

Personal tax update (Lecture P1416 – 16.27 minutes)

Gesture of thanks

Summary – Payments made to employees by the company's former chairman/director were made by reason of employment, meaning that PAYE and NICs were payable.

Orient Overseas Container Line Limited (UK Branch) was an international container shipping company, whose chairman and majority shareholder was Mr CC Tung. Having received a takeover offer from COSCO Shipping, Mr Tung's shareholding was sold on 24 July 2018. He resigned as director and chairman on 3 August 2018. In an email to the company's global employees, Mr Tung announced a 'special discretionary payment' would be made to staff, funded by the Tung family but distributed through the company, acting as agent.

In September 2018, UK employees received their payment, which on average represented around half of their annual salary.

Initially their payslip showed:

- the gross sum as a 'bonus';
- PAYE and NICs deducted at source.

Later, believing that the payments were not income 'from' employment, or a cash benefit paid 'by reason of' employment, the company claimed a repayment of the PAYE and NICs. It argued that the payments were 'a simple act of generosity by Mr CC Tung'.

HMRC disagreed, arguing that the payments were made 'as a consequence of the recipients being employees and having contributed to the success of the business justifying the significant premium on share value which benefited Mr CC Tung'.

The company appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal accepted that Mr Tung had made a personal payment:

"as a mark of appreciation to the UK workforce.....following the successful sale of the business."

The payments were not from past, present or future employment and so were not taxable under s.62 ITEPA 2003. The payments were non-contractual, voluntary and not expected by the recipients.

However, the payments were made through the company's payroll, to an employee by the employer, acting in an administrative capacity. To receive a payment, the individuals had to be an employee, with the sum paid calculated by reference to their length of service and salary.

The Tribunal concluded that the individuals received their payment 'by reason of employment'.

The appeal was dismissed.

Compensation for change in pension rights

Summary – Facilitation payments made as part of an integrated package of changes were taxable as earnings from employment and subject to Income Tax and NICs. The payments were made to induce employees to work willingly in the future.

Pensions schemes operated by E.ON UK Plc included two categories of defined benefit schemes. In March 2018, to reduce the costs of operating these schemes, the company agreed certain changes with unions. The 'integrated package' comprised a:

- two-year pay deal;
- commitment not to make further changes to pension arrangements for five years as well as certain other commitment; and
- "Facilitation Payment" amounting to 7.5% of salary, subject to a minimum of £1,000.

Employees were warned that, if they did not agree to the changes, they would receive neither the Facilitation Payment nor the pay rises.

One employee, Mr Brotherhood, was used as a test case for all employees whereby E.ON UK Plc did not deduct PAYE or NICs from the facilitation payment made claiming:

- the sum was not earnings from his employment;
- the payment was made to compensate him for the adverse changes made to his pension arrangements.

HMRC disagreed and sought to tax the sum through PAYE, so collecting both income tax and NICs.

The First Tier Tribunal found that the facilitation payment was part of the integrated package which changed the future relationship between the company and its employees. It was part of an inducement for employees to provide future services but on different terms and was therefore taxable.

The Upper Tribunal disagreed, finding for the taxpayer. The facilitation payment was compensation for the detrimental changes made to the defined benefit pension arrangements. The facilitation payment put the employee in the same position as before the changes, meaning that payment was not taxable employment income.

HMRC appealed to the Court of Appeal.

Decision

The Court of Appeal agreed with the First Tier Tribunal that the facilitation payment was an inseparable part of the integrated package that had been agreed.

That package related to future employee rewards and benefits for those working for the company and was therefore taxable as earnings from employment.

The First Tier Tribunal's decision was reinstated.

SEIS denied

Summary – SEIS compliance certificates were denied for ten companies created by a director as three conditions had not been satisfied.

Mr Doshi was a Chartered Accountant who had many years of experience working in the media and retail industry entrepreneur.

While working as the Chief Operating Officer for the Prime Focus World group of companies he became aware of the demand for more audio-visual content related to religious sites.

Having identified ten places of religious significance (nine in India, one in Nepal), he sought to raise funds from investors under the SEIS to create audio-visual content related to these religious sites.

With the first company, he sought to raise funds from investors subscribing for 150,000 ordinary £1 shares.

However, having raised close to the £150,000, he set up nine further companies, one for each site, and proceeded to raise further sums of £150,000 for each company in the same way.

HMRC refused the SEIS applications of all ten companies.

The ten companies appealed as one to the First Tier Tribunal, claiming that they met the required conditions and that their investors were eligible claim SEIS relief.

HMRC argued that none of the companies satisfied all of the required conditions, stating that the companies:

1. did not satisfy the Risk-to-Capital condition (s.257AAA ITA 2007);
2. did not satisfy the Trading Condition (s.257DA ITA 2007); and
3. were engaged in Disqualifying Arrangements (s.257CF ITA 2007).

Decision

As a reminder, the Risk-to-Capital condition requires that at the time of the share issue, the issuing company must have objectives to grow and develop its trade in the long-term. The Tribunal noted that the company's financial projections showed that the intention was to develop and produce one film, before moving to the next. The Tribunal accepted HMRC's claim that "given the high risk of failure with each film, this sequential process was not a strategy that could easily lead to the appellants' growth".

The Trading Condition requires that throughout the three years immediately following the issue of shares, each company must be carrying on a qualifying trade. However, there was little evidence of trading on a commercial basis.

It was clear that almost all of the work for each company was subcontracted to companies and individuals connected to Mr Doshi and that those persons were prepared to work for little or no money. Without Mr Doshi's connections, none of the companies would have had sufficient funding to pay for the work that was undertaken. This could not be considered to be "trading conducted on a commercial basis".

Finally, Mr Doshi told the Tribunal that he had concluded, through discussions with friends, that it would be best to proceed with one company for each of the religious sites chosen for emotional reasons. However, the Tribunal confirmed that HMRC were correct that this was artificial fragmentation and that “this artificial fragmentation was motivated by the desire to obtain more SEIS relief than would have been possible had just one company been set up in place of the ten appellants”.

The appeals were all dismissed.

The Legend of the Golden Temple Ltd and others v HMRC (TC08999)

Failure to notify property sale

Summary – Neither the taxpayer’s mental health nor ignorance of the law represented a reasonable excuse for failing to report a property sale that the taxpayer knew would result in a chargeable gain.

In 2006, Felicity Harber had bought a property for £135,000 which she had let out since 2007.

As landlord, she was aware of the need for gas safety checks, she collected the rent and paid the mortgage. Believing that her earnings were below the threshold, she had never completed a tax return and had not notified HMRC of her rental income.

From 2014 she had lodgers in her own house but, having checked with HMRC, understood that the related income was covered by the rent-a-room scheme.

In 2018, having instructed estate agents and solicitors, she sold her rental property for £252,000. She was aware that there might be a tax consequence of the sale but took no professional advice about her CGT position as this would have been "expensive". She believed that by reporting the sale on the government's Land Registry site she would hear in due course from HMRC. She did not contact HMRC or check their website to see if she had to notify her CGT liability.

Later, HMRC issued her with a "failure to notify" penalty of £3,265.11, which she appealed on the grounds that she had a reasonable excuse, because of her mental health condition and/or because it was reasonable for her to be ignorant of the law. In her defence, she provided details of nine First Tier Tribunal cases supporting her case.

However, these had been generated by artificial intelligence (AI). She had not checked their validity and so was unaware that none of these authorities were genuine.

Decision

The First Tier Tribunal noted that Felicity Harber had:

- been able to liaise with both solicitors and estate agents regarding her property sale;
- put money aside to cover the approximate capital gains tax that she believed would be payable;
- had previously contacted HMRC about letting rooms in her main residence.

As a result, the Tribunal found that her mental health did not provide a reasonable excuse as she was clearly capable of managing her affairs.

Further, she was not ignorant of the law. Having previously obtained advice from HMRC, and knowing that she had made a capital gain, a reasonable person would not simply have put some money to one side and waited to be contacted by HMRC. They would have contacted HMRC or spoken to their solicitor or an accountant to discuss and then report the disposal for CGT purposes.

The First Tier Tribunal accepted that Felicity Harber was unaware that the AI generated cases were false and further, she did not know how to check their validity. While not determinative in this case, this did highlight the potential limitations when relying on the use of AI to obtain tax information independently of seeking professional tax advice.

Felicity Harber's appeal was dismissed.

Felicity Harber v HMRC (TC09010)

Undeclared property disposals

Summary – The proceeds from the sale of several properties was used to pay for the care of the taxpayer's wife who was in extremely poor health. Unsurprisingly, capital gains tax was still payable.

Sunday Salokun was an experienced property investor, who was aware of the obligation to pay capital gains tax on a gain made on disposal of a property.

His wife was ill and required 24-hour care. Social services refused to help pay for her care.

Social Services had told him to sell his properties as it was his "responsibility to pay for his wife's medical expenses because he owned multiple properties".

Having sold the properties, he did not declare the gains as he did not believe that he should have to pay the tax on the sale. By funding his wife's medical expenses, he had saved the government "hundreds and thousands of pounds".

HMRC disagreed and raised assessments and penalties accordingly.

Sunday Salokun appealed.

Decision

The First Tier Tribunal sympathised with Sunday Salokun's position. However, the Tribunal found that he knew about his obligation to declare the disposals and pay tax on the gains but chose not to comply.

The Tribunal confirmed that the assessments had been validly issued and were made in time.

Further, the non-declaration of the property disposals and capital gains was deliberate. Sunday Salokun made no attempt to conceal his intention at any point. The penalties were valid.

However, since issuing the penalty assessments, HMRC had reclassified the disclosure to be unprompted rather than prompted and had recomputed the penalties accordingly. As these differed from the penalties assessed and notified, HMRC asked the Tribunal to exercise its right under s 50(6) TMA 1970 to reduce the penalty assessments for those years. The Tribunal agreed.

Mr Sunday Salokun v HMRC (TC08986)

SDLT on farm and granary

Summary – A granary bought at the same time as a farm was found to be part of the grounds relating to the farm, meaning that this was the purchase of residential, rather than mixed use property.

In 2019, Steven Bowen and his wife bought two leaseholds, Old Valley Farm and The Granary, registered under two title numbers at the Land Registry but bought together for a single price of £1,625,000:

- Old Valley Farm leasehold consisted of a farmhouse, outbuildings and over 14 acres of land;
- The Granary leasehold consisted of the granary building and land of less than an acre.

There was a single approach from the main road to the buildings. The Granary was not connected to any of the Old Valley Farm buildings but was sited on a small triangular plot of land, bordered on two sides by Old Valley Farm.

A single TR1 was completed for the transfer, and a single SDLT return stating that the two properties had been purchased in a single, mixed-use transaction.

Following an enquiry, HMRC issued a closure notice calculating the SDLT payable on the basis that the transaction was of entirely residential property.

Following a review, Steven Bowen appealed arguing that the purchase was of mixed used properties as The Granary:

- was separate to the farm, and its land was commercially farmed by a third party;
- did not form part of the garden and grounds of Old Valley Farm;
- had been marketed and sold separately with full planning permission for development.

Decision

The issue for the First Tier Tribunal to decide was whether The Granary was part of the grounds of Old Valley Farm, meaning that this was a single purchase of residential property.

The Tribunal took a multi-factorial approach as set out by the Upper Tribunal in Hyman [2021] UKUT 68 (TCC), concluding that The Granary and its land were part of the grounds of Old Valley Farmhouse.

The Tribunal concluded that The Granary and its land were not in agricultural or other commercial use. At the time of purchase, The Granary building was derelict. Although its land had been used for grazing in the past, there was no binding agreement to that effect in place at the effective date of the transaction.

Further, the lease:

- prohibited the use of the property for commercial purposes;
- indicated a link between The Granary and Old Valley Farmhouse.

The Granary shared two out of its three boundaries with Old Valley Farmhouse and was sufficiently close to Old Valley Farmhouse to be capable of being grounds.

The final nail in the coffin was that Steven Bowen stated that, given its proximity to the farmhouse, he had acquired The Granary to prevent someone else from purchasing it.

The Tribunal concluded that this made it clear that “the use or function of that property, at the effective date of the transaction, was to support the use of Old Valley Farmhouse as a dwelling”.

With The Granary forming part of the grounds at the effective date of the transaction, the purchase was one of residential property and not mixed-use property.

The appeal was dismissed.

Steven Bowen v HMRC (TC09003)