporate events and awards evenings and was a successful author.

The Tribunal considered whether, had Ms Adams' services been supplied under a contract directly between herself and the BBC, she would be regarded as an "employee" of the BBC. This required a close consideration of the agreed contractual terms between the BBC and the PSC, together with a review as to what had happened in practice. In light of this the Tribunal found that:

- Ms Adams did not receive any "typical" employment benefits such as sick or holiday pay
- whilst on air, on her BBC Radio Scotland show, she had ultimate control as to which callers to take and which questions to ask. However the BBC had ultimate editorial control over the content of the programme
- Ms Adams placed great importance on her "brand", for example by building her own social media presence. This was "consistent" with a career as a freelance journalist for over 20 years
- the BBC placed no restrictions on Ms Adams' ability to work for other media outlets (she was free to accept any other engagements during the period of alleged "employment" with the BBC)
- Ms Adams had no right of substitution
- Ms Adams was most often recognised in public for her *Loose Women* appearances. For that reason her "professional identity is, if anything, linked more closely to *Loose Women* than it is to the BBC"
- although there was some debate between the parties as to how Ms Adams' professional work (in terms of both remuneration and time) could be split for the periods in question between her BBC and her non-BBC work, even on HMRC's figures at least 30% of her income derived from non-BBC work. In any event, the Tribunal held that it would be "wholly artificial" just to look at the two tax years in question in isolation. It was, rather, necessary to consider her overall professional career. In taking that approach Ms Adams' BBC work was considered to be even less significant

Balancing all of the above (and more) the Tribunal held that Ms Adams' hypothetical contract with the BBC was not one of employment. Accordingly the IR35 rules did not apply.

6. See here for our Tax Team's earlier commentary on this decision.
7. *Big Bad Wolff Limited v HMRC* [2019] UKUT 121.
8. The Social Security (Categorisation of Earners) Regulations 1978 (SI1978/1689).
9. *Atholl House Productions Ltd v HMRC* [2019] UKFTT 0242 (TC).

Interestingly the Tribunal distinguished the facts of this case with those in *Ackroyd*[10]. Crucially, in the Tribunal's view, in *Ackroyd* (i) the BBC's contract with the intermediary was for seven years, following one for five years, (ii) the non-BBC income was de minimis, (iii) Ms Ackyroyd was given a clothing allowance, (iv) the BBC had first call on Ms Ackroyd's time, and (v) Ms Ackroyd was required to obtain the BBC's consent for non-BBC engagements.

The decision can be viewed here.

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First-tier Tribunal – option granted to director not "employment related" under deeming provision

On 8 April 2019, the First-tier Tribunal[11] held that an option granted to a company director was not an employment-related securities option (ERSO) under the deeming provision of ITEPA 2003[12].

An option had been granted by a company in respect of services provided by an individual on a consultancy basis. HMRC accepted at the time that the option was not an ERSO. Subsequent to the grant of the option, that individual became a director of the company and the company refinanced. As a result of the refinance, the company granted a new (replacement) option to the now-director. When the director came to exercise the option years later, HMRC sought to tax the ensuing gain as employment income (rather than CGT).

The Tribunal took the view that the new option was not, as a matter of fact, granted by reason of employment. Recognising that this gave rise to an anomaly, given that section 471(3) of ITEPA (the deeming provision) was engaged as the new option was "made available" by the employer, the Tribunal looked for ways to limit the application of the deeming provision in this particular case. It felt able to effectively ignore the deeming provision in this case as it would otherwise be "at variance with the factual reason" behind the granting of the option or (alternatively) that when viewed "realistically" the right to acquire the new option was not made available by the company as the director's employer.

The decision can be viewed here.

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European Commission: pre-2019 CFC rules amounted to illegal state aid

On 2 April 2019, the European Commission (EC) announced that the UK's controlled foreign company (CFC) regime exemption for certain finance income amounted (in part) to illegal state aid. Then, on 25 April 2019, the EC published its full decision in this case.

The UK's CFC regime was amended with effect from 1 January 2019, therefore the EC's decision should only relate to the period from January 2013 (when the CFC regime was updated) to December 2018. This was confirmed in the EC's press release of 2 April.

The CFC regime from 2013 introduced a "group finance exemption" (GFE). The GFE, broadly, provided for a full or partial (75%) exemption from the CFC charge for finance income received by a non-UK subsidiary of a UK company from another non-UK group company. The GFE could apply even if the financing income in question derived from UK activities, or the funds to finance the loan(s) derive from UK capital contributions.

10. *Christa Ackroyd Media Limited v HMRC* [2018] UKFTT 69 (TC), where the IR35 rules were held to apply.
11. In *Vermilion Holdings Ltd v HMRC* [2019] UKFTT 230 (TC).
12. Section 471(3) (a similar deeming provision applies to employment-related securities (section 421(B)(3))).

In the EC's press release, Commissioner Vestager was quoted as saying that, through the GFE, the UK "gave certain multinationals a selective advantage by granting them an unjustified exemption…".

The EC made a distinction between (1) loans between non-UK subsidiaries of a UK-headquartered group, where the finance income derives from UK activities (in which case the GFE in the EC's view amounted to illegal state aid), and (2) loans between non-UK subsidiaries of a UK-headquartered group, where the finance income does not derive from UK activities (in which case the GFE was justified in the EC's view).

It remains to be seen whether the UK government will appeal the EC's decision but HMRC is now required to recover underpaid tax for the 2013-2018 period which, it has been estimated, could amount to more than £1bn in total.

The EC press release can be viewed here and the full decision here.

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UK's chargeable gains group relief rules contrary to EU law – First-tier Tribunal

On 25 March 2019, the First-tier Tribunal[13] held that the denial of intra-group transfer relief (section 171 TCGA 1992) for transfers to a non-UK EU parent was contrary to the right to freedom of establishment.

The appellant (a UK company) made two disposals (of intangible assets and shares, respectively) to non-UK members of the same group of companies as the appellant (a Swiss and a Dutch company, respectively). Neither transferee had a permanent establishment in the UK. HMRC took the view that the appellant was liable to corporation tax on chargeable gains in respect of each transfer.

The Tribunal found in favour of the appellant in respect of the transfer of shares to the Dutch company (the ultimate parent of the group) but not in respect of the transfer of intangible assets to the Swiss group company.

For the intra-group transfer of intangible assets to the Swiss company, the Tribunal agreed with HMRC that the effect of the denial of section 171 group relief was not to amount to a restriction on the ultimate parent's freedom of establishment. The Tribunal took the view that relief would also have been denied for this transfer had the ultimate parent been a UK company (or otherwise subject to UK tax).

However, for the intra-group transfer of shares to the Dutch ultimate parent company the Tribunal found that the requirement for the Dutch company to be subject to UK tax (in order for section 171 to apply) was a restriction on the parent's freedom of establishment. It would appear from the Tribunal's decision that, had the appellant been able to pay the assessed tax in instalments, the denial of section 171 relief would have been a "proportionate" means of balancing the allocation of taxing rights between member states.

Whether the decision will be appealed remains to be seen. Taxpayers that have incurred UK tax on intra-group transfers of assets to non-UK EU parents (or to other non-UK EU group companies) may want to consider whether they have grounds for any tax repayment.

The decision can be viewed here.

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13. In *Gallagher Ltd v HMRC* [2019] UKFTT 207 (TC).

AG opines that provision and maintenance of cashpoints not exempt from VAT

On 2 May 2019, the Advocate General (AG) in *Finanzamt Trier v Cardpoint GmbH*[14] opined that the outsourced operation of ATMs is not within the scope of the VAT exemption (Article 135(1)(d) of Directive 2006/112/EC).

The services in question consisted in operating and maintaining the ATMs, replenishing them, installing computer hardware and software to enable the reading of bank card data, and sending withdrawal authorisations requests to the appropriate bank.

In light of the fact that the VAT exemptions must be interpreted strictly, the AG's view was that none of the services in question (i) had the effect of transferring a sum of money, or (ii) entailed legal and financial changes characterising a transfer of money. Rather, in the AG's view, the services were merely of a physical, technical or administrative nature.

Accordingly the AG opined that the VAT exemption for transactions concerning payments was not available to the services in question. Whether the ECJ follows the AG's opinion or not will be closely watched by the European financial outsourcing industry.

The decision can be viewed here.

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14. Case C-42/18.

About RPC

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19119

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

38/F One Taikoo Place
979 King's Road
Quarry Bay, Hong Kong
T +852 2216 7000

12 Marina Boulevard
38/F MBFC Tower 3
Singapore 018982
T +65 6422 3000