

Business tax round up (Lecture P1296 – 13.47 minutes)

Salary or scholarship

Summary – The taxpayer was not entitled to a refund of tax as the income received was employment income taxable under s62 ITEPA 2003 and not scholarship income exempted under s776 ITTOIA 2005.

Dorothy Johnson qualified as a Registered General Nurse in May 1994.

In 2001 she applied to South Bank University to train as a midwife with placements at Whipps Cross University Hospital Maternity Unit. South Bank arranged all the placements.

During the midwifery course, Dorothy Johnson received payments for what she called 'living expenses' on payment advice slips. She had been told that: 'when you enter into training, you would not be paid less than you were paid as a registered nurse' which was the case. She did not pay any of the course fees.

In March 2003, having passed the relevant exams and obtained the required practical experience, she became a Registered Midwife Nurse and became employed by Whipps Cross as a Band F midwife in May 2003.

She retired in March 2016, which was the earliest pensionable age allowed under the NHS superannuation scheme.

Less than a year later, she became aware of the Widening Access Training Scheme, a type of training scholarship that applied to those who had undergone post-registration training. She believed that as a trainee midwife she qualified. Under this scheme, qualifying individuals undertaking a relevant full-time training course aimed at widening their professional knowledge may be exempt from tax. She claimed a repayment of £4,868.64 relating to the period from 17 September 2001 to 24 March 2003 when she was on the payroll of Barts Health NHS Trust while undertaking training to qualify as a midwife.

However, Dorothy Johnson was informed that she was not eligible as HMRC guidance stated:

'... employees of the Trust who were employed under a contract of employment and were receiving a salary and retained employment benefits (e.g. pay awards, increments, sickness, maternity and annual leave) should be classified as employees of Barts Health during the training period.'

As an employee receiving a salary rather than a training/scholarship bursary, no refund of income tax or national insurance was due for the period of her training.

She appealed to the First Tier Tribunal.

Decision

The principal issue for determination was whether the income received by Dorothy Johnson qualified as 'Scholarship Income' under s.776 ITTOIA 2005.

The First Tier Tribunal concluded that:

She was in employment from 1 October 1997 to 31 March 2016 when she retired. There was a change in her job position on 24 May 2003, from being a Band 6 RGN to an RMN on obtaining her qualification as a Registered Midwife Nurse.

The Tribunal reached this decision on the basis that:

- only workers directly employed by the NHS can participate in the superannuation scheme and the NHS trust continued to make contributions as an employer into her NHS superannuation scheme during her training period. Further, there were no gaps in her own contributions into the pension scheme.
- During the training period she continued to be paid as an employee on the same salary and she continued to receive benefits. This was in line with the guarantee being given when she made the decision to undertake training, that she would not take home less than before.

The income received during training represented 'earnings' under s.62 ITEPA 2003 and was therefore liable to income tax under PAYE. The income was not eligible for relief under s 776 ITTOIA 2005 as this only applies to individuals in full-time education, which covers 'bursary, exhibition or other similar educational endowment'. No part of the income received during the training period could be identified as scholarship income.

Appeal dismissed

Dorothy Johnson v HMRC (TC08346)

Right to acquire – grant or exercise date?

Summary – A share option is granted when the right was acquired and so the taxpayer was liable to UK tax on all three tranches despite being no longer resident in the UK on exercise. Further, his restricted shares remained granted by reason of employment when they were exchanged as part of a subsequent share for share exchange.

In 2001, John Charman had been granted three tranches of share options by reason of his employment, which were exercisable on the first, second and third anniversaries of the grant, conditional on him still being employed. He exercised all three tranches, the first two while UK resident but at the time that the third tranche was exercised, he was no longer UK resident.

The First Tier Tribunal had agreed with John Charman that he had acquired the options when each tranche became exercisable, and not when the options were granted in 2001. As he had become non-UK resident before the third tranche vested, he was only liable to UK tax on exercise of the first two tranches.

The Upper Tribunal had overturned the First Tier Tribunal's decision finding that the lower Tribunal had erred in law. The Upper Tribunal found that the contractual rights created by the option documents amounted to the creation of a 'right to acquire securities' at the date the options were granted and so all three tranches were subject to UK tax.

In 2002, John Charman had been awarded restricted shares in the company which, as part of an initial public offering, were exchanged for restricted shares in another company. The restrictions were lifted in 2005. John Charman argued that he had acquired these shares as a shareholder, as when they were exchanged all shareholders were granted shares in the new company, whether or not they were employees. However, the First Tier Tribunal had found that he had acquired these shares as a director or employee of the company, making them subject to income tax. The Upper Tribunal agreed with the First Tier Tribunal that the share exchange did not change the link between the acquisition of the shares and his employment.

Decision

The Court of Appeal upheld with the Upper Tribunal's decision. To be taxable under UK law, a right to acquire securities did not have to be immediately exercisable but rather, what mattered, was that the employee had a contractual or other legal right, upon whatever terms, to acquire securities.

The Court of Appeal agreed that John Charman had acquired the share for share restricted shares by reason of his employment, making them liable to income tax. While it was true that some shareholders, who were not employees, benefited from the share for share exchange, this did not mean that John Charman's shares fell outside the employment-related legislation. *The share for share exchange before the restrictions were lifted did not break the initial employment-related link. The shares were originally granted by reason of his employment and remained so, making them liable to income tax when the restrictions were subsequently lifted.*

John Charman v HMRC [2021] EWCA Civ 1804

Refundable Class 3 contributions

Summary - Class 3 National Insurance Contributions paid, at a time when the taxpayer genuinely believed that they would never work again, should be refunded by HMRC.

Christine Bradley was employed as a personal shopper at an online supermarket for ten years. Over that period she felt bullied by her co-employees. Despite raising this with line management the situation did not improve and eventually she resigned in 2015 suffering with severe anxiety.

She believed that all workplaces would be the same as her previous employer and that she would be bullied again. She believed that she could live "off the land" picking and eating berries.

At the time she left her employment, aged 46, she had made 29 years of National Insurance contributions, with 35 years being needed to be entitled to a full state pension. In March 2017, without seeking any advice on the matter, she paid £733.20 in voluntary Class 3 contributions in respect of 2016/17.

From 1 April 2018 Christine Bradley started house sitting pets and subsequently set up a small business providing pet sitting services. Consequently, she was then entitled to make Class 2 contributions but was not required to do so as her business operated below the small business profit threshold.

In April 2018 and February 2019 she wrote to HMRC requesting that the Class 3 contribution paid be refunded and/or reallocated to later years as payment for 2017/18 and 2018/19 Class 2 NICs contributions. Both times HMRC refused the refund request and stated that the payments could not be reallocated.

Christine Bradley appealed to the First Tier Tribunal.

Decision

Where Class 3 NICs have been paid, they can be refunded where they do not enhance the contributor's entitlement to benefit at the time of payment. The First Tier Tribunal concluded that the contribution was not automatically repayable as Christine Bradley's contribution had enhanced her entitlement to benefit.

Where, as in this case, contributions had benefited the contributor, they can only be refunded where the contribution was made in error (but not through the benefit of hindsight).

The Tribunal concluded that such an error had been made. Suffering from extreme anxiety, she made an error of judgement, believing that she would never work again. Had she been thinking clearly, she only needed to work for six years in the twenty years before retirement age to obtain a full state pension. As an error was made at the time of paying the Class 3 contributions, the First Tier Tribunal found that repayment should be made by HMRC (Regulation 52 Social Security (Contributions) Regulations 2001).

Christine Bradley v HMRC (TC08344)

Company ineligible for EIS

Summary – Despite all activities being outsourced to third parties, the company was still trading but not on a commercial basis with a view to profit. EIS relief was not available.

CHF PIP! PLC (PIP) owned the intellectual property for the stories that became a children's TV series, PIP Ahoy! The company issued shares between May and November 2018 and submitted Form EIS 1 seeking HMRC's authority to issue compliance certificates to investors so allowing them to claim EIS income tax relief on their investments.

The company argued that it was carrying on a qualifying trade and that it satisfied the risk to capital condition contained within the legislation. The company created a children's television series and sold related merchandise for a profit.

However, HMRC refused permission, stating that the company was not carrying on a qualifying trade as all activities were outsourced to other companies and that the company had no control over business decisions. The company simply received royalties and license fees which were excluded activities.

The company appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal accepted that outsourcing activities rather than undertaking these themselves was trading. However this was not a qualifying trade as it was not conducted on a commercial basis with a view to making a profit. The company's turnover had been decreasing and it had been making losses. Although it had taken steps in an attempt to improve matters, the Tribunal found the company's turnover and profit forecasts to be "wholly unrealistic" and that they represented "a pious hope rather than evidence of a genuine intention to make a profit." Pip Ahoy was "a bit stale" and a "little quaint" and was behind the times for what preschool children were choosing to view.

The appeal was dismissed.

Although not needed, the First Tier Tribunal went on to consider whether the activity was an excluded activity as well as the potential risk to capital issue:

- The Tribunal concluded that receiving royalties and licence fees as the company did was not an excluded activity as the company had created the intellectual property and had the right to exploit that property.
- The Tribunal stated that the risk-to-capital condition would not be met because at the time of the share issue the company did not have a realistic objective of growing and developing its trade in the long term.

CHF PIP! PLC v HMRC (TC08305)

Disposal of partnership office premises

Summary – Entrepreneurs’ Relief was available on the disposal of a partnership’s premises as this disposal was part of the disposal of the partnership business as a whole, even though this had taken for more than 20 years.

In the 1970s, Christopher Thomson became a partner in an accounting firm, Voisey & Co. based in Warrington. In 1974 the partnership bought the premises it had been renting.

In 1996 Christopher started to consider his retirement and succession. He identified two accountants working in the practice who were suitable to take over from him. However, these ‘New Partners’ were young and he was concerned that many of the firm’s clients were his personal clients for whom he had worked for a number of years. He also held a number of executorships, trusteeships and directorships.

Consequently, it was agreed that:

- The New Partners would each pay Christopher Thomson £20,000 a year for the then £434,000 of work in progress until he was left with a token 1%;
- Christopher Thomson would transfer clients over time to the New Partners, starting with compliance and audit matters followed by the more difficult longstanding clients;
- As clients were transferred the new work was credited to the New Partners and so gradually Christopher’s share of profits reduced and he gradually reduced his hours to match.

This process took many years. Due to the deaths of key clients and threatened litigation in respect of trustee positions held by the retiring partner the full handover was not completed until 2021.

In 2017/18, prior to the full handover, the partnership disposed of its office premises to his pension scheme who rented it back to the partnership on a three-year lease at £32,000 a year with options to renew.

Christopher Thomson claimed entrepreneurs’ relief on the gain arising on disposal arguing that there had been a material disposal of part of the business.

Following an enquiry, HMRC issued a closure notice denying the entrepreneurs' relief claim stating that the sale of the partnership premises was the disposal of an asset that did not represent all or part of a business. HMRC accepted that it may be that separate disposals in different tax years could be taken to be the disposal of the whole or part of a business but evidence was required to treat these disposals together as part of the same transaction. In this case, the process has taken some 22 years from 1996 and HMRC stated that the facts did not justify treating the process as part of the same transaction.

Following Statutory Review, HMRC upheld the decision, and Christopher Thomson appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal stated that the disposal of the premises needed to be considered in context.

Since 1996, Christopher Thomson had been trying to transfer ownership of the accounting practice but was hindered by difficult client relationships. At the time that the premises was sold, Christopher Thomson was entitled to less than 10% of the profits and he had disposed of 99% of the goodwill and old work in progress. At this time it was only the premises that he still fully owned. So, while the period of time over which the disposal took place was long, based on the facts, the disposal of the property was part of the continuing disposal of his share in the partnership business.

The First Tier Tribunal found that the disposal of the partnership property to Christopher Thomson's pension scheme did represent the sale of part of a business and so entrepreneurs' relief was available.

Christopher Thomson v HMRC (TC 08337A/V)