RPC

Tax update

April 2017

In this update we report on recent HMRC guidance on partnership follower notices and penalties, the new employment status checker for the intermediaries legislation (IR35) and details of tax avoidance scheme for income and national insurance contributions which HMRC has highlighted in its Spotlight 37. We also comment on three recent cases involving whether section 167, Taxation of Chargeable Gains Act 1992, is compliant with Human Rights and EU law, a dispute concerning loan relationship debits for foreign exchange losses and the invalidity of Regulation 80 determinations due to HMRC's failure to obtain the necessary statutory consents for PAYE codes to be sent to a taxpayer electronically.

News items

HMRC guidance on partnership follower notices and penalties

On 6 March 2017, HMRC published guidance confirming that penalties will be issued to each of the relevant partners of a partnership which has received a follower notice, where corrective action has not been taken on time. more›

HMRC publishes new employment status checker for IR35

On 2 March 2017, HMRC published a new employment status checker to determine whether the intermediaries legislation will apply to a particular set of facts. more›

Spotlight 37: HMRC reveals details of a new tax avoidance scheme for income tax and National Insurance Contributions (NICs)

HMRC is aware of a new disguised remuneration tax avoidance scheme that attempts to avoid income tax and NICs by paying contractors in the form of redeemable loyalty points. more›

Case reports

Reeves: Tribunal concludes that capital gains tax legislation is compliant with Human Rights and EU law

In *William Reeves v HMRC*, the First-tier Tribunal (FTT) has held that section 167, Taxation of Chargeable Gains Act 1992 (TCGA), is compliant with the European Convention on Human Rights (ECHR) and EU law. more›

Any comments or queries

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

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

Michelle Sloane
Senior Associate
+44 20 3060 6255
michelle.sloane@rpc.co.uk

About this update

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

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

To subscribe to any of our publications, please [click here].

Smith and Nephew: Tribunal allows loan relationship debits for foreign exchange losses incurred on change in functional currency

In *Smith and Nephew Overseas Limited and others v HMRC*, the FTT allowed appeals against HMRC's disallowance of foreign exchange losses incurred as a result of a change in functional currency following a company reorganisation. more>

Ridgecrest: Tribunal allows appeal against Regulation 80 determinations

In *Ridgecrest Cleaning Services Pendergate Ltd v HMRC*, the FTT allowed an appeal against determinations of underpaid tax made under Regulation 80 of the Income Tax (PAYE) Regulations 2003 (the PAYE Regulations), as HMRC had not obtained the necessary statutory consent from the taxpayer to notify it of changes to employee PAYE codes electronically. more>

News items

HMRC guidance on partnership follower notices and penalties

On 6 March 2017, HMRC published guidance confirming that penalties will be issued to each of the relevant partners of a partnership which has received a follower notice, where corrective action has not been taken on time.

Penalties will be up to 20% of the value of the denied advantage, with each partner liable for their appropriate share of the total amount. A penalty reduction is, however, available if the partnership cooperates with HMRC.

A copy of HMRC's guidance can be found here.

Back to contents>

HMRC publishes new employment status checker for IR35

On 2 March 2017, HMRC published a new employment status checker to determine whether the intermediaries legislation will apply to a particular set of facts.

The service can be used for current and future engagements in the private or public sector. HMRC has confirmed that it will stand by the result given by the checker unless it is subsequently shown that the information provided was inaccurate.

The employment status checker can be found here.

Back to contents>

Spotlight 37: HMRC reveals details of a new tax avoidance scheme for income tax and National Insurance Contributions (NICs)

HMRC is aware of a new disguised remuneration tax avoidance scheme that attempts to avoid income tax and NICs by paying contractors in the form of redeemable loyalty points.

The planning involves a contractor becoming an employee of an umbrella company. The contractor is paid in two parts. The first part is a small basic wage with little or no tax and NICs deducted and the second part is used to advertise the contractor's services on a job board.

HMRC does not accept that this, and other similar planning, has the intended fiscal effect. It says it will investigate the tax affairs of all contractors and umbrella companies using such planning arrangements.

A copy of Spotlight 37 can be found here.

Back to contents>

Case reports

Reeves: Tribunal concludes that capital gains tax legislation is compliant with Human Rights and EU law

In *William Reeves v HMRC*[1], the First-tier Tribunal (FTT) has held that section 167, Taxation of Chargeable Gains Act 1992 (TCGA), is compliant with the European Convention on Human Rights (ECHR) and EU law.

Background

William Reeves (the Appellant) a non-UK resident taxpayer, appealed against HMRC's disallowance of his claim for holdover relief from capital gains tax under section 165, TCGA.

The Appellant had disposed of his interest in a UK-based business by transferring it by way of gift to a newly-formed UK incorporated company (NewCo) of which he was the sole shareholder and director. HMRC disallowed the Appellant's claim for holdover relief on the basis that it was precluded by section 167, TCGA (which covered gifts to foreign-controlled companies) because the Appellant's wife was a non-UK resident and as an "associate" of his could be deemed to "control" NewCo.

It was agreed that HMRC's decision was correct on a literal interpretation of section 167(2), because although NewCo was controlled by the Appellant, section 416(6), Income and Corporation Taxes Act 1988 (ICTA)[2], attributed control of NewCo to his non-resident wife and children.

The Appellant argued that:

1. the purpose of section 167 was to deny holdover relief for a gift that would take a business asset indirectly outside the charge to capital gains tax because, although the company to which the gift was made was resident in the UK, it was controlled by a non-UK resident person who could dispose of the asset free from capital gains tax. Section 288, TCGA, provided that "control" was to be construed in accordance with section 416, ICTA "unless the context otherwise required", and the context of the case did "otherwise require". Therefore, section 416 should be construed omitting subsection (6), which concerned fictional "control" of a company, and was in contrast to section 167, which concerned "real" control
2. the effect of section 416(6) on section 167(2) had been overlooked by Parliament, so that, even if the context did not otherwise require "control" in section 167(2) to be construed omitting section 416(6), its inclusion was a clear drafting error that should be corrected
3. by precluding holdover relief, section 167(2) breached the Appellant's rights under ECHR, Protocol 1, Article 1 (Article 1) and Article 14. However wide the margin of appreciation, it would be just as irrational to deny him holdover relief by treating his wife as having control of NewCo as it would be to deny relief by treating his children as having control. He had been denied holdover relief because he had non-UK resident relatives, whereas if he did not have a wife or children, or did not have a non-UK resident wife or children, he would be entitled to relief. Such discrimination could not be justified
4. section 167(2) restricted the free movement of capital contrary to the Treaty on the Functioning of the European Union (TFEU), Article 63, because it discriminated against non-UK resident transferors who were more likely to have non-UK resident relatives.

1. [2017] UKFTT 192 (TC).
2. Rewritten to Corporation Tax Act 2010, sections 451(1), (4)-(6) and 1069(3).

FTT's decision

The FTT, in dismissing the appeal, held that:

1. given that anti-avoidance provisions sometimes have a greater scope than is strictly required with possible unforeseen and unwelcome consequences, it was not possible to conclude that Parliament necessarily intended control, for the purposes of section 167(2), to refer to "real" as opposed to "fictional" control. Accordingly, section 416(6) could not be disapplied with the result that holdover relief was precluded by section 167(2)
2. before a court could correct a statutory drafting error, it had to be sure of:
   - the intended purpose of the provision in question
   - the fact that, by inadvertence, Parliament had failed to give effect to that purpose in the provision, and
   - the substance of the provision that Parliament would have made. Although it was likely that Parliament had not considered the effect of importing the definition of "control" in section 416(6) into section 167, the FTT was not sure that was the case. Accordingly, it was not possible to correct the legislation in the way the Appellant sought
3. the FTT had some sympathy with the Appellant's argument that it was irrational to deny him relief because his wife and children were treated under section 167, by virtue of section 416(6), as having control of NewCo. However, given the high hurdle for those alleging infringement of Article 1, and the wide margin of appreciation accorded to the state, as the Appellant had had an effective means of challenging it, the FTT was unable to conclude that section 167 was devoid of reasonable foundation amounting to a breach of his rights. The FTT was of the view that the Appellant had not been treated differently to any other person with a non-UK resident wife and children and therefore had not been subject to any unlawful discrimination. The Appellant had not suffered any difference in treatment and had been taxed in the same way as a UK resident with a non-resident wife and children.

Comment

This was an unusual case in that it was HMRC who, on this occasion, relied on a literal interpretation of the legislation under consideration.

It would appear that when such an interpretation leads to the result desired by HMRC it is happy to urge the FTT to adopt such an interpretation but when a literal interpretation does not lead to the desired result, often in the context of perceived tax planning arrangements which HMRC does not approve of, it will urge the FTT and courts to adopt a purposive interpretation of the relevant statutory provisions. Some consistency from HMRC in this regard would be welcome.

A copy of the decision can be found here.

Back to contents>

Smith and Nephew: Tribunal allows loan relationship debits for foreign exchange losses incurred on change in functional currency

In *Smith and Nephew Overseas Limited and others v HMRC*[3], the FTT allowed appeals against HMRC's disallowance of foreign exchange losses incurred as a result of a change in functional currency following a company reorganisation.

Background

Smith and Nephew Group is a multinational group engaged in the development, manufacture and marketing of medical devices. The first and second appellants, Smith and Nephew Overseas Limited (SN Overseas) and T P Limited (TP), respectively, are UK incorporated companies which

3. [2017] UKFTT 151.

were at all material times resident in the UK. The third appellant, Nephew Finance Holdings Limited (SN Finance), was incorporated in the Cayman Islands but resident in the UK for the purposes of corporation tax.

Following a change in their functional currency from sterling to US dollars, as the result of a company reorganisation, SN Overseas, TP and SN Finance, claimed foreign exchange losses of £445,868,096, £138,188,096 and £90,652,234, respectively. The appellants claimed that their exchange losses, which were included within the statement of total recognised gains and losses in each of their respective accounts, arose as a result of the fall in value of the pound against the US dollar.

HMRC did not accept that the exchange differences shown in the appellants' accounts represented losses, or that the correct accounting treatment had been applied by the appellants, and issued closure notices pursuant to paragraph 34(2), Schedule 18, Finance Act 1998, disallowing the losses claimed by the appellants.

The appellants appealed to the FTT.

FTT's decision

There were three issues before the FTT.

Were the appellants' accounts compliant with GAAP?

The first issue for the FTT to determine was whether the appellants' accounts complied with the UK generally accepted accounting practice (GAAP) for the purposes of section 85A, Finance Act 1996[4]. Both the appellants and HMRC relied on expert evidence. In essence, the difference between the experts was in relation to the approach adopted by the appellants for accounting for a change in their functional currency. The appellants' expert considered that the appellants had been correct to adopt the foreign operation method whereas HMRC's expert was of the view that only the single rate method was appropriate. The FTT preferred the expert evidence relied upon by the appellants and concluded that the appellants' accounts were GAAP compliant.

Were the exchange differences "exchange losses" within section 103, Finance Act 1996[5]?

The FTT noted that "an exchange loss is the comparison at different times of the expression in one currency of the valuation put by the company in another currency in relation to an asset". The FTT therefore agreed with the appellants that this was an arithmetic exercise and that the legislation does not require any exposure to exchange rates between two dates, just a comparison at different times first in one currency and then in another. The FTT concluded that because there was a fall in the value of the assets (the intercompany receivables), it followed that the exchange differences were exchange losses within section 103, Finance Act 1996.

Did the exchange differences "fairly represent" a loss arising to the appellants as defined by section 84(1) Finance Act 1996[6]?

The FTT rejected HMRC's argument that "fairly represents" required an overarching 'sanity check' to prevent an arithmetic difference from giving rise to a loss. The "fairly represents" rule did not override the appellants' accounts and the FTT concluded that the exchange differences did "fairly represent" losses.

The FTT allowed the appellants' appeals.

4. Rewritten to Corporation Tax Act 2009.
5. Rewritten to Corporation Tax Act 2009.
6. Rewritten to Corporation Tax Act 2009.

Comment

As debits are now calculated with regard to profit and loss entries and the "fairly represents" rule has been abolished, this decision is largely of historic interest. However, it does provide helpful guidance on the meaning of "fairly represents" for cases which are still working their way through the appeal process and have yet to be determined. The decision also suggests that the FTT will, in general, be slow to upset GAAP compliant accounts.

A copy of the decision can be found here.

Back to contents>

Ridgecrest: Tribunal allows appeal against Regulation 80 determinations

In *Ridgecrest Cleaning Services Pendergate Ltd v HMRC*[7], the FTT allowed an appeal against determinations of underpaid tax made under Regulation 80 of the Income Tax (PAYE) Regulations 2003 (the PAYE Regulations), as HMRC had not obtained the necessary statutory consent from the taxpayer to notify it of changes to employee PAYE codes electronically.

Background

Ridgecrest Cleaning Services Pendergate Ltd (the Appellant) is a cleaning services company which employs several hundred cleaners whose earnings are subject to PAYE.

HMRC sent tax code notifications to the Appellant electronically, in that the employee PAYE codes were accessible to the Appellant electronically via HMRC's PAYE online website. The Appellant overlooked the online notification and applied the old PAYE codes.

HMRC claimed that the Appellant had deducted insufficient tax in respect of two of its employees and issued determinations to the Appellant, pursuant to Regulation 80 of the PAYE Regulations, seeking recovery of the underpaid tax (the Regulation 80 determinations).

The Appellant did not dispute the calculation of the amounts claimed by HMRC but argued that it had taken reasonable care to comply with the PAYE Regulations and that any failure to deduct the correct amount of tax was due to an error made in good faith.

The Appellant also argued that the Regulation 80 determinations were invalid because although the employee PAYE codes were accessible to the Appellant electronically through the PAYE website, it had not given the required statutory consent for the codes to be sent through that medium. The Appellant had not received paper notification of the PAYE codes and argued that it was unaware that it should have checked its online PAYE account. The Appellant argued that HMRC should recover the tax due from the employees by making a direction under Regulation 72(5) of the PAYE Regulations.

HMRC contended that the medium by which the PAYE codes were sent was irrelevant and that in any case the required consent had been given by the Appellant when it signed up to PAYE online in 2004.

With regard to Regulation 72(5), HMRC argued that a Regulation 72(5) direction could not be made once a Regulation 80 determination had been made as Regulation 80(3), which provides that a direction under Regulation 72(5) does not apply to tax determined under Regulation 80, prevented it from doing so.

7. [2016] UKFTT 778 (TC).

FTT's decision
The Appellant's appeal was allowed.

In relation to the interaction between Regulation 80 and Regulation 72(5), the FTT concluded that once a Regulation 80 determination has been made by HMRC, although in principle it is possible for a Regulation 72(5) direction to be made, Regulation 80(3) prevents any Regulation 72(5) direction from having effect in relation to an amount of tax payable which is already the subject of a Regulation 80 determination. In the view of the FTT, once HMRC has issued a Regulation 80 determination, Regulation 80(3) prevents a Regulation 72(5) direction having effect in relation to tax covered by the Regulation 80 determination.

The FTT said that its jurisdiction with regard to appeals made against a Regulation 80 determination did not extend to matters concerning reasonable care and errors made in "good faith". Such matters could only be considered in an appeal against a Regulation 72(5) direction and as HMRC had chosen not to issue such a direction, it could not consider whether the Appellant had exercised reasonable care and acted in good faith.

With regard to the Appellant's contention that it had not given the necessary consent to receive changes to PAYE codes electronically, under Regulation 213(4) of the PAYE Regulations, HMRC may only deliver information by electronic communications if the employer has consented to delivery of information in that way. The FTT rejected HMRC's argument that registration for PAYE online signified consent for the purposes of Regulation 213(4). The FTT said that the online registration process did not inform the Appellant in sufficiently clear terms that it could be taken to have agreed to receive PAYE notices by internet only. Given the fact that paper notifications were normally sent and that it was therefore possible that the online PAYE facility was seen as something that could be used at the Appellant's option, the FTT was not persuaded that the Appellant had given the requisite consent to receive PAYE notifications electronically.

Comment
With regard to the Appellant's argument that HMRC's refusal to withdraw the Regulation 80 determinations and issue a Regulation 72(5) direction had deprived it of the opportunity to raise matters relating to the reasonable care it had taken to comply with its PAYE obligations and that any errors made had been made in good faith, the FTT was of the view that the exercise of such powers by HMRC was a matter outside its jurisdiction which fell within the remit of judicial review.

Although the taxpayer in this case secured the outcome it desired, a taxpayer who wishes to challenge the manner in which HMRC has exercised its powers should give careful consideration to the correct forum for such a challenge.

A copy of the decision can be found here.

Back to contents>

About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 83 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol.

"... the client-centred modern City legal services business."

At RPC we put our clients and our people at the heart of what we do:

- Best Legal Adviser status every year since 2009
- Best Legal Employer status every year since 2009
- Shortlisted for Law Firm of the Year for two consecutive years
- Top 30 Most Innovative Law Firms in Europe

We have also been shortlisted and won a number of industry awards, including:

- Winner – Overall Best Legal Adviser – Legal Week Best Legal Adviser 2016-17
- Winner – Law Firm of the Year – The British Legal Awards 2015
- Winner – Competition and Regulatory Team of the Year – The British Legal Awards 2015
- Winner – Law Firm of the Year – The Lawyer Awards 2014
- Winner – Law Firm of the Year – Halsbury Legal Awards 2014
- Winner – Commercial Team of the Year – The British Legal Awards 2014
- Winner – Competition Team of the Year – Legal Business Awards 2014

Areas of expertise

- Competition
- Construction & Engineering
- Corporate/M&A/ECM/PE/Funds
- Corporate Insurance
- Dispute Resolution
- Employment
- Finance
- Insurance & Reinsurance
- IP
- Media
- Pensions
- Professional Negligence
- Projects & Outsourcing
- Real Estate
- Regulatory
- Restructuring & Insolvency
- Tax
- Technology

17110

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

11/F Three Exchange Square
8 Connaught Place
Central Hong Kong
T +852 2216 7000

12 Marina Boulevard
#38-04 Marina Bay Financial Centre Tower 3
Singapore 018982
T +65 6422 3000