Personal service companies

Are we sure that something has not gone wrong here?

A great deal has been written lately about the case of *Christa Ackroyd Media Ltd v HMRC* [2018] UKFTT 69 and the decision of the First-tier Tribunal is certainly deserving of close analysis.

The facts are pretty well known. Christa Ackroyd is a TV journalist who presented various BBC TV programmes for some years. Her company, Christa Ackroyd Media Ltd, entered into a contract with the BBC. HMRC considered that the arrangements fell within the intermediaries legislation in ITEPA 2003 ss 48–61, with the result that a substantial amount of tax unexpectedly arose. The reasons (and motivation) behind these arrangements are controversial and the subject of some dispute; no doubt we will hear more about that in due course.

The aspect which is intriguing me is how to apply the judgment more widely – for example, to the position of a concert pianist.

If we look at the judgment in *Ackroyd*, we are told by the tribunal that we have to consider mutuality of obligations; the degree of control exercised by the putative employer; and whether the terms are consistent with a contract of employment – such as the provision of any necessary equipment, the provision of other benefits and whether the individual has to hire his own helpers.

The mutuality of obligation was said to be Ackroyd's obligation to perform the work and the BBC's obligation to pay her for it. When it comes to control, the BBC was said to exercise control over her services, although she had no set hours or set working days and no set location. Nor did she have any holiday pay, sick pay or pension entitlement.

Let us assume that a famous concert pianist is engaged to play Beethoven's Piano Concerto No. 5 at the Royal Albert Hall. He turns up and they pay him – so there is your mutuality of obligation. Using the tests in *Ackroyd*, do they have control over his services? You bet they do. He must attend at the Royal Albert Hall on a specific day, at a specific time and play a specific piece on a specific instrument. In fact, we can be much more precise than that. The piece he is being paid to play has certain specific notes and he will be told that he must play every one of them the right number of times – and in the right order. That is substantially more control than the BBC had over the services of Christa Ackroyd. Moving on to other provisions in the contract, he would not be permitted to send a substitute; nor will there be any holiday pay, sick pay or pension entitlement – just like Christa Ackroyd. Nor will he provide his own equipment because the piano will be provided and all the supporting people in the orchestra will also be provided, so he will not hire his own helpers. And of course, his entire performance will be under the direction of a man with a stick.

> Assume that a famous concert pianist is engaged to play Beethoven's Piano Concerto No. 5 at the Royal Albert Hall ... On the basis of *Ackroyd*, the concert pianist would be regarded as an employee

As a result of all this, it is inescapable, on the basis of the judgment in *Ackroyd*, that the concert pianist would be regarded as an employee. But we know that he would not be an employee and would be properly regarded as self-employed. This would be the case whether he was directly engaged or whether he provided his services through a company, and we would have to consider the hypothetical contact which would have existed between him and those for whom the services were provided.

How can this be right when, on the *Ackroyd* tests, the case for him being an employee would be absolutely overwhelming? ■

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EMI state aid approval lapses

What are the practical implications of the expiry of EU state aid approval for EMI schemes?

The enterprise management incentive (EMI) regime was introduced by FA 2000 as a way of helping smaller entrepreneurial businesses recruit and retain the best talent. As the tax benefits afforded by EMI are only available to companies with certain qualifying business activities, they involve the provision of state aid. Under EU rules, state aid is unlawful unless it falls within an applicable exemption or if it is seen as compatible with treaty provisions. The current EMI regime was approved by the European Commission in a decision of 9 July 2009 (although it was noted that the UK had put the regime in place many years previously, in breach of EU rules). The approval lapsed on 6 April 2018, and whilst a Commission decision to renew approval has been sought by the UK government, it has not yet been forthcoming.

On 4 April 2018, HMRC issued Employment Related Securities Bulletin No. 27 (April 2018) stating that 'the state aid approval applies to the granting of share options and therefore that share options granted up to and including 6 April 2018 won't be affected by this lapse of the approval'. There is no clarity on the length of time it may take to secure fresh approval, but the UK government is 'working hard to ensure this period is as short as possible'.

Grant of new EMI options: In terms of companies wanting to grant EMI options, the best advice is to wait for fresh approval to be secured. The Bulletin warns that 'EMI share options granted in the period from 7 April 2018 until EU state aid approval is received may not be eligible for the tax advantages'. Aid implemented without EU clearance could result in the UK government being required to recover the tax benefits from the option holder.

> If there is a pressing need to grant EMI options ... it would be worth granting on terms which would enable the options to be unilaterally surrendered by the grantor and re-granted when state aid approval is issued

If there is a pressing need to grant EMI options, perhaps due to the onset of a close period for share dealing purposes or there are other strong commercial drivers, it would be worth granting on terms which would enable the options to be unilaterally surrendered by the grantor and re-granted when state aid approval is issued. The terms of the option would require careful drafting, particularly where they are subject to the achievement of vesting or other performance conditions. Any satisfaction of the conditions or time vesting during the intervening period could be credited under the terms of the replacement option. However, the one-year holding period for the purposes of entrepreneurs' relief would only commence at the time of the replacement option grant, which would need to be notified to HMRC as an EMI option through HMRC's employment related securities service.

A perhaps more challenging issue would

be any increase in the market value of the shares during the intervening period. If the full tax advantages are to be secured, the replacement EMI option would need to be granted at the then current market value. Alternatively, the previous exercise price could be maintained, with a commitment by the company to provide a grossed-up bonus to meet the tax liability arising at exercise.

Exercise of existing EMI options: Whilst the words of HMRC in the Bulletin that the tax reliefs associated with EMI attach to the 'grant' of the EMI option are to be welcomed, the wording in the approval states clearly that 'the notification covers duration until 6 April 2018, which is the period during which EMI share options can be exercised' (emphasis added). For EMI options exercised in the period prior to the issue of new state aid approval, there remains a residual risk that they may not be tax free. However, it seems unlikely that recovery action would be taken by the Commission, on the basis it is arguable that they have created a legitimate expectation that EMI options granted pursuant to their approval (with a ten-year life span) do not involve state aid. Even if the Commission took action, it is not clear the basis on which recovery could be pursued. It is arguable that the unauthorised tax advantages should apply in respect of the growth in value of the shares from 7 April 2018 onwards and not from the original grant date. Equally, given the wording in the Bulletin which confirms 'HMRC will continue to apply its current guidance and practice, in relation to… options validly granted as EMI share options up to and including 6 April 2018', it is not anticipated they would pursue tax on the exercise of pre-7 April 2018 qualifying EMI options.

Undoubtedly there will be companies in the middle of a sales process, where EMI options will need to be exercised prior to completion. It seems that any tax risk associated by loss of EU approval would be outweighed by the commercial need to get transactions done. However, cautious purchasers may wish to retain a proportion of EMI option proceeds to cover any tax risks, pending further clarity on the position. ■

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Digital lessons for HMRC

HMRC must have the humility to learn from its own failings and French tax return problems.

In his March 2015 Budget Statement, the then chancellor of the exchequer George Osborne promised to 'abolish the annual tax return altogether'.

A week, a month, three years are a long time in politics. Somewhere along the way, this promise has morphed into two computer-driven projects.

First, 'making tax digital'. This is a project which will, if realised in the way which its HMRC paymasters currently envisage, require individuals and businesses to file quarterly tax declarations online. Starting with VAT-registered traders in April 2019, this will eventually expand to everyone within the self-assessment tax regime. Ignoring Parliament's concerns that the project is being rushed ahead much too fast, with regulations published before pilot projects have been completed and lessons learned, HMRC's main hope for this phase of the MTD project is that it will reduce errors in VAT returns and so increase the amount of VAT collected by the Treasury.

Second, at a later date, online tax return filing which is based on pre-populated tax returns provided to taxpayers by HMRC, using data mined by what it once affectionately called its 'web-bots' in a software suite known as Connect. Leaving aside the massive international concern arising from data-scraping by unscrupulous companies of Facebook members' information, and the consequential issues regarding the public perception of Connect, we have to question whether it is safe for the tax authorities to rely on software in this way.

The peril of excessive reliance on software systems is illustrated by the recent adverse publicity suffered by HMRC in respect of the cancellation of income tax return penalty notices. This demonstrates that the department's software simply cannot be trusted on its own to administer public taxes and to respond to the needs of individual taxpayers in a way which bears any resemblance to reality. Against this background, it's disturbing to see the public statement from HMRC to the effect that it is not monitoring data regarding wrong penalty notices, because it is not persuaded that there is a business case to do so. But that's only the half of it.

Across the English Channel, the French tax authorities are also embracing pre-filled tax returns. It appears that 500,000 pre-filled French tax returns for 2017 contain errors which understate the tax liability and so could expose French taxpayers to sanctions. This emphasises the importance that the software used by tax authorities must not only work as intended, but must be recognised by the population at large as working properly.

Large-scale software failures bring the tax system into disrepute and cause untold misery and anxiety (not to say time wasted and costs incurred) for the tax-paying public. History is full of examples of tax-collection systems which have fallen into disrepute when their systems fail, so fostering tax evasion.

If HMRC wishes to use making tax digital and Connect to accelerate the timely collection of the correct amount of tax, it should learn from its own problems and from those of the French tax authorities. It should take time to ensure that MTD and Connect are fit for purpose. To do otherwise would be irresponsible, unjust and would exacerbate the tax gap. ■

George Bull, RSM UK (RSM's Weekly Tax Brief)

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Share valuation specialists

"The estimation of the value of a share in a company whose shares cannot be bought and sold in the open market, and with regard to which there have not been any sales on ordinary terms, is obviously one of difficulty."
Lord Fleming in Salvesen's Trustees v IRC [1930]

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