

Personal tax update (Lecture P1406 – 25.57 minutes)

Replacement shares options

Summary –Replacement share options were taxable under the employment related securities deeming provision. It did not matter that the original options had been granted to the individual's consultant company for services delivered at that earlier time.

Vermilion Software Ltd was incorporated in 2003 to market a fund management software product and provide support for that product.

In 2006 the business arranged further equity funding from new investors, which involved creating a holding company, Vermilion Holdings Ltd. Quest Advantage Ltd, owned by Mr Noble and one other, had provided corporate advisory services. With costs exceeding the budget, an option was granted to Quest Advantage Ltd to acquire shares in Vermilion Holdings Ltd.

In financial difficulty, Vermilion Holdings Ltd appointed Mr Noble as director. As part of further restructuring, it became necessary to amend the terms of the 2006 option. This was replaced with a new option in 2007, on amended (and less beneficial) terms, which included Mr Noble becoming the option-holder, instead of his consultant company.

HMRC considered that, although the 2006 option was not an employment-related share option, the replacement option granted in 2007 was an employment-related share option because it was granted by Vermilion Holdings Ltd, Mr Noble's then employer. It was therefore deemed to be made available by reason of his employment (s.471(3) ITEPA 2003).

The inner House of the Court of Session had found for the taxpayer, holding that, on a realistic view of the facts, the reason Mr Noble received the 2007 option was that he had agreed to give up part of his entitlement under the 2006 option. It was therefore not in fact made available by reason of his employment as required by s 471(1). The deeming provision in s 471(3) did not apply because it would give an 'anomalous, absurd and unjust' result.

The case moved to the Supreme Court.

Decision

The Supreme Court stated that the purpose of s.471 ITEPA 2003 was to define when the employment-related share option rules would apply.

S.471(1) provided a causal test; whether the option was granted by reason of Mr Noble's employment, but this could be difficult to decide. Consequently, the deeming provision in s.471(3) sought to avoid the inquiry into causation. Here, if an employer grants an option to one of its employees, the option is conclusively treated as granted by reason of that employee's employment.

The Supreme Court stated:

“It is not open to the taxpayer to defend a demand for tax from HMRC by carrying out the subsection (1) exercise in order to disapply the subsection (3) deeming provision.”

The Supreme Court found that the 2006 option was cancelled, not varied and a new option over a different and new class of shares conferred by Vermilion Holdings Ltd to Mr Noble, an employee at the time. Under the deeming provision in s.471(3), this was an employment related security liable to income tax.

The argument that the 2007 option was made available as a replacement for the option granted in 2006 as a reward for services held no ground as the deeming provision applied.

HMRC v Vermilion Holdings Ltd [2023] UKSC 37

Backdated Income Protection Plan payments

Summary - Backdated Income Protection plan payments were subject to National Insurance Contributions in the tax year they were paid, not in the tax year that they related to.

Kirin Kalia was an employee of Crowe LLP and participated in the LLP's Income Protection plan entitling employees to be paid an amount corresponding to roughly 75% of their basic salary whilst they are not working due to sickness.

Crowe LLP:

- insured their risk to cover 75% of the participant's basic salary, and certain specified benefits, Crowe's liability for pension contributions and employers' NICs.
- Only paid out *if and when* the insurance company paid out under the policy.

Due to illness, Kirin Kalia ceased working on 19 October 2017 and was paid:

- her contractual sick pay at her full rate of pay until the end of December 2017;
- statutory sick pay until April 2018.

At that point, payments under the Income Protection plan should have kicked in but Aviva claimed that the employee's illness was excluded from cover.

Kirin Kalia challenged Aviva's refusal to make payments with the Financial Ombudsman where it was found that her illness was in fact covered by the policy. As a result, in June 2020, 15 months' worth of backdated payments were paid over in one sum.

Crowe LLP reported the payment as a single payment of earnings in June 2020, accounting for PAYE and NICs on that basis. Further, interest was paid to compensate Kirin Kalia for the delay in payment.

The issue in this case was whether the sum paid should have been treated as 15 late payments of monthly sick pay which were paid simultaneously. According to Kirin Kalia, this treatment for NICs purposes had a bearing on her entitlement to employment and support allowance. The Tribunal made no findings as regards her entitlement to state benefits.

The basic rule under s.6 Social Security Contributions and Benefits Act 1992 is that a liability to Class 1 NICs arises when earnings are paid.

However, this basic rule is modified by Regulation 7, Social Security (Contribution) Regulations 2002 where earnings are paid otherwise than at regular intervals. Kirin Kalia argued that Regulation 7(1)(a) applied which states:

“if on any occasion a payment of earnings which would normally fall to be made at regular interval is made otherwise than at the regular interval, it shall be treated as if it were a payment made at that regular interval’

She claimed she was entitled to be paid sick pay each month under the terms of the Income Protection plan, meaning that the June 2020 payment represented 15 delayed monthly payments of sick pay.

However, HMRC argued that the payment made represented arrears of pay, which should be treated as a single payment made in June 2020.

Decision

The First Tier Tribunal found that under the terms of Regulation 7, each individual payment should be allocated for the purposes of NICs to the earnings period in which the payments would normally fall, in other words to the earnings periods for the months of April 2019 to June 2020 respectively.

However, paragraph (3) overrides this where the monthly earnings relate to months falling into the earlier tax year. This meant that the April 2019 to March 2020 related payments were still assessable in June 2020. The effect of this override meant all of the NICs fell in 2020/21 and the appeal was dismissed.

The Tribunal did point out that for the purposes of claiming state benefits, Kirin Kalia may under Regulation 58 apply to reallocate to the 2019/20 tax year the NIC payments excluded from treatment under Regulation 7(1).

Kirin Kalia v HMRC (TC08952)

Share sale consideration

Summary – The First Tier Tribunal had not erred in law when interpreting the sale and purchase agreement in respect of a £1.1 million loan repayment. Further, it was under no obligation to consider if an adjustment to consideration was required for working capital.

Michelle McEnroe and Miranda Newman were the sole shareholders in Kingly Care Partnership Limited

On 25 October 2013 they entered into a share sale and purchase agreement (SPA) to sell their shares to Active Assistance Finance Limited for £8 million, subject to a working capital adjustment and an earn out.

On at completion, £1.1 million was paid to Allied Irish Bank to redeem a loan owed, with the buyer’s solicitors transferring the remaining £6.9 million payable to the couple, after having deducted professional fees.

In their Self Assessment tax returns, Michelle McEnroe and Miranda Newman each showed the consideration received for the disposal of their shares as one half of £6.9 million, plus the working capital adjustment and the earn out received later.

Following an enquiry, HMRC issued closure notices stating that the consideration should be one half of £8 million plus the earn out, the amount stated in the sale and purchase agreement.

Michelle McEnroe and Miranda Newman appealed to the First Tier Tribunal, with the only point in dispute being whether the consideration for the shares was £8 million, or £8 million less the bank debt. Neither the additional payment following the reconciliation of the working capital adjustment nor the earn-out were not in dispute at that time.

Having never received the full £8 million, the taxpayers argued that the reported proceeds should be £6.9 million, the sum that they received.

The First Tier Tribunal found in HMRC's favour and the taxpayers appealed to the Upper Tribunal, including an additional argument that the First Tier Tribunal should have considered the working capital adjustment referred to in clause 3.3 of the sale and purchase agreement.

Decision

The Upper Tribunal found that based on the facts presented at the time, the First Tier Tribunal had correctly found that:

“there was no ambiguity in the SPA and that no reference to the (bank) debt is made in any clause relevant to the consideration for the purchase of the Shares”.

Referring to the case notes, the Upper Tribunal noted that the First Tier Tribunal had considered the working capital clause at the time stating that:

“Clause 3.3 refers to Completion Accounts and any adjustment in relation to them. Neither the Appellants nor HMRC argue that this clause did or should adjust the [consideration]”

It was reasonable for the First Tier Tribunal not to have given further consideration to this point as neither party had argued at the time that an adjustment to consideration was needed to reflect clause 3.3 on working capital. It was too late to amend the First Tier Tribunal's findings of fact, which is the only stage at which the facts of a case can be established.

The case was dismissed.

Michelle McEnroe and Miranda Newman v HMRC [2023] UKUT 00255 (TCC)

No gain, no loss on separation

Summary – No gain no loss treatment applied to a property where the beneficial interest was effectively transferred in the tax year that a couple separated.

Abigail Wilmore married in 2012. She worked as an HR Director in the fashion industry and her 'high paying job' was the main source of income for the couple.

The couple lived in a property, Ravenshurst, registered in her sole name which had been bought using a mortgage raised based on Abigail Wilmore's income.

In the spring of 2015, the couple bought a second property, Thornfield, with the intention being that once renovated, it would become their main residence. The major renovations were expected to take about 12 months.

To facilitate the purchase, the couple re-mortgaged their first property as a buy-to-let property and took out a mortgage on the new property based on Abigail Wilmore's income.

In September 2015, the couple separated with Abigail Wilmore continuing to live in Ravenshurst, and her husband moving into Thornfield, which was still being renovated.

By December 2015, correspondence indicated that the couple had agreed each of them would retain the property that they were living in and that from that time Abigail Wilmore stopped contributing to the Thornfield mortgage and was not involved in any decision making in relation to the property. She converted her buy-to-let mortgage on Ravenshurst, the first property, back to a home-owner's mortgage.

This arrangement was confirmed in a draft petition dated 4 April 2016, with a lump sum payment of £75,000 being due to her. The sum was reduced to £35,000 in June 2016 and the final consent order sealed by the Family Court on 17 October 2016, taking effect from the Decree Absolute on 23 December 2016.

In September 2016, her husband had sold Thornfield, but she took no proceeds from the property's sale.

Abigail Wilmore accepted that legal title of Thornfield did not pass until after 5 April 2016. However, she believed that her beneficial interest was transferred to her husband after separation in 2015 but before 5 April 2016, meaning that the transfer took place on a no gain no loss basis.

HMRC disagreed and in November 2020, issued a discovery assessment for £14,377, representing the capital gains tax due on her half share of the Thornfield property sold in 2016/17. HMRC argued that any agreement reached between 10 September 2015 when they separated and 5 April 2016, whether verbal or written, was not legally binding and could have been varied at any time. This meant that there was 'no formal transfer of the appellant's interest' in Thornfield prior to 5 April 2016.

Abigail Wilmore appealed.

Decision

The First Tier Tribunal concluded that:

- by the agreement entered into by the separated couple in December 2015, Abigail Wilmore had effectively transferred her beneficial interest in Thornfield to her husband;
- from December 2015, a constructive trust arose whereby she was the legal joint owner of Thornfield, but no longer held any beneficial interest in the property;
- the disposal of her beneficial interest in Thornfield had taken place by 5 April 2016 on a no gain no loss basis.

The Tribunal found that the October 2016 consent order was not relevant as it was preceded by the December 2015 agreement reached between the parties.

Finally, the Tribunal found that the lump sum order was not a payment linked to Abigail Wilmore transferring her equitable interest in Thornfield but rather it was "a ball-park figure" towards recognising her greater financial contributions to the marriage.

Abigail Wilmore v HMRC (TC08959)

NOTE: For disposals on or after 6 April 2023, the application of the no gain no loss rule that applies to divorcing couples is now extended beyond the end of the tax year of separation.

Fee not deductible

Summary – An introducer’s fee payable on the sale of a property to a third party was not a deductible expense for capital gains tax as it was not capital in nature.

Wayne and Beverley Bottomer were interested in investing in property and were told about a potential property by a third party who, due to cashflow issues, was unable to buy it himself. It was agreed informally that if the couple went ahead with the purchase, the third party would receive a fee.

The couple bought the property and had intended to renovate it themselves. However, with Wayne Bottomer seriously ill and requiring hospital treatment for cancer, the couple approached the third party, who verbally agreed to manage the project on their behalf, in return for a 50% share of any profit when the property was sold.

Having completed the project, the property was sold for a profit of £64,000, half of which was paid over as agreed. The couple declared the sale on their Self Assessment tax returns, with each claiming a deductible expense of £16,000 against their respective gains.

HMRC agreed that the disposal gave rise to a chargeable gain rather than a trading profit but disallowed the deductions made, arguing they did not fall within s.38 TCGA 1992 as they were neither property acquisition costs nor incidental costs of acquisition or disposal.

The taxpayers appealed.

Decision

The First Tier Tribunal found that the sum paid was not expenditure incurred on the property nor was it represented in the state of the property when it was sold.

The sum paid had not been agreed at the time of acquisition and so could not be wholly and exclusively for the purposes of the acquisition.

The payment was not incidental costs of either purchase or sale and so were not deductible for CGT purposes. The third party had simply found the property and subsequently overseen the renovation works. This was more akin to a shared business project. One might ask how the payment would have been treated if it had been found to be a trading transaction? It may well have been deductible.

Wayne and Beverley Bottomer V HMRC (TC08968)

Diversification of farming business

Summary – Business Property Relief was not available for an LLP that let a barn to be used as a wedding venue. The lack of services provided meant that its business was “wholly or mainly an investment business.”

On her death in May 2015, Helen Butler was a member of Tufton Warren Farm LLP, with the only other members being the trustees of her late husband's will trust, in which she had a life interest.

This case concerned a claim for business property relief made by the personal representatives and trustees against the value of the LLP. All parties agreed that the LLP was carrying on a business. The issue was whether the estate interests were "relevant business property". If its activities were found to consist of "wholly or mainly of...holding investments" (s.105(3) IHTA 1984) Business Property Relief would not be available.

The LLP's activities fell into three categories agreed between the parties as follows:

1. farming (non-investment activity);
2. commercial lettings (investment activity);
3. a disputed wedding venue business operating from an historic barn on the farm.

The wedding business was the most significant aspect of the LLP's activities. The taxpayers argued that the LLP provided a package of facilities and wedding related services meaning that Business Property Relief was available.

However, from 2013 when Helen Butler became ill, the LLP was involved with little other than its staff showing potential customers around the venue. An independent third party took on everything else, including the bookings, setting up the venue, the catering and staffing the event.

HMRC argued that this was a business wholly or mainly holding investments, and so denied the relief.

Decision

Having looked at the LLP's activities as a whole, the First Tier Tribunal concluded that simply providing the venue and effectively outsourcing the wedding related services meant that the property was held predominantly for investment purposes. This was not a fully serviced property but rather more like a village hall.

The judge said that at no point did the LLP "provide amenities and services that went significantly beyond the amenities that are provided in a property held predominantly for investment purposes."

Business Property Relief was denied.

Eva Mary Butler and others v HMRC (TC08949)

ATED charge did not apply

Summary – With a property value of below £500,000, the ATED charge did not apply and so no penalties were payable.

Derrida Holdings Limited is a property investment company owned jointly by a married couple.

In January 2017, the company bought a derelict pub for £265,000 which was financed by refinancing its first property that had been acquired in 2016. The property was gutted and refurbished for a total cost of £191,000 and then let from August 2019.

In January 2021, in the course of a conversation with others, the husband learned about the existence of ATED. He telephoned the company's accountant, who was unaware of ATED but advised that the company should submit an ATED return even though the value of the property was less than £500,000.

An ATED return was submitted on 31 January 2021 for the year ending 31 March 2021, but the return did not include any value for the property.

HMRC wrote to explain that an ATED return must be submitted and paid within 30 days of the first day within which the company became liable in a period. Having failed to submit and pay by 30 April 2020, HMRC issued late filing penalty assessments. These were upheld by HMRC following a statutory review.

Having learned that a decision can only be reviewed once, the company appealed to the First Tier Tribunal.

The company's main argument was that not only did it not know about ATED's existence, it was also unaware that they had risen above the threshold. Indeed, they believed they had not.

HMRC's argued that a reasonable person seeking to check their tax position would visit the HMRC website, where the ATED guidance is easy to find and the information is clear and unambiguous.

Decision

Although an ATED return had been submitted, this did not automatically mean that the company was liable to the ATED charge.

The First Tier Tribunal stated that the ATED charge is an annual tax charge on UK residential properties over £500,000 which are held by companies, partnerships or collective investment schemes.

The company had been asked to provide confirmation of the value of the property at the revaluation date for ATED periods from 2018/19, which was 1 April 2017.

The Tribunal found that:

“On the balance of probability, the value of the property as at 1 April 2017 was certainly not above the threshold and was unlikely to have been very different to its purchase price and indeed might have been less.”

With the property's value below £500,000, the First Tier Tribunal found that the company had been wrong to submit the return. This was “a simple error that was swiftly rectified.”

The Tribunal found that “as a matter of fact, although a return was submitted, the appellant was not within the charge and therefore there was no requirement for the return.

Consequently, the penalties were cancelled.

Derrida Holdings Limited v HMRC (TC08905)