Corporate tax update

July 2019

Welcome to the latest edition of our Corporate Tax Update, written by members of RPC's tax team. This month's update reports on the key developments from June 2019 and includes summaries of the recent decision of the Upper Tribunal on corporate tax residence in *Development Securities plc*, two ECJ decisions on cross-border loss relief and yet another decision on the application of the 'IR35' rules.

Consideration paid for a "free" item was attributable to that item for VAT purposes

On 27 June 2019, the Upper Tribunal dismissed the taxpayer's appeal and held that part of a payment made for a "free" item under a promotion was, for VAT purposes, attributable to that item. more›

VAT groups and partnerships – First-tier Tribunal interprets VATA to conform with EU law

On 25 June 2019, the First-tier Tribunal held that the grouping rules in the Value Added Tax Act 1994 (VATA) could be interpreted to allow a Scottish Partnership to form a VAT group with the companies it owned. more›

First-tier Tribunal holds that retention payment earned, for taxation of earnings purposes, when paid (not over the course of the retention period)

On 24 June 2019, the First-tier Tribunal held that a retention payment was earned, and therefore taxed, in full in the tax year in which the payment was made. more›

Two ECJ decisions restrict scope of *Marks & Spencer* decision on cross-border loss relief

On 19 June 2019, the ECJ published decisions in two cases on two aspects of Swedish law that allow a Swedish parent company to claim relief for losses of overseas subsidiaries in certain circumstances. more›

Latest IR35 decision demonstrates importance of contractual terms

On 13 June 2019, the First-tier Tribunal held that similar (but not identical) short-term engagements between a single personal service company and two hospitals, when considered separately, should be taxed differently under the 'IR35' rules. more›

Any comments or queries?

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Jersey-incorporated SPVs held not to be UK tax resident – Upper Tribunal overturns decision on appeal

On 5 June 2019, the Upper Tribunal (UT) held that a number of Jersey-incorporated companies were, in fact, resident for tax purposes in Jersey. more>

HMRC publishes IPT call for evidence

On 3 June 2019, HMRC published a "call for evidence" on The Operation of Insurance Premium Tax (IPT). more>

Consideration paid for a "free" item was attributable to that item for VAT purposes

On 27 June 2019, the Upper Tribunal[1] dismissed the taxpayer's appeal and held that part of a payment made for a "free" item under a promotion was, for VAT purposes, attributable to that item.

In this case Marks & Spencer (M&S) made a promotional offer to customers whereby the customer was entitled to select three food dishes and claim a "free" bottle of wine (or non-alcoholic drink) for £10.

The correct VAT treatment of the promotional offer was important as food items are, generally, zero-rated whilst wine is standard-rated. M&S argued that as the wine was provided "free" of charge, none of the £10 should be apportioned to it for VAT purposes. HMRC argued that the £10 should, in part, be apportioned to the bottle of wine.

The Upper Tribunal considered whether there was a "direct link" between the wine and (part of) the consideration paid. Both parties accepted this to be the correct test to apply. There had to be "reciprocal performance" such that the payment received by the provider (M&S) constituted the value actually given in return for the wine supplied to the customer.

In the Tribunal's view, the payment of £10 constituted consideration both for the three food items and for the bottle of wine. The wine would not be provided unless the customer paid the £10, therefore (according to the Tribunal) the required "direct link" was present. The Tribunal appeared to place some weight on the fact that, here, there was a "single simultaneous transaction" between M&S and the customer. The Tribunal distinguished the case of *Kuwait Petroleum* on the basis that, in that case, there were two separate transactions that "destroyed" the reciprocity of performance.

The Tribunal took the view that the word "free" was being used in a marketing or promotional sense only. The economic reality was that the package offered by M&S consisted of 4 items, which included the wine. This was not changed by the fact that some customers (less than 1%) chose not to take up the offer to include the bottle of wine.

The decision can be viewed here.

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VAT groups and partnerships – First-tier Tribunal interprets VATA to conform with EU law

On 25 June 2019, the First-tier Tribunal held[2] that the grouping rules in the Value Added Tax Act 1994 (VATA) could be interpreted to allow a Scottish Partnership to form a VAT group with the companies it owned.

Although not a "body corporate" the partnership could, in the Tribunal's view, form a VAT group with the companies that it controlled through the possession of voting rights. The Tribunal considered that it was able to arrive at a statutory construction of section 43A of the VATA that is in conformity with EU law[3].

1. In *Marks and Spencer plc v HMRC* [2019] UKUT 0182 (TCC).
2. In *Baillie Gifford & Co v HMRC* [2019] UKFTT 0410 (TC).
3. Namely the ECJ decision in *Larentia* and *Minerva*. For our commentary on this decision, see here.

As the VAT grouping rules are to be amended by Finance Act 2019, the implications of this decision are likely to be limited to outstanding VAT group applications with similar fact patterns (namely, a partnership having control of bodies corporate).

The decision can be viewed here.

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First-tier Tribunal holds that retention payment earned, for taxation of earnings purposes, when paid (not over the course of the retention period)

On 24 June 2019, the First-tier Tribunal held[4] that a retention payment was earned, and therefore taxed, in full in the tax year in which the payment was made. The taxpayer had argued that as the payment was made in return for continued active employment during a stated period (spanning, at least in part, three tax years) the payment should be apportioned between them on a "just and reasonable" basis.

The Tribunal agreed with HMRC that section 18 of ITEPA 2003 sets out the rules as to when earnings are treated as received for tax purposes. The result was that the payment was treated as received upon the earlier of (i) payment and (ii) Mr Murphy becoming entitled to it. Although the Tribunal accepted that the conditions that attached to the payment required continued employment throughout the (15 month) retention period, it did not agree with Mr Murphy that the payment was earned in or in respect of that period. The entitlement to the payment did not accrue *during* the retention period. If Mr Murphy had left his employment at any point during the period, he would have been entitled to nothing. The payment was made on a certain date (clearly within one tax year) and Mr Murphy only became entitled to it on the same date. Applying section 18, the Tribunal therefore agreed with HMRC that the payment was taxable, in full, in the one tax year.

The decision can be viewed here.

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Two ECJ decisions restrict scope of *Marks & Spencer* decision on cross-border loss relief

On 19 June 2019, the ECJ published decisions in two cases on two aspects of Swedish law that allow a Swedish parent company to claim relief for losses of overseas subsidiaries in certain circumstances.

These decisions are of interest as they serve to limit the principle established in the case of *Marks & Spencer*[5]. In *Marks & Spencer* the ECJ held that:

- A restriction of the freedom of establishment (limiting the right of a company to deduct losses of a foreign subsidiary) is justified by the need to preserve the balanced allocation of the power to impose taxes between member states, and to prevent the risk of losses being used twice.

4. In *Murphy v HMRC* [2019] UKFTT 0409 (TC).
5. C-446/03.

- However, it is disproportionate for the member state of the parent company to deny the ability for the parent to use the losses of a non-resident subsidiary that are “final”. To rely on this, the parent must be able to show (broadly-speaking) that there is “no possibility” for the non-resident subsidiary to use the losses in its own state.

In the first case[6] a Swedish parent company (*Memira*) argued that the freedom of establishment[7] meant that it should be able to use (by way of deduction against profits for Swedish tax purposes) losses incurred by its German subsidiary where the German subsidiary had been absorbed by merger. On the facts, neither Swedish law nor German law allowed the losses to be used by the Swedish parent. The ECJ held that EU law did not assist *Memira*. The German subsidiary’s losses were not “final” (for EU law purposes) as there existed the possibility that the subsidiary could be sold to a third party, at a price reflecting the availability of the losses. *Memira* therefore, in an economic sense, had the possibility of an ‘indirect’ deduction of the subsidiary’s losses.

In the second case[8] another Swedish parent (*Holmen*) argued that the freedom of establishment meant that it should be able to use losses incurred by a Spanish subsidiary of its Spanish subsidiary (ie losses of *Holmen’s* sub-subsidiary). The Swedish rules prevented *Holmen* from using the losses incurred by a non-resident sub-subsidiary. The ECJ drew a distinction between cases where the subsidiary and sub-subsidiary were resident in the same member state, and cases where they were not. Where they were resident in the same member state, the losses of the sub-subsidiary could be “final” (for EU law purposes). Where they were not resident in the same member state, the ECJ held that to allow the parent to use the losses could lead to group tax rate optimisation strategies and that therefore it would not be disproportionate in those cases to allow the parent member state to deny use of the losses.

The decisions can be viewed here and here.

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Latest IR35 decision demonstrates importance of contractual terms

On 13 June 2019, the First-tier Tribunal held[9] that similar (but not identical) short-term engagements between a single personal service company and two hospitals, when considered separately, should be taxed differently under the ‘IR35’ rules.

The company provided the services of a urologist to two hospitals.

The Tribunal concluded that a hypothetical contract between the urologist and the Royal Berkshire Hospital (RBH) would be considered to be a contract of employment. A hypothetical contract between the urologist and the Medway Maritime Hospital (MMH), on the other hand, would be one of self-employment.

There was a written contract between the personal service company and MMH. It contained a right for the company to provide a substitute to MMH. The Tribunal decided that this was not an “illusory” right. No such right existed as regards the supply to RBH.

6. *Skatteverket v Memira Holdings AB* (Case C-607/17).
7. Article 49 of the Treaty on the Functioning of the European Union.
8. *Skatteverket v Holmen AB* (Case C-608/17).
9. In *George Mantides Ltd v HMRC* [2019] UKFTT 0387 (TC).

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In addition, the MMH contract contained no obligations around minimum hours of work and included a one day's notice provision. The hypothetical contract with RBH would, in the Tribunal's view, have included a week's notice clause and a 30-40 hour week requirement.

These factors, on balance, led the Tribunal to reach its conclusion that the engagement with RBH was, for tax purposes, akin to employment (unlike the engagement with MMH). On each of these 3 factors, the MMH engagement pointed away from employment.

The decision can be viewed here.

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Jersey-incorporated SPVs held not to be UK tax resident – Upper Tribunal overturns decision on appeal

On 5 June 2019, the Upper Tribunal (UT) held[10] that a number of Jersey-incorporated companies were, in fact, resident for tax purposes in Jersey. This decision overturned the 2017 decision of the First-tier Tribunal (FTT), which held that the companies were UK tax resident as a result of the central management and control (CMC) of the companies being exercised in the UK (through the companies' parent). The UT took the view that the FTT had incorrectly concluded that the Jersey company directors had abdicated their decision-making responsibility.

The facts of the case were that a group headed by a UK resident parent undertook a tax-planning proposal designed, and carefully implemented, by its accountants. The aim of the proposal was to allow the group to access latent capital losses on certain assets (including UK real estate) on the basis that the crystallised losses would include indexation. Very broadly, the proposal involved newly-established wholly-owned Jersey companies purchasing the assets at an artificially high price and selling them shortly afterwards at a loss. Critical to the success of the proposal was that the Jersey companies would be treated as non-UK resident prior to sale of the assets.

The FTT, in a lengthy judgment, agreed with HMRC that the tax planning scheme did not work as the Jersey companies were UK tax resident throughout.

The UT dismissed out of hand one of the reasons for the FTT's decision. The first reason (in the UT's view the "subsidiary" one) for the FTT's decision was that the directors of the Jersey companies had a specific task entrusted to them by the UK parent, after which they were to resign. This specific task was to implement the tax planning scheme devised by the UK parent with the help of its accountants. This was considered by the UT to be wholly irrelevant to the question of CMC. Quoting the decision in *Wood v Holden*[11], the UT held that "*the mere fact that a 100% owned subsidiary carries out the purpose for which it was set up, in accordance with the intentions, desires and even instructions of its parent does not mean that central management and control vests in the parent*".

On the FTT's "primary" reason for deciding that CMC of the companies was exercised in London, the UT considered the FTT to be "untenable and wrong". The FTT had held that the

10. In *Development Securities plc and others v HMRC* [2019] UKUT 169 (TCC).
11. [2006] STC 443.

Jersey company directors had abdicated responsibility for exercising CMC due to the fact that, from the outset, the Jersey directors knew that they were being asked to cause the companies to act in a manner contrary to their commercial interests. In other words (according to the FTT) the Jersey company directors were not exercising CMC as they were not exercising their judgment as directors. In the Upper Tribunal's view, however, the FTT had reached this view on the back of a fundamental misunderstanding.

Firstly the FTT was incorrect (according to the UT) to say that the Jersey companies acquired the assets on uncommercial terms (ie at a price above market value). The purchases were funded by the parent, not the Jersey companies.

Secondly, as the Jersey companies had no employees and there was no question as to the transactions prejudicing creditors, in the UT's view the primary duty of the Jersey company directors would be to their shareholders (ie the UK parent). Therefore, in acting as they did, the Jersey directors were not in breach of their duties. In the words of the UT:

"the essential error committed by the FTT was to focus on the uncommerciality of the transactions to the individual Jersey Companies without having regard to the actual duties the directors owed to those companies".

The UT decision is of particular interest when looking at the CMC of SPVs. It makes a distinction between circumstances where the parent *influences* the SPV (so that CMC remains with the board of the SPV) and where the parent controls the SPV in such a way so that decisions that should, properly, be taken by the board of the SPV are in fact taken by the parent. Such parent "control" can be carried out in a number of ways, from usurping the SPV's board functions to cases whereby the SPV board simply 'rubber stamps' decisions taken elsewhere. On the facts, in this case, the UT took the view that the actions of the Jersey company directors did not amount to an abdication of CMC; they were not merely "rubber stamping" decisions taken by their parent.

The decision can be viewed here.

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HMRC publishes IPT call for evidence

On 3 June 2019, HMRC published a "call for evidence" on The Operation of Insurance Premium Tax (IPT). The stated purpose of the call for evidence is:

- to modernise the administration and collection of IPT; and
- to understand any emerging insurance industry practices that might lead to unfair IPT outcomes

As the call for evidence is limited to the *operation* of IPT, it does **not** consider IPT rates or exemptions.

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The specific questions posed include:

- whether, in limited circumstances, IPT should be collected from brokers
- whether existing, limited, powers to collect unpaid IPT from the insured should be bolstered
- whether the mismatch between the IPT treatment of commission and of administration fees distorts the market
- whether a public register (of IPT-registered insurers) would be helpful
- whether unregistered insurers pose an issue to the industry
- whether IPT returns should also include details as to IPT-exempt premiums

The closing date for comments is 17 July 2019.

The call for evidence can be viewed here.

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About RPC

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