Corporate tax update

June 2020

Welcome to the latest edition of our corporate tax update, written by members of RPC's tax team. This month's update reports on some of the key developments from May 2020. As well as some further COVID-19 related tax developments, this month's report also has a bit of a sports theme with summaries of decisions involving an ex-England cricket captain and football referees. As ever we hope you, your family and friends are all staying safe.

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ABOUT THIS UPDATE

Our corporate tax update is published every month, and is written by members of RPC's Tax team.

We also publish other Tax updates on the first and last Thursday of every month, and a weekly blog, RPC's Tax Take.

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COVID-19: HMRC guidance on trading activities

HMRC has published guidance on the impact of COVID-19 driven changes to trading activities. The guidance sets out how HMRC will apply existing legislation and case law to scenarios including where businesses have, as a result of COVID-19:

- changed their product lines
- provided goods and services to key workers free-of-charge, or at significant discounts
- donated supplies to charities, hospitals and care homes

On the question as to whether a business has commenced a separate trade (with the tax consequences that follow) HMRC state that although the exact treatment will depend on the precise facts of each case, (by way of example) if a business that is already manufacturing clothing articles starts to manufacture gowns and face masks using the same staff and premises then this should be treated as an extension of the same trade and not the commencement of a new trade.

As to the risk of COVID-19 resulting in a permanent cessation of trade for tax purposes, the new guidance makes it clear that if a business closed its doors to customers, or otherwise ceased trading during the lockdown period, but intended to continue trading after restrictions were lifted, then the trade should not necessarily be treated as having ceased. Whether or not the business does, in fact, resume the same or similar activities once lockdown has ended would then need to be assessed.

On the topic of refunds (such as gym memberships and subscriptions) offered by businesses during lockdown, the HMRC guidance states that where these are included as trade expenses in GAAP-compliant accounts HMRC would expect these amounts to be allowable for tax purposes.

The guidance can be viewed here.

Rectification of contract rejected if effect would be to provide a tax benefit

On 29 May 2020, the High Court[1] declined to exercise its discretion to allow rectification of a contract that had adverse tax consequences.

In 2008, former England cricket captain Michael Vaughan (MV) (via his personal services company (PSC)) entered into a contract to write newspaper articles. Upon expiry of the initial contract in 2011, a new 4-year contract was entered into. This new contract, however, was entered into by MV himself (and not his PSC) although payments continued to be made to the PSC. HMRC took the view that, as the contract was entered into by MV personally, the amounts paid were correctly treated as his income for tax purposes.

In 2018, the newspaper, PSC and MV entered into a deed of rectification. This deed set out that it had all along been the parties' intention that the new 2011 contract should be between the newspaper and the PSC. As the deed was not binding upon HMRC, the PSC and MV asked the court to declare that (if the true interpretation of the 2011 contract was not that it was entered into by the PSC) the contract should be rectified to have that same effect.

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The court held that the 2011 contract was between the newspaper and MV personally. A reasonable reader of that contract would not conclude that naming MV as a party (rather than the PSC) had been a clear mistake.

On the rectification issue, the court did find that a rectifiable mistake had been made in the formulation of the 2011 contract. All three parties had the same intention, the court held, namely to extend (and not alter) the initial 2008 contract. However, the court declined to exercise its discretion to rectify the 2011 contract as there remained no issue between the parties to be resolved. This had been achieved by the 2018 deed of rectification. The fact that MV and HMRC were in dispute as to the tax treatment of the payments under the contract did not justify the exercise of discretion to rectify.

Emphasis was placed upon the apparent lack, in 2011, of any tax motive in entering into the new contract. The court was being asked to rectify in order to deliver an advantageous tax treatment that was not at the forefront of the parties' minds at the time. This could be contrasted with a situation whereby the parties were (at the relevant time) motivated by tax advantages. In that (hypothetical) scenario, the 2018 deed of rectification would not necessarily have resolved all live issues and the court may have been minded to exercise its discretion to rectify in order to deliver what the parties had intended.

This decision highlights the risk of looking to rely on rectification to provide a tax treatment that was not initially contemplated. Full consideration should be given to the likely tax consequences of any contract (with written records as to the parties' intentions).

The decision can be viewed here.

Taxation of COVID-19 business support schemes and payments – draft legislation

On 29 May 2020, HMRC published draft legislation providing for the taxation of COVID-19 business support grants. The consultation on this draft legislation has now closed, and the legislation will take effect from the date of Royal Assent of Finance Bill 2020.

The legislation covers:

- Self-Employment Income Support Scheme (SEISS)
- Coronavirus Job Retention Scheme (CJRS)
- Small Business Grant Fund (SBGF)
- Retail Hospitality and Leisure Grant Fund (RHLGF)
- Discretionary Grant Fund (DGF)
- other parallel schemes in the devolved administrations, and other payments made, or schemes provided, by public authorities in response to COVID-19

Payments under such schemes are to be treated as taxable income where the recipient is within the scope of either corporation tax or income tax.

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HMRC will also be given powers to recover payments to which recipients were not entitled to under the SEISS or the CJRS or where a CJRS payment has not been used to pay employees, make pensions contributions, pay PAYE or National Insurance contributions. HMRC will also be able to charge a penalty in cases of deliberate non-compliance.

The draft legislation can be viewed here.

Employment-related options granted "by reason of" employment – HMRC wins appeal

On 27 May 2020, the Upper Tribunal[2] held that an option granted to a director was acquired "by reason of" employment for the purposes of ITEPA 2003. The gain arising on exercise of such option was subject to tax as employment income.

The facts of this case were that an individual (N) had been an advisor to a company (V). A different company (Q) of which N was then a director was given an option over shares in company V (2006 option). HMRC gave a non-statutory clearance that the 2006 option was not an "employment-related" option for ITEPA 2003 purposes.

In 2007, company V got into financial difficulties. A new option was granted by company V to company Q (to replace the 2006 option) and N became a director of company V. In 2016, company Q novated the 2007 option to N. Upon exercise by N of that 2007 option, HMRC considered that the 2007 option was a right or opportunity which had been made available to N by company V as his employer.

The First-tier Tribunal (FTT) held that:

- **as a matter of fact**, the right to acquire the 2007 option was not granted by reason of employment (rather, it stemmed from the 2006 option)
- however, the 'deeming' provision in ITEPA[3] was engaged as, at the time of grant of the 2007 option, N was (for ITEPA purposes) an employee of company V
- this gave rise to an anomaly that would lead to an injustice

The Upper Tribunal (UT) held that the FTT had erred in its interpretation of "by reason of employment". As the 2007 option was granted as part of an arrangement whereby N was made a director of company V, that option was granted "by reason of" employment. It was not necessary (for the ITEPA rules to apply) that employment was the sole reason for the granting of the option. Having reached that conclusion, the UT did not need to consider the 'deeming' provision at s.471(3) of ITEPA. The UT decision, in allowing HMRC's appeal, has reinforced the commonly-held view as to the correct interpretation of s.471.

The decision can be viewed here.

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Transaction costs VAT recovery – actual use overrides intended use (AG opinion)

On 14 May 2020, the Advocate General[4] opined that the actual use of services is determinative (in terms of VAT deductibility) in cases where there had been a prior intended, but aborted, use.

In this case the taxpayer had incurred input tax on services relating to a potential share acquisition (and related bond issue). The acquisition failed, however, and the bond issue proceeds were lent to the taxpayer's parent. The taxpayer nevertheless sought to recover the input tax.

It was noted by the AG that, provided the intention was for the purchaser to actively provide taxable management services to the acquired group, input tax recovery could still be allowed even if the acquisition was aborted (on this, see the ECJ decision[5] in the *Ryanair* case).

However, it was the AG's opinion that intended use was overridden by actual use. As the VAT recovery position of the bond issue related transaction costs was governed by the proceeds' use for lending (rather than the intended use of financing an aborted purchase) the input tax was not deductible. One presumes that the result might have been different, had the taxpayer instead retained the funds for the purposes of another acquisition.

The AG's opinion can be viewed here.

Corporate capital loss restriction – draft HMRC guidance published

On 12 May 2020, HMRC published draft guidance on the corporate capital loss restriction applicable from 1 April 2020.

Under these new rules, companies face restrictions as to the amount of carried forward capital losses that can be set against chargeable gains. The restriction applies a 50% limit on chargeable gains accruing after 1 April 2020 that can be sheltered by carried forward capital losses.

The draft guidance covers calculation (with examples) of the capital loss restriction. It also specifically addresses application of the new rules to collective investment schemes, REITS, life insurance companies and companies in insolvent liquidation. It also covers:

- impact on non-UK resident companies with UK property businesses; and
- companies with an accounting period that 'straddles' 1 April 2020

The draft guidance can be viewed here.

Football referees held not to be employed for tax purposes – the final whistle for HMRC?

On 6 May 2020, the Upper Tribunal[6] dismissed HMRC's appeal against a 2018 decision of the First-tier Tribunal (FTT) that certain football referees and other match day officials were not employees of Professional Game Match Officials Limited (PGMOL). Accordingly, PGMOL did not have tax and national insurance contributions liabilities in respect of the officials in question.

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The decision helpfully summarises the case law on mutuality of obligation although, as this decision amply demonstrates, whether an individual is, or is not, an employee for tax purposes remains a highly fact-dependant question.

Background

PGMOL is a joint venture run on a "not-for-profit" basis, with three 'members' being the Football Association, the Premier League and the English Football League. PGMOL's role is to provide referees and other officials for matches in the most significant national football competitions. It also organises courses, conferences and training for these officials.

The appeals in question related only to payments (ie match fees and expenses) made by PGMOL to individuals in the so-called "National Group" of elite officials. This is, effectively, the group of elite football officials just below the group who routinely officiate Premier League matches.

This National Group of referees and other officials primarily refereed matches in the second, third and fourth tiers of English football, as well as FA Cup matches and (in capacity as 'fourth' officials) in the Premier League.

PGMOL's principal argument was that no contractual relationship existed between PGMOL and the National Group referees. These referees are, before the season starts, sent a number of documents (some requiring signature) which include a "Code of Practice", set of "Guidelines" and "Match Day Procedures". However, according to PGMOL none of these in isolation nor taken together amounted to a "contract" between employee and employer. PGMOL's position was that for these National Group officials, match officiating was a hobby (albeit a very serious one). They managed their match officiating around other paid work (which "paid the bills"). These individuals are hugely ambitious and committed, and love the role. They therefore, largely, adhered to PGMOL's requests on a voluntary basis.

HMRC, in contrast, argued that taking into account the written documents in their entirety and the wider factual matrix, there were express annual contracts between PGMOL and the referees. It was HMRC's position that each individual engagement to officiate at a particular match was a contract of employment, existing in the context of an overarching or umbrella contract.

FTT decision

PGMOL's appeal against HMRC determinations for income tax and class 1 NICs was allowed by the FTT. Although the FTT concluded that the National Group referees did each have a contractual relationship with PGMOL (both in the form of individual engagements for specific matches and also a seasonal 'overarching' contract), on the key question the FTT disagreed with HMRC and held that these contractual arrangements did not give rise to a contract of service.

Applying the established multi-factorial test for employment status, the FTT held (amongst other things) that:

- the documents contained no legal obligation to provide work or to accept work offered. The FTT noted that "this is not an ordinary situation" as PGMOL is dealing with highly-motivated individuals, who generally wished to make themselves available for such high-profile matches as regularly as possible. There was therefore no need to impose a legal obligation to accept work.

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- there was no sanction if a National Group official could not attend an 'accepted' match for any reason. Rather than being a breach of the contract that the FTT had identified, the official would simply not be paid (and PGMOL would find a replacement).
- on match day, the referee was undoubtedly in charge; his decisions are final and the FTT was not able to ascribe to PGMOL a sufficient degree of control over the officials to satisfy the test for employment status.
- the other relevant factors did not otherwise point to a relationship of employment between PGMOL and the officials.

UT decision

The UT dismissed HMRC's appeal against the FTT decision concluding that the FTT had not erred in law in its decision that these referees were engaged under contracts for services. Specifically, the UT held that the FTT had not erred in law in concluding that that there was, on these facts which included the lack of a sanction if an official did not attend a match, insufficient mutuality of obligation (which has been descried as the "irreducible minimum" for a contract of employment).

The decision can be viewed here.

ANY COMMENTS OR QUERIES

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ENDNOTES

1. In *MV Promotions Ltd and another V Telegraph Media Group Ltd and HMRC* [2020] EWHC 1357 (Ch).
2. In *HMRC v Vermilion Holdings Limited* [2020] UKUT 162 (TCC).
3. Section 471(3) ITEPA 2003.
4. In *Sonaecom SGPS SA v Autoridade Tributária e Aduaneira* (Case C-42/19) EU:C:2020:378.
5. *Ryanair Ltd v HMRC* (Case C-249/17).
6. In *Professional Game Match Officials Limited v HMRC* [2020] UKUT 147 (TCC).