Corporate tax update

September 2019

Welcome to the latest edition of our Corporate Tax Update, written by members of RPC's tax team. This month's update reports on the key developments from August 2019. Although this was a relatively quiet month in the corporate tax world, this update includes summaries of an important Upper Tribunal decision on the correct tax treatment of "trail commissions" and a First-tier Tribunal decision on the recovery of pre-incorporation input VAT.

VAT cost sharing exemption available for social housing associations – HMRC Brief

On 22 August 2019, HMRC published Revenue & Customs Brief 8 (2019) in which it announced the continued application of the VAT cost sharing exemption (CSE) to cost sharing groups (CSGs) implemented by social housing associations. more›

Upper Tribunal holds that loyalty bonuses paid to investors were taxable as annual payments (subject to income tax withholding)

On 9 August 2019, the Upper Tribunal held that so-called "loyalty bonuses" paid to investors by an investment platform service provider (Hargreaves Lansdown, "HL") were "annual payments" subject to withholding of basic rate income tax. more›

Upper Tribunal holds operation of salary sacrifice neither a supply, nor an economic activity, for VAT purposes

On 7 August 2019, the Upper Tribunal dismissed HMRC's appeal and held that the operation of a salary sacrifice scheme by an employer did not constitute an economic activity for VAT purposes. more›

Input VAT on legal fees incurred (by future owner/director) prior to incorporation of company held to be recoverable by First-tier Tribunal

On 2 August 2019, the First-tier Tribunal held that a company could recover input VAT on legal fees incurred by a shareholder / director (Mr McKee) of the company even though the legal fees were incurred (i) prior to incorporation of the company and (ii) in respect of a claim against him by a third party. more›

Any comments or queries?

Ben Roberts
Senior Associate
+44 20 3060 6184
ben.roberts@rpc.co.uk

Adam Craggs
Partner
+44 20 3060 6421
adam.craggs@rpc.co.uk

Robert Waterson
Partner
+44 20 3060 6245
robert.waterson@rpc.co.uk

VAT cost sharing exemption available for social housing associations – HMRC Brief

On 22 August 2019, HMRC published Revenue & Customs Brief 8 (2019) in which it announced the continued application of the VAT cost sharing exemption (CSE) to cost sharing groups (CSGs) implemented by social housing associations.

The CSE, broadly, provides an exemption for VAT on services provided within groups whose members make exempt (or non-business) supplies provided:

- the intra-group supplies are "directly necessary" to enable the group members to make such exempt (or non-business) supplies
- only each member's exact share of the cost of the intra-group supplies are recovered, and
- exempting the intra-group supply would not lead to distortion of competition.

In 2017, ECJ decisions on the CSE held that its scope was limited to activities in the "public interest". In light of this, HMRC issued Briefs in 2018 confirming that going forward the CSE would not be available for the banking and insurance industries (amongst others). The position for social housing groups was that they could continue to apply the CSE, pending a review.

The latest Brief is welcome news for the social housing industry as it confirms that social housing associations can continue to apply the CSE (as they meet the "public interest" requirement). Helpfully, HMRC also confirm that if further changes are required, HMRC will announce them giving at least 12 months' notice (without retrospective effect).

For these purposes a "social housing association" is a housing association defined in section one of the Housing Associations Act 1985 and other registered social landlords who provide social housing for the benefit of the community, on a not-for-profit basis[1]. The CSG is not itself required to be a housing association and normally will not be such a body. The CSE does not apply to arrangements entered into by private landlords.

The Brief can be viewed here.

Back to contents>

Upper Tribunal holds that loyalty bonuses paid to investors were taxable as annual payments (subject to income tax withholding)

On 9 August 2019, the Upper Tribunal held[2] that so-called "loyalty bonuses" paid to investors by an investment platform service provider (Hargreaves Lansdown, "HL") were "annual payments" subject to withholding of basic rate income tax.

Very briefly, HL operated a platform through which investment products were made available to investors. HL passed on to investors any share of the annual management charge (AMC) rebated to HL. HL's terms and conditions provided for the payment of "loyalty bonuses" to clients in certain circumstances. HL negotiated lower AMCs with providers and passed on the benefit of the reduction by paying a "loyalty bonus" to investors.

1. Together with equivalent bodies in Scotland and Northern Ireland.
2. In *HMRC v Hargreaves Lansdown Asset Management Ltd* [2019] UKUT 0246.

The Upper Tribunal's decision overturns that of the First-tier Tribunal (FTT). The FTT had held that the loyalty bonuses did not represent "pure income profit" in the investor's hands (a key requirement in determining whether any payment is an annual payment subject to withholding) on the basis that the loyalty bonus was, in fact, the passing on to investors of their share of the AMC rebated to HL and could not therefore amount to "profit".

It was not surprising that HMRC appealed the FTT decision, which went directly against HMRC's publicly stated view of "trail commissions". HMRC's stated view is set out in Revenue & Customs Brief 4 (2013), which can be viewed here.

The decision looked at two of the characteristics of an "annual payment", as established by case law.

The recurrence condition

In order to constitute an annual payment, the payment must recur or at least be capable of recurrence (even if the obligation to pay is contingent). The Upper Tribunal (agreeing with the FTT on this point) held that the loyalty bonuses were paid on a monthly basis, under a binding contractual obligation, and the only contingency was whether the relevant investment continued to be held at the end of any particular month. The payments were therefore held to be capable of recurrence as the kind of investments acquired by HL were more likely to be long-term investments, and the fact that the arrangements might be terminated in the future should not affect the question of recurrence.

The "pure income profit" condition

On this issue, the Upper Tribunal disagreed with the FTT. The Tribunal held that the FTT erred in its approach by not basing its decision on the terms of the contractual arrangements in place. The pertinent question, according to the Upper Tribunal, is whether the payment is a taxable receipt in the hands of the recipient (here, the investor) without any deduction for expenses. In this regard it was noted that:

- the AMC and payment of any rebate was purely a matter between HL and the relevant fund manager
- the fact that an investor has to bear the AMC (in the sense it reduces the distribution of income or value of the investment) does not give rise to a deductible (for tax purposes) expense
- the investor did not have to do anything (other than hold the relevant investment at the end of the month) in order to receive the loyalty bonus
- in particular, the investor did not need to incur any expense in order to receive the loyalty bonus

On this basis, the Upper Tribunal held that the "loyalty bonus" was exactly that; it was a payment in return for an investor's loyalty and as such amounts to "pure income profit".

The decision can be viewed here.

Back to contents>

Upper Tribunal holds operation of salary sacrifice neither a supply, nor an economic activity, for VAT purposes

On 7 August 2019, the Upper Tribunal[3] dismissed HMRC's appeal and held that the operation of a salary sacrifice scheme by an employer did not constitute an economic activity for VAT purposes.

The employer (Pertemps) offered certain employees the option of participating in a salary sacrifice scheme. Pertemps provides permanent and temporary workers to clients. Employees of Pertemps working on temporary assignments were given the option of (i) being paid a 'full' salary, out of which they would have to meet their travel and subsistence expenses, or (ii) receiving a reduced salary but being paid their expenses. The amount of the reduction under option (ii) was the amount of the expenses plus a fixed amount of 50p or £1 per shift.

In the usual way, the salary sacrifice scheme offered tax and national insurance contributions (NICs) savings for the employees, and employer NICs savings for Pertemps.

HMRC's view of the arrangements was that, for VAT purposes, Pertemps was making a taxable supply to its employees. The consideration for this supply, in HMRC's view, was the 50p or £1 fixed amount (per shift) deducted from the salaries of participating employees.

The First-tier Tribunal had held that Pertemps did supply services to its participating employees, but that the operation of the salary sacrifice scheme was not an "economic activity" for VAT purposes (end result being, no VAT due).

The Upper Tribunal's decision is one better for the taxpayer in that it agreed with the FTT that there was no "economic activity" here, but disagreed with the FTT on the question as to whether there was a supply at all for VAT purposes. In finding against HMRC on both legs of the two-tier approach set out in *Wakefield College*[4], the Tribunal agreed that no VAT is due in respect of the salary sacrifice arrangements.

On the "economic activity" test, the Tribunal was not swayed by the arguments put forward on behalf of HMRC that there was a "general market" for the services provided by Pertemps under the salary sacrifice arrangements. The Tribunal held that Pertemps was simply acting as an employer, making tax and NICs deductions in accordance with the law. The fact that other employers did the same did not, in the Tribunal's view, mean that there was a "general market" for the services that could support the position that Pertemps was providing the services for the purposes of obtaining income on a continuing basis.

On the "supply" question, the Tribunal's view was that Pertemps did not supply anything at all in return for the payment of the 50p or £1 fixed amount. Rather than providing some sort of administrative services to participating employees (as HMRC argued), the Tribunal held that Pertemps was merely complying with its tax and NICs obligations.

The decision can be viewed here.

Back to contents>

3. In *HMRC v Pertemps Ltd* [2019] UKUT 234 (TCC).
4. [2018] EWCA Civ 952.

Input VAT on legal fees incurred (by future owner/director) prior to incorporation of company held to be recoverable by First-tier Tribunal

On 2 August 2019, the First-tier Tribunal held[5] that a company could recover input VAT on legal fees incurred by a shareholder/director (Mr McKee) of the company even though the legal fees were incurred (i) prior to incorporation of the company and (ii) in respect of a claim against him by a third party.

Mr McKee, a software programmer, had been engaged as a consultant by Jumar Solutions Ltd (Jumar). During this time Mr McKee developed software in his spare time, outside of his responsibilities with Jumar, and with the intention of developing the software after he had left Jumar. Jumar issued proceeding against Mr McKee in the mistaken belief that he was looking to develop a product that infringed Jumar's copyright and confidential information. Mr McKee instructed solicitors, personally, to defend the claim and was successful before the High Court in June 2016.

Very soon after succeeding at the High Court, Mr McKee incorporated Koolmove Ltd as a vehicle through which to develop the software as a business. Koolmove became registered for VAT and submitted VAT returns that sought to recover the VAT on the significant legal costs incurred by Mr McKee in successfully defending Jumar's claim. HMRC wrote to Koolmove, disallowing the recovery of this input VAT, on the basis that "the engagement letter between Mr McKee and his solicitors do not mention [Koolmove], therefore the legal costs were provided to Mr McKee in his personal capacity as [Koolmove] did not exist at the time of the litigation."

The appeal to the First-tier Tribunal rested upon the application of regulation 111 of the Value Added Tax Regulations 1995 (Exceptional claims for VAT relief). In particular regulation 111(1)(b), when read with regulation 111(2)(d), provides that input VAT on supplies made prior to incorporation may be recoverable by a company if:

- the supplies were made for the company's benefit and for the purposes of the business to be carried on by it
- the supplies were made to a person who, at the time, was not a "taxable person" for VAT purposes but who became a member or officer of the company
- the supplies were made within the 6 months before the company's effective date of registration, and
- the cost of the supplies are reimbursed in full by the company.

The Tribunal held that Koolmove could recover the VAT on the legal costs, on the basis that Mr McKee always intended to exploit the software he developed during his time working for Jumar through his own company. The incorporation of Koolmove took place as soon as reasonably practicable after Mr McKee succeeded at the High Court in defending Jumar's claim, and the Tribunal accepted that it would have made no sense to incorporate the company before the outcome of the High Court case was known.

The decision can be viewed here.

Back to contents>

5. In *Koolmove Ltd v HMRC* [2019] UKFTT 502 (TC).

About RPC

RPC is a modern, progressive and commercially focused City law firm. We have 78 partners and over 600 employees based in London, Hong Kong, Singapore and Bristol. We put our clients and our people at the heart of what we do.

"... the client-centred modern City legal services business."

We have won and been shortlisted for a number of industry awards, including:

- Best Legal Adviser every year since 2009 – Legal Week
- Best Legal Employer every year since 2009 – Legal Week
- Shortlisted – Banking Litigation Team of the Year – Legal Week Awards 2019
- Shortlisted – Commercial Litigation Team of the Year – Legal Business Awards 2019
- Shortlisted – Best Copyright Team – Managing IP Awards 2019
- Shortlisted – Insurance Team of the Year – Legal Business Awards 2018
- Winner – Best Employer – Bristol Pride Gala Awards 2018
- Winner – Client Service Innovation Award – The Lawyer Awards 2017
- Shortlisted – Corporate Team of the Year – The Lawyer Awards 2017
- Winner – Adviser of the Year – Insurance Day (London Market Awards) 2017
- Winner – Best Tax Team in a Law Firm – Taxation Awards 2017
- Winner – Claims Legal Services Provider of the Year – Claims Club Asia Awards 2016

Areas of experience

- Advertising & Marketing
- Alternative Dispute Resolution
- Commercial Contracts
- Commercial Litigation
- Competition
- Corporate Crime & Investigations
- Corporate
- Data & Technology
- Employment & Pensions
- Financial Markets Litigation
- Health, Safety & Environmental
- Insurance & Reinsurance
- Intellectual Property
- International Arbitration
- Private Equity & Finance
- Product Liability & Regulation
- Real Estate
- Regulatory
- Restructuring & Insolvency
- Tax
- Trusts, Wealth & Private Client

Tower Bridge House
St Katharine's Way
London E1W 1AA
T +44 20 3060 6000

Temple Circus
Temple Way
Bristol BS1 6LW
T +44 20 3060 6000

38/F One Taikoo Place
979 King's Road
Quarry Bay, Hong Kong
T +852 2216 7000

12 Marina Boulevard
38/F MBFC Tower 3
Singapore 018982
T +65 6422 3000

RPC