

## Personal tax round up

(Lecture P1141 – 13.28 minutes)

### Image rights payments

*Summary – The sums payable under the Playing Contract and Image Rights Agreement were an overall package required by the player and were a reward for his services as a footballer and formed part of his earnings.*

Hull City AFC (Tigers) Limited runs a football club that was promoted to the Premier League for the 2008-09 season.

Following his release by Manchester City, on 7 July 2008 the club signed Mr Geovanni Gomez (known as Geovanni) on a 2-year Playing Contract. On 7 November 2008, well into the season, a contract was signed in respect of Geovanni's overseas image rights between the club and Joniere Limited, a company registered in the British Virgin Islands. In September 2009 Geovanni's contract was extended by a year, and potentially a further year; the Image Rights Agreement was similarly extended. Geovanni left the club when they were relegated in 2010 with both his playing contract and the Image Rights Agreement terminated at that time.

Between December 2008 and July 2010 the club paid Joniere a total of £440,800, under the Image Rights Agreement. HMRC argued that the club should have accounted for PAYE and NIC on this amount as it was taxable as part of Geovanni's earnings, rather than his image rights under the separate image rights agreement.

#### *Decision*

The First Tier Tribunal stated that real issue was whether the payments made were emoluments as a reward for Geovanni's past, present or future services as a football player or whether they were consideration for the licensing of Geovanni's image rights. It was important to consider the substance of the payment rather than merely its form.

The Tribunal were satisfied from expert evidence that in 2008 Premier League clubs outside the top 6 did not generally have the skills to maximise commercial opportunities involving the exploitation of image rights. Although Geovanni came from Manchester City, at that time they were a mid – league team where he played for one season, mainly coming on as a substitute. He did not have an image rights agreement while there.

The Tribunal found that there was no reliable evidence as to how the Hull City arrived at the annual image rights payment. Moreover, the club did not have the resources to exploit Geovanni's overseas image rights or any real interest in commercially doing so. The Tribunal was not satisfied that Geovanni's overseas image rights had any commercial value.

The Tribunal concluded that, viewed realistically, the sums payable by the Club to Joniere were actually paid to secure Geovanni's services as a footballer and not to obtain the right to commercially exploit his overseas image.

The appeal was dismissed.

*Hull City AFC (Tigers) Limited v HMRC (TC07074)*

## Insurance bond and personal allowance

*Summary – The gain on surrender of a life insurance bond was taxable as income but eligible for top slicing relief, and the taxpayer was entitled to claim a deduction for their personal allowance.*

Mrs Silver had purchased a life insurance bond in October 1993 for £55,000. Approximately £2,200 was withdrawn from the bond annually over the next 21 years and she surrendered the bond in May 2015 for just under £120,000. The Chargeable Gain Certificate issued by the insurance company showed a gain close to £110,000 calculated as the bond's surrender value plus amounts withdrawn minus purchase price.

In 2015/16, Mrs Silver had other income that amounted to £31,101. HMRC argued that because her adjusted net income was £141,822 she was not entitled to any personal allowance.

Mrs Silver argued that she was entitled to top slicing relief of about £22,000 under s535 ITTOIA 2005. HMRC argued that their manual was quite clear that top slicing relief could not be used where the taxpayer was not entitled to a personal allowance. *Decision*

The First Tier Tribunal agreed with HMRC that the chargeable event gain was income making her total income £141,822 for 2015/16.

Under normal circumstance her personal allowance would be deductible from this amount. However, under s35 ITA 2007, where an individual's adjusted net income exceeds £100,000, the allowance is reduced by one-half of the excess. Having taken this adjustment into account, the Tribunal agreed with HMRC, that she had no personal allowance left.

But was this affected by top slicing relief?

The legislation requires a hypothetical tax calculation so that rather than taxing the full gain in the year of surrender, a hypothetical annual equivalent is calculated. In this case the amount was £5,272.43 ( $£110,721 \div 21$ ). Hence Mrs Silver's hypothetical income under this calculation was £31,101 plus £5,272.43 making a total income of £36,373 for each year.

The Tribunal went on to say that the legislation:

'Consistently applying the assumption that Mrs Silver's income was only £36,373.43 meant that she was (in this hypothetical scenario) entitled to a personal allowance in this calculation.'

The Tribunal made it clear that parliament's intention with top slicing relief was:

'to allow a person who had taken income over a number of years to have relief when provisions taxed them to the entire income in a single year. The relief was intended to make the tax liability approximate to what it would have been had the income been taxed in the year it was actually received. So when carrying out the hypothetical tax calculation it made every kind of sense that the taxpayer should be treated as entitled to the reliefs that that hypothetical income would have entitled her to.'

The Tribunal disagreed with HMRC, saying that their approach was inconsistent with parliament's intentions. Their approach would result in someone who was a basic rate taxpayer in the year of surrender, and who would not have had any higher rate tax to pay on the withdrawals from the bond had it been taxable year by year, having to pay higher rate tax on the entire gain. As the Tribunal stated, top slicing relief would be denied to those it was intended to help.'

*Marina Silver v HMRC (TC7103)*

### **CIOT response to private sector off-payrolling**

The CIOT has set out its view in response to HMRC's consultation on how the off-payroll working rules will apply from 6 April 2020.

Remember, the off-payroll working rules apply to those deemed to be working like employees, typically through their own company. They do not apply to the self-employed. From 6 April 2020, the plan is to extend these rules to all sectors, excluding small private businesses.

#### *CEST needs improving*

The CEST tool was launched when the off-payroll working rules were introduced for the public sector in April 2017 to help businesses and workers decide the employment status of their engagement.

The CIOT are concerned that this tool is not good enough. It has previously raised concerns that CEST does not factor in all the criteria established by case law as needing to be considered before reaching a decision on whether IR35 applies. Consequently, CEST does not always give an accurate employment status determination.

Colin Ben-Nathan, Chair of CIOT's Employment Taxes Sub-committee, said:

"If businesses are to make the correct decisions on whether the off-payroll rules apply then we think that the existing CEST will need to be significantly improved. And we also think that the improved version will need to be ready by October 2019 at the latest so that new and existing contracts can be reviewed by April 2020.

"Until CEST takes proper account of mutuality of obligation, multiple engagements, contractual benefits - such as holiday pay, maternity/paternity pay - and whether someone is in business on their own account, it is unlikely it will be able to reach the right decision on status. And this is important because otherwise the lack of confidence in CEST will increase disputes between businesses and contractors and so lead to significant time and effort having to be expended by businesses, contractors, HMRC and the courts in trying to resolve them."

#### *Exclusion for small businesses*

The CIOT welcome the Government's decision to exclude small private sector entities from rules, and suggest the Government consider extending the exclusion to small public sector businesses to ensure a level-playing field.

The CIOT also questions how employee numbers will be calculated in the small entity test. A test based on a simple employee number count (even if averaged across the year) may discriminate against businesses with predominantly part-time employees; this could discourage businesses from taking on part-time employees in order to retain small business status.

*[www.tax.org.uk/media-centre/press-releases/press-release-improvements-needed-hmrc's-assessment-tool-payroll-working](http://www.tax.org.uk/media-centre/press-releases/press-release-improvements-needed-hmrc's-assessment-tool-payroll-working)*

## **Frozen gain cannot disappear**

*Summary – the Supreme Court found that a scheme intended to operate as a reorganisation should be treated as two separate conversions.*

Mr and Mrs Hancock sold the entire share capital of Bluebeckers to another company in exchange for loan notes issued by the purchasing company.

The deal was structured in three stages:

Stage 1 was the exchange of Bluebeckers Ltd shares for Lionheart notes, which, being convertible into foreign currency, were not Qualifying Corporate Bonds (QCBs).

Stage 2: As a result of an earn-out provision dependent on the performance of the business, further loan notes were issued as QCBs.

Stage 3: Both sets of notes (QCBs and non-QCBs) were converted into one series of secured discounted loan notes that were QCBs. These QCBs were subsequently redeemed for cash.

The issue to decide was whether there was one disposal of exempt QCBs or two separate disposals:

- The Hancocks argued that the result of Stages 2 and 3 was that they were not chargeable to CGT as they were selling exempt QCBs;
- By contrast, HMRC argued that the two sets of loans notes should be treated separately, meaning that the gain relating the original non-QCBs, that had originally been deferred, now crystallised.

The Court of Appeal had agreed with HMRC and the appeal moved to the Supreme Court.

### *Decision*

In this case, the Hancocks crystallised a gain when they exchanged their shares in Bluebeckers Ltd for redeemable loan notes. This transaction was a reorganisation under s126 TCGA 1992. Rollover relief was available under s127 TCGA 1992 meaning that the gain on the original non-QCB loan notes was deferred.

The Supreme Court appreciated the strength of the Hancock's argument that s116 TCGA 1992 allows the possibility of a single transaction that involves a pre-conversion holding of both QCBs and non-QCBs. However, the court stated that if their interpretation was correct, it would be extremely easy for taxpayers to use the roll-over provisions to avoid CGT, rather than defer it. There was no magic whereby the frozen gain relating to the non-QCBs could on conversion "disappear in a puff of smoke."

Agreeing with the Court of Appeal, the Supreme Court stated that that 'the intention of Parliament was that each security converted into a QCB should be viewed as a separate conversion'. As a result, there had been two conversions: one of QCBs and one of non-QCBs. The gain relating to the original non-QCBs was chargeable.

*Hancock and another v HMRC [2019] UKSC 24*

## **Investigations and discovery assessments**

*Summary – The discovery assessment was valid and HMRC had been entitled to obtain information on a voluntary basis as part of an investigation.*

HMRC had received information from the police suggesting that Mr Hunter had diverted and retained confidential cash payments from his company. HMRC wrote to Mr Hunter in February 2015 informing him that it was opening an investigation.

Following the investigation, HMRC considered that two sums credited to Mr Hunter's bank account represented undeclared income, and issued a discovery assessment.

The issue was whether the discovery assessment was valid.

### *Decision*

The first question was whether the discovery assessment was stale, given that the insufficiency of tax had been discovered long before the assessment was issued. The tribunal accepted that the relevant HMRC officer did not believe that he had discovered a tax loss at the time of receipt of the information from the police in late 2014, by the time he opened his investigation in February 2015 or by the time of his meeting with Mr Hunter in April 2015. The officer had only made the relevant discovery 'between November 2016 and February 2017' when he had received an unsatisfactory explanation for the credits in Mr Hunter's bank account. The seven-month delay between the discovery and the issue of the assessment was a 'reasonable passage of time', as during that time HMRC and Mr Hunter had 'made attempts to settle matters.'

The First Tier Tribunal found that Mr Hunter had been careless in not declaring the relevant income or keeping records. He believed that he did not need to keep records as the receipts were not taxable income. However, the Tribunal found that both credits were taxable receipts. In the absence of any documentation, it rejected Mr Hunter's contention that the credits represented a loan, and found that they were likely to be payments for work performed by him.

*K Hunter v HMRC (TC07140)*

*Adapted from case summary in Tax Journal 31 May 2019*

## **Supply Chain Fraud**

HMRC is aware of increasing levels of fraud in labour supply chains and with companies offering payroll services. HMRC recognises that these arrangements are mostly used legitimately, however, they would like employers to take extra care when engaging with these services.

Payroll Company Fraud, at its most basic, occurs when a business transfers staff and payroll responsibility to a fraudulent Payroll Company who supply the staff back to the business. When they are fraudulent, these Payroll Companies will not make the necessary payments to HMRC for Income Tax, National Insurance Contributions or VAT.

The companies conducting the fraud are not limited to specific sectors or business types – providing there is a workforce and a subsequent need for a payroll function, they can target any business. However, they are more likely to target companies whose financial position is weak, almost certainly to exploit this vulnerability with cheap payroll services, offering the struggling business an opportunity to cut in-house payroll costs.

The fraudsters can offer cheap services as, ultimately, they're stealing the tax and National Insurance contributions.

### *Co-Employment*

The co-employment model is something we have seen more often recently. This is generally defined as when control and supervision of an employee's activity is shared amongst two or more business entities. One company will be the original employer and the other/others will take over the personnel related functions, claiming that the workforce is employed jointly by all companies.

There are a number of risks that can occur here – primarily with the new company set-up accruing debts to HMRC and then dissolving. Businesses entering into a co-employment model should undertake sufficient due diligence to ensure the business arrangements are tax compliant.

### *Mini Umbrella Companies*

An umbrella company is a company that acts between the ultimate employer and the staff doing the work. The workforce is segmented into small companies with, usually, a very small number of employees in each company. This is done with the intention of exploiting specific allowances designed to help small businesses, with the aim of reducing the tax paid to HMRC.

With some of these schemes, promoters will offer “payroll services” to legitimate employment agencies, at a rate that is not commercially viable, sometimes with the offer of financial inducements to win the contract.

### *Employers need to be vigilant*

If it can be shown that a company knew, or should have known, that transactions in their supply chain are linked to fraud they may lose the right to recover VAT paid on these transactions. Additionally, in some cases, they may also still be liable for any unpaid tax or National Insurance.

HMRC recommends that business undertake sufficient and proportionate due diligence checks before entering into an arrangement with a payroll or umbrella company.