

Personal tax update (Lecture P1336 – 17.57 minutes)

Unpaid paid overtime and allowances

Summary – The settlement sum was a reward for services, taxable in full as employment income. No deduction was available for the success fee and indemnity insurance that was payable.

Keith Murphy was one of a number of Metropolitan Police officers who sued the Metropolitan Police for unpaid overtime as well as other employment allowances.

In defending their case, the officers agreed to pay their legal team a success fee should they win but also took out indemnity insurance to cover these costs, should they lose.

Successful in their case, the claimants received £4.2 million plus 'agreed costs' but the success fee and insurance premium were not part of those 'agreed costs'. These were payable directly by the Metropolitan Police from the £4.2 million. The balance was payable to the officers.

The Metropolitan Police taxed the total gross compensation payment received under PAYE but, believing that the success fees and indemnity insurance were deductible costs from the payment, Keith Murphy claimed tax relief for these amounts in his tax return.

Following an enquiry, HMRC raised a discovery assessment on Keith Murphy on the basis that his share of the success fee or insurance premium was not deductible. HMRC argued that the full settlement sum was employment income subject to income tax.

The First Tier Tribunal agreed with HMRC, finding that the full payment arose from employment. How that sum was used, did not change the nature of the settlement amount.

The Upper Tribunal agreed with Keith Murphy and overturned the decision. The amounts used to pay the legal and insurance costs were effectively the same as the agreed court costs.

HMRC appealed to the Court of Appeal.

Decision

The Court of Appeal found in favour of HMRC.

The fact that the Metropolitan Police paid both the success fees and indemnity insurance directly to the payees did not change the nature of the full settlement sum. This was a reward for services, taxable in full under PAYE.

Indeed, the settlement amount had been increased by £200,000 to recognise the fact that the principal settlement sum would be taxable.

In summary:

- The compensation payment was taxable as employment income;
- The payment of court costs under a court order were non-taxable as these represented the work done by the legal representatives;
- The cost of the success fee and indemnity fee were not incurred necessarily in the performance of the duties of the employment and so were non-deductible.

The First Tier Tribunal's decision was reinstated.

HMRC v Mr Keith Murphy [2022] EWCA Civ 1112

Inducement to change pension scheme

Summary –The payments made represented compensation for a loss of pension rights and not taxable employment income.

E.ON UK Plc operated a number of pension schemes for its employees, including two defined benefit schemes which were the subject of this case.

In an attempt to reduce costs, the company made 'facilitation payments' designed to compensate members for a number of changes that were to be made to their employment package. The changes included a two-year pay deal, a requirement for defined benefit members to make increased future pension contributions in order to retain the same level of pensions benefits as before and a commitment by E.ON UK Plc not to make any further pension changes for five years.

Believing that the payments were not earnings, but rather represented compensation for adverse changes made to members' pension arrangements, the company did not deduct PAYE or NICs from the payment made.

HMRC disagreed and raised assessments accordingly.

E.ON UK Plc appealed to the First Tier Tribunal with the case of one individual, Mr Brotherhood, treated as a test case for the members as a whole.

The First Tier Tribunal found that the pension facilitation payment could not be separated from the rest of the negotiated package that was designed to change future employment conditions and that the payment as a whole represented an inducement to provide future employment services. Consequently, the payment was from the members' employment and liable to PAYE and National Insurance.

The company appealed to the Upper Tribunal.

Decision

The Upper Tribunal found that the First Tier Tribunal had erred in law in finding that the payments were from employment, rather representing compensation.

The Tribunal accepted that the settlement payment represented part of a package that changed future employment conditions. However, the payment represented compensation for the changes

made to future pension rights. The payments put the individuals in the same position as before the change.

Remaking the decision, the Upper Tribunal found that the payments were not derived from employment and as a result, not taxable as employment income

E.ON UK Plc v HMRC [2022] UKUT 00196 (TCC)

Buying and selling horses

Summary - Enterprise Investment Scheme relief was denied as the risk to capital condition was not met and the company did not meet the qualifying trading requirement.

Valyrian Bloodstock Limited, incorporated in February 2019, sought to raise horses as well as buy and sell bloodstock.

In 2019, the company bought six horses for £192,400 with the intention to sell these horses when they were two or three years old, without training them. Once sold, the proceeds would be reinvested in new bloodstock, with all remaining funds used for the upkeep of the horses. No further horses could be bought until one was sold.

In March and June 2019, shares were allotted to four investors. In November 2019, the company provided HMRC with four EIS1 compliance statements

With no advance assurance from HMRC confirming that EIS relief would apply, HMRC requested additional information. This confirmed that the horses were stabled with a third party, financial information was, 'sketchy' and 'inaccurate'. There were no financial forecasts nor a business plan and other documentation provided was shown to be in draft form only. HMRC believed that Advance Assurance had not been sought because the required supporting information was not available.

HMRC refused to issue the required EIS certificates stating that the Risk to capital condition had not been met. There was no evidence to demonstrate that the company intended to grow and develop its activities in the long term.

More specifically, HMRC stated that:

- There was no indication that the number of employees or turnover were likely to be increased;
- The company had neither provided any financial forecasts nor a business plan to demonstrate growth and development of the company in the long term.
- None of the money raised from selling a horse was used to build the company's infrastructure;
- With almost everything done by third parties, the company was not acquiring expertise that it would use to build its brand and reputation in the long term;
- The company was not being managed by entrepreneurs. The investors were individuals using a tax advantaged scheme with little or no entrepreneurial involvement.

Further, HMRC argued that the company did not meet the qualifying trading requirement as its activities consisted of dealing in goods of a kind held as an investment.

Valyrian Bloodstock Limited appealed to the First tier Tribunal.

Decision

The First Tier Tribunal stated that it was necessary to look at the circumstances at the time the shares were issued, together with other supporting evidence available at that time.

The Tribunal stated that they saw no evidence of how revenue would increase through time. In fact, the evidence provided showed that the company intended to use all of its funds raised on the purchase of the horses and their upkeep. The company failed to provide financial forecasts nor a business plan to demonstrate growth and development of the company. The Tribunal concluded that there was nothing to suggest that this would be anything other than a three year investment.

The Tribunal concluded by stating:

“Looked at objectively, we find that it was an investment opportunity in a “wrapper” that was perceived as being tax efficient.”

The horses were held for capital appreciation rather than as trading stock.

The appeal was dismissed.

Valyrian Bloodstock Limited v HMRC (TC08578)

Payments under a consent order

Summary - Payments that were made under a High Court consent order were not deductible enhancement expenditure under s.38(1)(b) TCG 1992.

St Peter’s Farm in Oxfordshire was owned by Dora Slade and comprised a farmhouse, garden, grounds and farmland. On her death:

- Jonathan James Slade, her son, inherited the farmland;
- Her residuary estate comprising the farmhouse, garden and grounds were left on trust for various family members including Jonathan James Slade.

In 1987, the farmhouse, garden and grounds were split into three separately registered titles known as the Farmhouse, the Northern Parcel and the Southern Parcel. The Farmhouse was sold without dispute.

By June 2009, Jonathan James Slade was the sole executor and trustee under Dora’s will, the other executors and trustees having died.

Sometime after 2010, Jonathan James Slade was advised that the two parcels of land had in fact remained part of the farmland which meant that Jonathan James Slade was beneficially entitled to that land; it did not fall within the residuary trust.

In 2012, Jonathan James Slade assented to both Parcels of land being transferred to Jonathan Mark Slade, his son, and himself as tenants in common. The titles to the land were registered accordingly.

In August 2015, the two men sold the Southern Parcel, with planning permission, for £250,000. It was this disposal that gave rise to the CGT issue in this appeal.

On 12 March 2018, the other family members commenced a claim in the High Court in their capacity as beneficiaries of the residuary trust under Dora Slade's will. They sought the following remedies for alleged breaches of trust and/or fiduciary duty:

- 1) A declaration that Jonathan James Slade and Jonathan Mark Slade held both parcels of land on the residuary trusts of Dora's will.
- 2) An order that Jonathan James Slade and Jonathan Mark Slade account to the beneficiaries for the proceeds of sale of the Southern Parcel and any profits obtained from those parcels of land.
- 3) In the alternative, damages for breach of trust and/or breach of fiduciary duty in a sum equal to the value of the parcels of land.

The father and son disagreed, claiming that Dora Slade's will did not intend the parcels of land to pass together with the Farmhouse as part of her residuary estate.

The High Court claim was settled shortly before the hearing by way of a consent order dated 8 August 2019, resulting in costs and payments to be made to other members of the family totalling some £275,000.

Jonathan James Slade and Jonathan Mark Slade claimed a deduction for the payments and costs in arriving at their chargeable gain

HMRC denied the deductions claiming that they did not fall under s.38(1)(b) TCGA 1992 which states that an amount is deductible if the expenditure is wholly and exclusively incurred on to establish, preserve or defend title to, or to a right over, the asset.

HMRC stated that the sums were incurred in preserving or defending entitlement to the proceeds of sale of the land, and not the land itself. Alternatively, the expenditure was partly incurred in preserving or defending entitlement to the proceeds of sale and partly in defending title to land.

Jonathan Mark Slade and Jonathan James Slade appealed.

Decision

The First Tier Tribunal found that the payments were incurred in respect of both the Southern and Northern Parcels of land and not wholly and exclusively on the Southern Parcel. Consequently, the payments and legal costs could not be said to fall within s.38(1)(b) TCGA 1992.

The First Tier Tribunal went on to say that the High Court Claim was a claim over the proceeds of sale of the Southern Parcel and not title of the land which had been sold. The Tribunal saw the payments made under the consent order as damages, rather than the costs of defending title to the land. The Tribunal stated:

"The right to take court action for compensation or damages is an asset for CGT purposes. Consequently, where a person receives compensation there is a disposal of an asset for CGT purposes and strictly there may be no acquisition cost. ESC D33 provides a concessionary treatment where the right of action arises in relation to damage to an underlying asset. The gain may be treated as if the receipt of compensation or damages was a part disposal of the

underlying asset. Where there is no underlying asset, any gain on disposal of the cause of action may be exempt up to a limit of £500,000.

It is not clear to us that the other family members would be liable to CGT on receipt of the damages provided for in the Consent Order. In particular, they were seeking to enforce their rights as beneficiaries under Dora's residuary will trust. They were not seeking to obtain title to the land themselves. As such, it is not clear that there was any underlying asset. It may be that their disposal of the right of action would not be taxed as a matter of concession. In any event, the tax treatment of damages in the hands of the other family members is irrelevant to the tax treatment of the appellants' disposal of the Southern Parcel."

The appeal was dismissed.

Jonathan Mark Slade and Jonathan James Slade v HMRC (TC08548)

Services provided by 'apart-hotels'

Summary - Serviced apartments were an investment business meaning that no business property relief was available.

The L Batley 1984 Settlement held just under one third of the shares in The Lawrance (Hotel) Living Ltd, which in turn owned four properties in York and Harrogate. Each of the properties consisted of a number of serviced apartments, a cross between hotels and self-contained apartments. The majority of guests were corporate customers who stayed for between one and three nights, who were given tea, coffee, milk etc, as well as WIFI, bedding and towels.

A ten-year anniversary charge was due on 14 November 2014, with the trustees claiming 100% business property relief on the trust's shareholding in the company.

HMRC denied the relief on the grounds that the business was holding investments, and not trading, meaning that it was not eligible for the relief.

The trustees appealed.

Decision

The First Tier Tribunal found that although a business, guests rarely spoke to staff and food and extras accounted for less than 5% of turnover. The business was not a hotel business but rather serviced apartments.

The reception was not used by guests but rather as an administration centre from which the apartments were serviced.

The Tribunal acknowledged that some apart-hotels could be categorised as providing services together with accommodation, this was not the case here. The company's principal activity was investment, so no business property relief was available.

The appeal was dismissed.

Bruce Firth and Rita Firth as The Trustees of The L Batley 1984 Settlement v HMRC (TC08542)

Additional dwelling supplement and COVID

Summary – Although he sold his second property, the taxpayer remained liable to the Additional Dwelling Supplement charge as his circumstances did not fall within the conditions required to allow a repayment to be made.

In February 2020 Iain Robertson bought a house and filed the electronic Land and Buildings Transaction Tax return online the same day. Already owning a flat that he had been unable to sell due to the COVID lockdown, he paid the £4,000 Additional Dwelling Supplement that fell due.

Once lockdown eased, the family who had intended to help him renovate the new house so that he could live in it were no longer able to do so. His savings had been used so he did some of the work himself, but due to underlying health conditions, he then spent three weeks in bed unable to do very much at all. His mobility deteriorated significantly.

Reluctantly, in April 2021, he sold his new house and his lawyer submitted a claim for repayment of the Additional Dwelling Supplement of £4,000.

HMRC denied the repayment stating that the conditions for Additional Dwelling Supplement repayment were not met.

Iain Robertson appealed, arguing that he had “been caught by a set of rules that were not meant” for his situation.

Decision

The Tribunal acknowledged that this was a very sad case. Iain Robertson had intended to occupy the house, but due to factors outside of his control, he had not done so.

It was the Scottish Parliament’s intention that Additional Dwelling Supplement should only be repayable in the limited circumstances set out in paragraph 8(1) Schedule 2A LBTSA.

Under paragraph 8(1)(a)), to be eligible for a repayment the buyer must dispose of the ownership of a dwelling (other than one that was or formed part of the subject-matter of the chargeable transaction). Since it was the house which triggered the payment of Additional Dwelling Supplement, it was the house which formed the subject-matter of the chargeable transaction. The disposal of the house could not trigger the repayment of the supplement.

Revenue Scotland could only apply the legislation as drafted; they had no discretion to change the rules based on Iain Robertson’s individual circumstances.

The appeal was dismissed.

Mr Iain Robertson v Revenue Scotland [2022] FTSTC 6