RPC

Tax update

September 2019

In this month's update we report on (1) HMRC's consultation on draft regulations implementing the requirement to disclose certain cross-border arrangements; (2) the Financial Secretary to the Treasury's statement to Parliament on HMRC powers; and (3) the government's response to the Joint Committee's recommendations on the Draft Registration of Overseas Entities Bill.

We also comment on three recent cases relating to (1) the setting aside of follower notice penalties; (2) the tax residency of Jersey incorporated SPVs; and (3) entrepreneur's relief.

News items

HMRC consults on draft regulations implementing the requirement to disclose certain cross-border arrangements

HMRC is seeking views on new rules that will require the disclosure to HMRC of certain cross-border arrangements that could be used to avoid or evade tax. The International Tax Enforcement (Disclosable Arrangements) Regulations 2019 will implement European Directive 2018/822, which requires the mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements from 1 July 2020. more›

Written statement to Parliament on HMRC's powers and taxpayer safeguards

In a written statement to Parliament, Jesse Norman has set out actions HMRC are taking to maintain and develop public trust in its operations in response to the House of Lords Economic Affairs Committee report entitled: "The Powers of HMRC: Treating Taxpayers Fairly". more›

Government response to recommendations on the draft Registration of Overseas Entities Bill

The government has published its response to recommendations made by the Joint Committee regarding the draft Registration of Overseas Entities Bill. The government has welcomed the report of the Committee and has committed to acting in several areas, including, amongst other things. more›

Any comments or queries?

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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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Case reports

Corrado – follower notice penalty set aside

In *Giulio Corrado v HMRC* [2019] UKFTT 275 (TC), the First-tier Tribunal (FTT) has set aside a follower notice (FN) penalty as the taxpayer's failure to take corrective action in response to a FN was reasonable in all the circumstances. more›

Development Securities – Jersey incorporated SPVs not UK tax resident

In *Development Securities plc and others v HMRC* [2019] UKUT 0169 (TCC), the Upper Tribunal (UT) has held that a number of Jersey-incorporated companies were in fact resident for tax purposes in Jersey. This decision overturned the decision of the FTT, which had 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. more›

Warshaw – preference shares can amount to ordinary share capital for the purposes of entrepreneurs' relief

In *Steven Warshaw v HMRC* [2019] UKFTT 268 (TCC), the FTT has confirmed that as the relevant preference shares did not attract a fixed dividend, they could amount to ordinary share capital, for the purpose of entrepreneurs' relief (ER). more›

News items

HMRC consults on draft regulations implementing the requirement to disclose certain cross-border arrangements

HMRC is seeking views on new rules that will require the disclosure to HMRC of certain cross-border arrangements that could be used to avoid or evade tax. The International Tax Enforcement (Disclosable Arrangements) Regulations 2019 will implement European Directive 2018/822, which requires the mandatory automatic exchange of information in the field of taxation in relation to reportable cross-border arrangements from 1 July 2020.

Comments on the consultation are required by 23.45 on 11 October 2019.

The consultation document can be viewed here.

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Written statement to Parliament on HMRC's powers and taxpayer safeguards

In a written statement to Parliament, Jesse Norman has set out actions HMRC are taking to maintain and develop public trust in its operations in response to the House of Lords Economic Affairs Committee report entitled: "The Powers of HMRC: Treating Taxpayers Fairly".

The statement confirms. amongst other things that: (a) HMRC will establish a Professional Standards Committee to advise the Commissioners on their approach to new technologies; (b) a full review of HMRC's powers is not considered necessary at this time; and (c) HMRC is reviewing the content, language and tone of its letters to ensure they are clear, courteous and tailored to the needs of the taxpayer.

The written statement can be viewed here.

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Government response to recommendations on the draft Registration of Overseas Entities Bill

The government has published its response to recommendations made by the Joint Committee regarding the draft Registration of Overseas Entities Bill. The government has welcomed the report of the Committee and has committed to acting in several areas, including, amongst other things:

(a) publishing guidance to help overseas entities understand the requirements of the Bill;

(b) publishing guidance ahead of the operational regime of the Register of overseas entities; and

(c) including an option on the Register to report suspicious or potentially incorrect information.

The government has also said that it is considering changes to the Bill but will undertake further work to consider the implications of the recommendations of the Committee before committing to such changes.

The response can be viewed here.

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Case reports

Corrado – follower notice penalty set aside

In Giulio *Corrado v HMRC* [2019] UKFTT 275 (TC), the First-tier Tribunal (FTT) has set aside a follower notice (FN) penalty as the taxpayer's failure to take corrective action in response to a FN was reasonable in all the circumstances.

Background

Mr Corrado had participated in what was commonly known as the 'Working Wheels' tax avoidance scheme, the details of which are not important for the purpose of this report.

In December 2014, following the FTT's decision in *Flanagan v HMRC* [2014] UKFTT 175 (TC) (in which it was held that the scheme was ineffective), HMRC issued to Mr Corrado a FN and an Accelerated Payment Notice (APN), pursuant to sections 204 and 219, Finance Act 2004, respectively.

Mr Corrado was required by the FN to take corrective action by completing a form confirming that the additional tax due and payable by him was £191,803.60. As the amount of tax due from him was only £16,580.29, Mr Corrado did not complete and return the form.

In January 2015, HMRC confirmed that Mr Corrado was in fact only liable to pay £16,580.29, and this was paid by him before the penalty deadline in March 2015.

HMRC issued a penalty to Mr Corrado in the sum of £57,541.08 for failing to "take corrective action" on receipt of the FN, pursuant to section 208, Finance Act 2014.

Mr Corrado appealed against the penalty.

FTT decision

The appeal was allowed.

The following three issues were before the FTT:

1. whether Mr Corrado had taken corrective action;

2. if he had not, were his actions reasonable in all the circumstances; and

3. if not, whether the penalty should be upheld in the original amount, increased or reduced.

The first issue
Agreeing with the FTT's decision in *Hutchinson v HMRC* [2018] UKFTT 290, the FTT determined that Mr Corrado had not taken corrective action. In the view of the FTT, corrective action requires taxpayers to clearly communicate to HMRC that they will irrevocably give up their claim to the tax advantage. No such communications took place; the discussions between Mr Corrado and HMRC centred around the amount of tax Mr Corrado was liable to pay.

The second issue
The FTT noted that it is important to consider all of the circumstances when deciding whether a taxpayer's actions were objectively reasonable, including their experience, other relevant attributes and the situation the taxpayer found himself in at the relevant time. The FTT concluded that it was reasonable for Mr Corrado to rely on his professional adviser to settle his dispute with HMRC. It was also reasonable for Mr Corrado not to return the relevant form to HMRC as the amount claimed was incorrect. The FTT concluded that, in all the circumstances, it was reasonable for Mr Corrado not to have realised that he had not taken the necessary corrective action.

The third issue
Given the FTT's conclusion that Mr Corrado's actions were reasonable, it was unnecessary for the FTT to consider this issue.

Comment
This decision is a timely reminder that on receipt of a FN, simply paying any additional tax due is not sufficient for the purpose of taking the corrective action required by section 208. Taxpayers who do not wish to challenge a FN must irrevocably give up their claim to the relevant tax advantage, either by amending their return to remove the claim or by settling their dispute on terms which relinquishes the tax advantage.

Whether a taxpayer's failure to take the required corrective action is reasonable, is to be determined on an objective basis. Whilst there will be exceptions, it will normally be reasonable (as it was in this case) for a taxpayer to rely upon his or her professional adviser.

The decision can be viewed here.

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Development Securities – Jersey incorporated SPVs not UK tax resident
In *Development Securities plc and others v HMRC* [2019] UKUT 0169 (TCC), the Upper Tribunal (UT) has held that a number of Jersey-incorporated companies were in fact resident for tax purposes in Jersey. This decision overturned the decision of the FTT, which had 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.

Background
A group, headed by a UK resident parent, implemented a tax-planning arrangement designed and carefully implemented by its accountants. The aim of the arrangements 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. In broad terms, 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 arrangements was that the Jersey companies would be treated as non-UK resident prior to the sale of the assets.

The FTT agreed with HMRC that the tax planning arrangements were ineffective as the Jersey companies were UK tax resident throughout. The taxpayers appealed to the UT.

UT decision
The appeal was allowed.

The UT was dismissive of the reasons the FTT had given for its decision. The first reason (in the UT's view the subsidiary reason) 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 arrangements 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. The UT referred to *Wood v Holden* [2006] STC 443, and commented 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".

With regard to the FTT's primary reason for deciding that CMC of the companies was exercised in the UK, the UT considered the FTT's reasoning to be "untenable and wrong". In the view of the FTT, the Jersey company directors had abdicated responsibility for exercising CMC due to the fact that, from the outset, they 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 judgement as directors. In the UT's view, the FTT had reached this view due to a fundamental misunderstanding. The FTT was incorrect 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.

Also, 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 was 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".

Comment

This decision provides helpful guidance when considering the CMC of SPVs. There is a distinction between circumstances where a parent influences an SPV (so that CMC remains with the board of the SPV) and where a parent controls the SPV in such a way that decisions which 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 the SPV board simply 'rubber stamping' decisions taken elsewhere. On the facts of this case, the UT was of the clear view that the actions of the Jersey company directors did not amount to an abdication of CMC as they were not merely 'rubber stamping' decisions taken by the parent company.

The decision can be viewed here.

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Warshaw – preference shares can amount to ordinary share capital for the purposes of entrepreneurs' relief

In *Steven Warshaw v HMRC* [2019] UKFTT 268 (TCC), the FTT has confirmed that as the relevant preference shares did not attract a fixed dividend, they could amount to ordinary share capital, for the purpose of entrepreneurs' relief (ER).

Background

Mr Warshaw was chairman of Cambridge Education Group Limited (CEG), a holding company, in which he held ordinary and preference shares.

On 12 March 2012, Mr Warshaw exchanged all of his shares in CEG for shares in Cambridge Education Holdings 2 (Jersey) Limited (CEH2). On 13 March 2012, Mr Warshaw exchanged all his shares in CEH2 for shares in Cambridge Education Holdings 1 (Jersey) Limited (CEH1).

Following these exchanges of shares, if Mr Warshaw's preference shares were 'ordinary share capital', as defined in section 989, Income Tax Act 2007 (ITA 2007), he would hold 5.777% of CEH1. If they were not, he would hold 3.5% of CEH1 and not satisfy the 5% threshold required in order for the company to be classified as Mr Warshaw's 'personal company', which would enable him to claim ER.

In December 2013, Mr Warshaw sold his shares in CEH1 and ceased to be a director of CEH1 and chairman of CEG. In 2015, he Warshaw claimed ER on this disposal.

HMRC opened an enquiry into Mr Warshaw's tax return and in due course issued a closure notice confirming that the capital gains arising on the disposal of the shares in CEH1 did not qualify for ER because CEH1 was not Mr Warshaw's 'personal company', for the purposes of section 169S(3), Taxation of Chargeable Gains Act 1992 (TCGA 1992).

Mr Warshaw appealed to the FTT.

FTT decision
The appeal was allowed.

The sole issue before the FTT was whether the preference shares held by Mr Warshaw amounted to 'ordinary share capital', as defined in section 989, ITA 2007. If they did, CEH1 would qualify as Mr Warshaw's 'personal company', for the purposes of section 169S(3), TCGA 1992, and he would be entitled to ER on the disposal of his shares.

The FTT firstly considered the nature of the shares. The preference shares were cumulative and attracted a right to a fixed dividend at 10% per year, but if there were insufficient reserves to pay the dividend in one year, payment was deferred to the next year and the dividend would be paid at 10% on the aggregate of the subscription price and the amount compounded. The FTT applied *Tilcon Limited v Holland (Inspector of Taxes)* [1981] STC 365, which supported the need to take into account both the percentage element and the amount to which it was applied to, in order to identify the rate of the dividend.

If, as was the case here, when the preference shares were issued, the articles of association of the company provided only that the percentage element of a dividend was fixed, then the shares did not have a right to a fixed rate dividend. As such, the shares fell within the definition of 'ordinary share capital', provided by section 989, ITA 2007, and CEH1 was Mr Warshaw's personal company. As such, he was entitled to ER on the disposal of his shares.

Comment
This decision confirms that if, at the time the preference shares are issued, the articles of association of the company provide only that the percentage element of a dividend is fixed, so the shares do not have a right to a fixed dividend, the shares will fall within the definition of 'ordinary share capital, in section 989, ITA 2007.

Taxpayers should consider carefully the precise wording of a company's articles of association and the rights attached to any shares disposed of when claiming ER.

The decision can be viewed here.

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About RPC

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