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Category	**Course title**	**Author**
Tax	Tax Case Update	Tony Jenkins

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Tax Case update

1. Introduction

Throughout most of the calendar year there are cases being heard by the various levels of the Courts including the Tribunal system. Some involve either historic tax law which has been subsequently amended or complex or obscure legislation. Other cases can be of very wide ranging application. These cases can come from different levels of the Court system. Those included in this update come from the First Tier Tribunal and the Upper Tribunal.

This module looks in detail at some of the important cases from different tax perspectives in the last few months.

2. Specific cases

2.1 Did IR 35 apply to BBC Presenters?

Three BBC presenters Joanna Gosling, Tim Willcox and David Eades ('G', 'W' and 'E') each operated personal services companies ('PSCs') Paya Ltd, Tim Willcox Ltd, and Allday Media Ltd, providing their respective services to the BBC. The PSCs were set up during 2003 and 2004.

Each of the Presenters had worked for the BBC for a number of years previously: G and W on a 'freelance' basis from 1999 and 2001 respectively; whilst E had been a BBC employee for some 16 years until he took voluntary redundancy in 2003 (at that time he also started to build up a portfolio of work outside the BBC, and also had a few radio presenting shifts at the BBC World Service on an ad hoc, freelance basis).

In the period from their establishment until 2014, the PSCs entered into a series of contracts with the BBC for the provision of the relevant Presenter's services to the BBC News channel ('News') and/or the BBC World channel ('World'). News and World provided live coverage of news events in the UK and around the world. During this period:

1. G mainly presented on News but she also presented news bulletins on BBC1 and BBC2 as well as on World and BBC London;

2. W worked primarily on News but also on World, in each case as a 'fill-in' presenter with no regular slot;

3. E presented on World. He also presented a number of programmes on BBC Radio but income received by E's PSC in respect of his radio presenting work was not the subject of the appeal.

The Presenters all did some other non-BBC work although not as news presenters and to varying degrees.

In 2014 the Presenters were all engaged directly by the BBC under continuing contracts, which the BBC treated as employment contracts for tax purposes

HMRC challenged the companies, arguing that the presenters' earnings for 2006/07 to 2013/14 were caught by the IR35 rules, making the companies responsible for tax and National insurance on those earnings.

The appeal followed the usual format of such cases whereby the Tribunal looked at mutuality, control and other provisions within the contracts to see if they were consistent with them being contracts of service.

Held:

The First Tier Tribunal decided that the BBC was aiming to shift the employment tax risk to the presenters through their personal service companies. The individuals had little choice but to contract with the BBC through personal service companies. The only alternative was to accept a substantial pay cut and become an employee. Considering a hypothetical contract, Judge Morgan concluded that IR35 applied to most of the contracts:

- Mutuality of obligation: Even though the presenters had the option to refuse to work on some dates, all three presenters were required to work for a minimum number of days if asked to do so, with the BBC being required to pay for that minimum number of days, regardless of whether work was actually provided. This was held to be a sufficient mutuality of obligation;

- Control: Before taking on other client work, the presenters needed to obtain the BBC's consent before accepting. Additionally, the BBC had ultimate control over the productions, with limited autonomy allowed when the presenters were presenting and interviewing. This was seen to be evidence of employment.

Judge Perrin agreed with the finding of the facts, but disagreed with the final conclusion reached by Judge Morgan. He found that there was no guarantee that their contracts would be renewed, there was a significant degree of flexibility to their work pattern that allowed them to refuse work and use their journalism skills elsewhere; although the editorial guidelines provided a framework as to what needed doing the news readers did have a significant amount of autonomy as to how they worked. In addition the newsreaders had no holiday pay, sick pay or pension provision.

The final decision rested with Judge Morgan's casting vote with the final decision going in HMRC's favour. However, the judges agreed that the presenters and their advisers had acted in good faith, and had not been careless in their decision to disapply the IR35 rules. This meant that the enquiry period was limited to four years, and so some of the determinations were invalid as they were issued out of time.

Paya Ltd, Tim Willcox Ltd, Allday Media Ltd v HMRC (TC07377)

Practical implications:

- On a split decision, the work done by three BBC presenters was held to fall foul of the IR35 rules so tax and NIC were due on payments made to them by their personal service companies.
- If these presenters had been investigated today, the new off-payroll rules in Chapter 10 ITEPA 2003 would apply and would have resulted in the BBC picking up the bill.
- The decision in HMRC's favour seems to give weight to:

    1. The relative longevity of the arrangements (in effect, continuously over the 5 and 7 years under appeal);

    2. The 'control' test could be satisfied by finding a sufficient 'framework of control' (thus referring more to 'overall control');

    3. There was no sense in which the Presenters were 'in business on their own (self-employed) account'.

2.2 What was the nature of the disposal?

The Leeds Cricket Football & Athletic Company Ltd (LCFA) owned the freehold of Headingley cricket ground (the property) which it leased to Yorkshire County Cricket Club (YCCC) whilst retaining the right to carry on hospitality, catering and advertising.

The hospitality operation generated significant revenue and overlapped considerably with the advertising operation. The catering operation employed 19 full-time staff.

On 30 December 2005 LCFA entered into a contract with YCCC for the sale of the property. The contract provided for the sale of the property and goodwill.

Goodwill was defined as the business carried on at the property including letting of advertising boards and provision of hospitality and catering services (the Cricket business), but excluding the hotel business and rugby activities. The catering business was licensed back to LCFA for an annual fee.

Although the ground prior to the sale was leased to YCCC, LCFA maintained the right to carry out hospitality, catering and advertising in the ground. This included selling corporate hospitality packages, selling advertising on the boards around the ground and providing meals and refreshments to visitors to the stadium on cricket days. The case called these activities the "cricket business". On the sale of the ground to YCCC, LCFA provided details of customer lists and transferred third party agreements to YCCC and the catering business was licensed back by YCCC to LCFA.

The question before the Tribunal was whether the sale was a disposal of:

- land with attached income streams that would be treated as a capital gain; or

- a business with attached goodwill.

Held:
The First Tier Tribunal found that:

- a business was being carried on prior to the transfer because the activities carried out by LCFA in running the various operations meant that it was not simply a passive income stream (as argued by HMRC)). The fact that the operations were ancillary to ownership of the property did not mean that a business was not being conducted;

- There was goodwill attached to the business because, on the evidence, the Tribunal were satisfied that this had been generated over the years by hard work and that there was an established client base and reputation. The goodwill was not subsumed into the value of the property, first because it was not necessary to distinguish between inherent (site) goodwill and adherent (free) goodwill and second because the evidence demonstrated that the Cricket business could have been sold and carried on elsewhere; and

- A business was transferred and goodwill was included in the transfer. The terms of the contract showed that goodwill had been assigned and the Tribunal rejected HMRC's arguments that LCFA was carrying on the catering business both before and after the sale (because this ignored the existence of the licensing arrangement). Because LCFA had engaged a third party to sell the hospitality packages it was not carrying on the hospitality operation (because in their view out-sourcing was part of running an efficient business). The Tribunal concluded that a business had been transferred because what was transferred was sufficient to put the transferee in possession of a going concern.

The Tribunal found that the Cricket business with attached goodwill was transferred together with the property and the appeal was allowed**.**

The Leeds Cricket Football & Athletic Company Limited v HMRC (TC07362)

Practical implications:

- The key to this decision was determining the true nature of what was being disposed of as it was central to the tax treatment

- The Tribunal did not accept HMRC's principal argument that there was no goodwill capable of transfer because there was no business to which it could be attached, and that LCFA's income from operations was primarily derived from the land.

- As rollover relief requires the asset disposed of to have been used 'for the purposes of the trade' (TCGA 1992, s. 152(1)), it seems strange that the focus was on the meaning of 'business' rather than the meaning of 'trade'.

2.3 Relationship between preference shares and entrepreneurs' relief

Stephen Warshaw (SW) was chairman of Cambridge Education Group Limited. Prior to 12 March 2012, he held 44,183 ordinary shares and 396,000 preference shares in Cambridge Education Group Limited.

Following a group reorganisation in March 2012, SW exchanged these old shares for new shares in a new company, Cambridge Education Holdings (Jersey) Limited. As a result of these changes, SW's shareholding in the new company replicated his original shareholding.

On 26 March 2012, SW subscribed for 24,660 B ordinary shares in the new company and became a director on 26 October 2012.

On 4 December 2013, SW disposed of his entire shareholding for cash and ceased to be a director from that date.

On 28 January 2015, he submitted his 2013/14 self-assessment tax return, including a capital gains computation for the disposal of the shares totalling £6,438,419, and a claim for entrepreneurs' relief in respect of the disposal.

On 5 October 2015, HMRC opened an enquiry into the return and later, in August 2017, issued a closure notice denying the entrepreneurs' relief claim.

The rights attaching to the various classes of shares in the new company were set out in its Articles of Association. The preference shares were cumulative; if there were insufficient reserves to pay the dividends in respect of those shares in a particular year, payment was deferred to a subsequent year. This meant that the rate at which the dividend would be paid, 10%, would be calculated as the aggregate of the subscription price and the total unpaid dividends.

The issue was how the preference shares were to be treated. In summary, if the preference shares were 'ordinary share capital', Mr Warshaw held 5.777%. However, if the preference shares were not 'ordinary share capital', he held only 3.5%.

HMRC argued that as the rate at which the dividend was paid on the preference shares was fixed at 10%, there was 'a right to a dividend at a fixed rate' and so the shares were should not be treated as ordinary share capital.

SW appealed arguing that because the rate of dividend is calculated by reference to any previous unpaid dividends, the preference shares did not have a right to a dividend at a fixed rate.

Held:

The First Tier Tribunal agreed with the taxpayer that the decision of Vinelott J in Tilcon v Holland offered some support. In reaching their decision they must take into account both the percentage element and the amount to which that percentage is applied.

In this case, under the Articles of Association, only the percentage element was fixed. The amount to which that fixed percentage was to be applied could vary.

Consequently, the preference shares could not be regarded as having a right to a dividend at a fixed rate and were therefore ordinary share capital as defined by s 989 ITA.

The appeal was allowed.
Stephen Warshaw v HMRC (TC07107)

Practical implications:

- The FTT held that a dividend payable at a specified percentage on a base amount that could vary was not payable at a fixed rate hence the shares on which it was payable were ordinary share capital.
- Cumulative preference shares represented part of a shareholder's ordinary share capital for the purpose of entrepreneurs' relief*.*
- Since entrepreneurs' relief was introduced in 2008, the majority of appeals have concerned the meaning of 'ordinary share capital' for the purposes of the personal company definition – this case provides a further contribution to that debate**.**
- Because Entrepreneur's relief represents such a valuable relief from Capital Gains Tax it is crucial that all the relevant conditions are met and one of the most important is that of the relevant shareholding as can be seen in this case. A similar issue was resolved in another case – Philip Hunt – TC07057

2.4 Meaning of 'potential lost revenue'

Prior to the introduction of the High Income Child Benefit Charge (HICBC) in January 2013, Mr Robertson was not required to notify his liability to tax to HMRC or to complete a self-assessment return as his income was taxed wholly under PAYE with annual income exceeding £50,000.

In 2012/13, 2013/14 and 2014/15 Mrs Robertson received child benefit but they did not elect to stop receiving the benefit. Under the HICBC legislation Mr Robertson should have notified HMRC of his liability to tax.

HMRC decided that the HICBC applied and issued discovery assessments for the three years unpaid HICBC as well as penalties charged at 20% of potential lost revenue for failure to notify chargeability.

Mr Robertson appealed against the penalties but not the assessments. The First Tier Tribunal concluded that there was no potential lost revenue and so no penalties could be charged.

HMRC appealed to the Upper Tribunal.

Held:

HMRC conceded that the penalties should be charged at 10% of the potential lost revenue, rather 20%.

The Upper Tribunal stated that potential lost revenue is defined under sch 41 para 7 FA 2008) as:

> 'So much of any income tax … to which P is liable in respect of the tax year as by reason of the failure to notify is unpaid on 31 January following the tax year'

The First-tier Tribunal should have concluded that HMRC had calculated the potential lost revenue correctly based on the unpaid tax liability. Instead, it decided that potential lost revenue was limited to and determined by the tax shown in an assessment, which was an error.

Allowing HMRC's appeal, the judges upheld the penalties calculated at 10% of the potential lost revenue.

HMRC v James Robertson [2019] UKUT 0202 (TCC)

Practical implications:

- Penalty provisions are important in tax legislation as they enforce taxpayers paying their liabilities
- Penalty provisions need to accurately drawn and easily comprehensible to ensure they achieve the intended objective
- When penalties are raised in respect of an amount is to be determined as with potential lost revenue clarity is required and hence this matter came before the Tribunal for decision and clarity