

Personal tax update (Lecture P1351 – 17.54 minutes)

Compensation under a settlement agreement

Summary – a compensation payment made to an employee was taxable as a payment for a restrictive undertaking confirming that the employee would not pursue claims against her employer arising out of her employment or its termination.

Mrs A had worked for her employer since May 2007. In October 2017, she wrote a formal grievance letter against her employer alleging, among other things, harassment on the grounds of sex, bullying, victimisation and intimidation.

Unhappy with the employer's grievances processes, she took the case to the Employment Tribunal but in return for a compensation payment of £1,055,000, she withdrew her claim. The settlement sum was paid to cover various confidentiality and non-disclosure obligations that she agreed to.

The employer treated the sum as a termination payment, allowing £30,000 as being tax free, with the balance taxable under PAYE. However, Mrs A disagreed with the tax treatment, believing that the payment was wholly in consideration for her agreeing to enter into the confidentiality and non-disclosure obligations and was not connected with the termination of her employment. She sought to reclaim £467,684 of tax.

Following an enquiry, HMRC issued a closure notice for £461,588 on the basis that the compensation was a taxable termination payment or alternatively, it was a restrictive undertaking sum paid in connection with current, future or past employment, taxable as earnings under s.225 ITEPA 2003, with no £30,000 exemption.

Mrs A appealed to the First Tier Tribunal arguing that the payment had no connection to her employment being terminated. She claimed that the terms of the Settlement Agreement did not restrict her future employment in any way but merely required her not to disclose the facts and circumstances surrounding the grievance and the termination of her employment.

Decision

The First Tier Tribunal stated that the logical approach to take was to consider HMRC's alternative argument first, as the charge to tax under s.225 ITEPA 2003 takes priority over the charge to tax under s.401 ITEPA 2003, as this later section does not apply to payments that are otherwise chargeable to tax (see section 401(3)). If the entire compensation payment fell within s.225 ITEPA, 2003 it would be wholly taxable under that provision and there would be no need to consider whether s. 401 applied.

The First Tier Tribunal found that any undertaking restricting an individual's conduct or activities, given in connection with their employment, is within the scope of s.225 ITEPA 2003.

Both parties accepted that the agreement contained restrictive undertakings. It was not a payment for damages but rather paid for the restrictive undertaking that Mrs A would not make or pursue any claims against her employer relating to or arising out her employment or its termination. In this case, the payment was taxable as earnings under s.225 ITEPA 2003.

The First Tier Tribunal went on to say that had s.225 ITEPA 2003 not applied, the payment would have been a termination payment taxable under s.401 ITEPA 2003, with no scope for apportioning part of it as consideration for the confidentiality and non-disclosure obligations agreed to.

The taxpayer's appeal was dismissed.

Mrs A v HMRC (TC08640)

'Blocked' dividends not taxable

Summary - Dividends credited to a 'blocked' directors' account were not 'paid' and so were not liable to income tax.

Marcus and Karen Jays were shareholders of Questor Properties Limited, a property management company in which they jointly held the single issued share.

To be able to make property purchases, the company had taken out several loans with Lloyds Bank Plc as well as ten interest rate hedging products. The company was trading successfully at the operating level but due to debilitatingly high interest costs, the business was at risk.

Marcus Jays believed that by showing strong dividend declarations, the company could attract external equity investors. However, Lloyds Bank Plc was unwilling to permit the couple to extract substantial profit from the business and wanted to limit the dividends paid. Consequently, an agreement was reached that restricted the level of dividends which could be 'paid' to the shareholders. Dividends in excess of these amounts were 'declared' but the amounts were credited to a 'blocked' account on which the directors were unable to draw. When submitting their tax returns the couple did not include the 'blocked' dividends as these had not been 'paid'.

HMRC argued that crediting the 'blocked' directors' accounts represented payment of the dividends and so issued discovery assessments on the basis that the couple should have included the full dividend 'declared' as taxable dividend income and not just the amount that was drawn.

Marcus and Karen Jays appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal stated that dividends are taxable when they are 'paid', which is the point when there is an enforceable right for the recipient to receive the declared amounts.

In this case, the 'blocked' dividends were not accessible until both the company and the bank reached agreement. If the agreement was breached and the 'blocked' dividends paid out, the bank could suspend the company's borrowings.

With no right to receive the 'blocked' dividends, these sums were not 'paid' and not subject to Income Tax.

The appeal was allowed.

Mr Marcus Jays and Mrs Karen Jays v HMRC (TC08639)

Same dividend, different dates

Summary – An interim dividend was treated as paid to two brothers on two different dates.

On 31 March 2016, the board of directors of Regis Group (Holdings) Limited resolved to pay an interim dividend of £40 million, split equally between Peter Gould and his brother.

For personal tax reasons, it suited the brothers to be taxed on the dividends in different tax years. By 2016/17, Peter Gould was non-resident for tax purposes and so he wanted his dividend to be taxed in that year, when no tax would be payable. By contrast, his brother was UK resident throughout but, due to changes introduced in FA 2016, being taxed on his dividend in 2015/16 would result in an effective tax rate of 30.56% rather than at 38.1% if it was delayed to the following year.

The brothers were advised that by declaring an interim dividend, the income would only become taxable when the dividend was actually paid. Consequently, the interim dividend declared was paid on two different dates:

- The brother's £20 million dividend was paid on 5 April 2016;
- Peter Gould's dividend was not paid until December 2016.

HMRC sought to tax Peter Gould's dividend on the earlier date, arguing that the two dividends must be treated as being due and payable on the same date, and that date was the day on which the earlier dividend was paid.

Peter Gould appealed.

Decision

The First Tier Tribunal concluded that Peter Gould had no enforceable right to be paid a dividend on the same day as brother. He only became entitled to his share of the interim dividend when it was actually paid.

The taxpayer's appeal was allowed.

Peter Gould v HMRC (TC08647)

Distribution in specie and SDLT

Summary – An SDLT scheme whereby a company bought a property that was subsequently distributed in specie to its shareholders failed.

On 2 July 2007, an unlimited company was incorporated on 2 July 2007, with Michael and Bridget Brown subscribing for 47,751 £1 shares each. The company used this money to pay the £95,000 deposit on a property that it was buying.

Soon after, the couple subscribed for further shares so that the total nominal value of the company's shares in issue was £960,002.

In August 2007, the company:

- used the balance of the money from the share subscriptions to complete the purchase of the property;

- resolved to reduce its share capital to £2, to be achieved by a distribution in specie of the property to the taxpayers.

The arrangement sought to take advantage of the “sub-sale relief” for SDLT contained in s.45 FA 2003 (as it was then in force). The case report neatly summarises the effect of s.45 by stating:

“S.45 made provision for the situation in which land was contracted to be sold by A to B, but there was an assignment, sub-sale, or other transaction as a result of which C became entitled to call for a conveyance. Broadly, in such a case the section provided that the first contract between A and B was to be disregarded and SDLT was to be charged only by reference to C’s acquisition under a notional (“secondary”) contract.”

In this case, with the property purchase and distribution in specie occurring on the same day, the couple argued that the effect of s.45 FA 2003 was that the purchase by the company should be disregarded and further, as a result of the distribution in specie, there was no consideration. As a result, no SDLT return was filed.

HMRC disagreed and in August 2011 HMRC issued a notice of determination to collect SDLT, calculated as 4% of £955,000, the relevant rate at that time.

On appeal, the First Tier Tribunal found that applying s 45(3)(b), there was consideration for SDLT purposes, which was the subscription monies paid to the company.

The couple appealed to the Upper Tribunal.

Decision

The Upper Tribunal found that the consideration should be £955,000.

In this case, the share subscription money was the money paid indirectly by the Browns to enable the company to buy the property, effectively for them. The amount of the consideration was equal to the purchase price of the property under the original contract and was liable to SDLT. This was slightly less than the total subscription sums as these also covered conveyancing fees.

The Upper Tribunal rejected the Brown’s argument that ‘consideration’ is limited to amounts provided for under a contract. This would have meant that there could be no consideration in respect of a distribution in specie which was a gratuitous transaction. The Tribunal stated that it was clear that purchases outside of ‘a binding and enforceable contract but in respect of which value in money or money’s worth is provided’ was liable to SDLT.

The appeal was dismissed

Mr Michael Brown and Mrs Bridget Brown v HMRC [2022] UKUT 00298 (TCC)

Buildings not yet constructed

Summary – Planning permission to build homes on land with boreholes did not mean dwellings were ‘in the process of being constructed’. Multiple Dwellings Relief (MDR) was denied.

Ladson Preston Ltd and AKA Developments Greenview Ltd each acquired plots of land with planning permission in place to build multiple dwellings on that land. Ladson Preston Ltd acquired bare land,

while AKA Developments Greenview Ltd bought land with commercial buildings on that were to be demolished.

Subsequent to purchase, both companies:

- built properties in line with the planning permission that had already been granted;
- claimed MDR, arguing that planning permission meant they satisfied Para 7, Sch 6B FA 2003 that dwellings were 'in the process of being constructed' on the land at the Effective Date.

Initially:

- Ladson Preston Ltd treated its acquisition as an acquisition of non-residential property but subsequently amended its return to claim MDR;
- AKA Developments Greenview Ltd computed its SDLT liability on the basis that the property acquired was "residential" but later claimed MDR.

HMRC denied the relief and so the companies appealed to the First Tier Tribunal who denied MDR, as it was land that had been acquired, with no interest in dwellings.

Decision

The Upper Tribunal stated that MDR is available where more than one residential dwelling is acquired or where residential dwellings which are in the process of construction are acquired.

The Tribunal found that it is not enough to have planning permission and intend to construct dwellings in the future. There must be some physical existence of the dwellings.

With no actual construction, other than some boreholes dug at one of the sites to test the ground, no building was in the process of being constructed.

The Upper Tribunal concluded that, there was no building in the course of construction, so no MDR relief was denied and the appeal dismissed.

Ladson Preston Ltd and AKA Developments Greenview Ltd v HMRC [2022] UKUT 301 (TCC)

Return deliberately withheld

Summary – Having made a conscious decision not to file his tax return on time, this was a taxpayer who had decided to default. Subsequent financial difficulties and health problems provided neither a reasonable excuse nor special circumstances.

Neal Futcher was issued a Notice to File his 2015/16 Self Assessment return on 6 April 2016.

By 1 July 2019, with no return submitted and based on information obtained from other sources, HMRC raised a determination for £253,341 under s.28C TMA 1970.

Finally, on 16 August 2019, Neal Futcher filed his 2015/16 return, 927 days late, showing a tax liability of £171,137.82.

This appeal is against the tax-gear penalty of £51,324.23 imposed by HMRC under s.55 FA 2009 for the late filing of his 2015/16 self-assessment tax return. Neal Futcher disputed the penalty was

chargeable “on the grounds that the late filing was not as a result of deliberate behaviour and that there are mitigating circumstances”.

In summary, Neal Fatcher claimed that he delayed submitting his 2015/16 return as it showed a large tax liability that he could not afford to pay. He believed that his business would shortly generate the necessary cash as sales and cash flow were forecasted to improve by April/May. He claimed that he only intended to delay the submission for a few months. However, that delay was extended when in 2017 and 2018 he experienced major financial problems with his business and then in 2019, he suffered severe health problems.

Decision

The Tribunal found that at the filing date, Neal Fatcher was aware of his obligation to file his 2015/16 tax return by 31 January 2017. His severe business problems did not start until much later in 2017 and 2018. Further, there was no evidence to suggest that he was suffering from his health conditions at that time. Indeed, in a letter dated 16 October 2019, he made it clear that he did not file his return as he had decided not to.

The Tribunal noted that at a time when he was seeking help for his medical problems, he managed to file his tax return. When pressed as to what caused him to submit the return in August 2019, he stated that “he had taken a week off to catch up with “mundane things” and it had been on his mind to do this.” When prompted, he agreed that receiving HMRC’s determination in July 2019 probably prompted him to do it. The Tribunal recorded that it was far from satisfied that his health and business difficulties ever prevented him filing his return.

With no reasonable excuse or no special circumstances, the appeal was dismissed.

Neil Fatcher v HMRC (TC08629)