Field Court Tax Chambers is a modern set of tax counsel with wide experience of UK and international tax related matters. It has expert counsel in all areas of tax and members have advised governments, multinational enterprises, tax authorities and businesses across the world on all areas of UK law, double taxation and tax related human rights law. Members have also represented clients as advocates throughout the UK court system, as well as in the European Court of Justice, the Privy Council and in courts across the globe.

FIELD COURT TAX CHAMBERS

Taxing matters

Peter Vaines delves into some most interesting tax issues

© iStockphoto/baona

IN BRIEF

- Entrepreneurs relief.
- New DOTAS hallmark.
- Restricted securities
- Careless conduct.

The recent case of *Mr and Mrs McQuillan v HMRC* TC 5074 gives rise to a most interesting issue (actually, if anybody else finds this interesting, they should buy an anorak and come on holiday with me).

The taxpayers each held 33 ordinary shares of £1 each in a trading company. Other shareholders had 30,000 non-voting shares which had no rights to dividends.

The question was whether these 30,000 non-voting shares were "ordinary shares" for the purposes of entrepreneurs' relief because if they were, the taxpayers obviously did not have the necessary five per cent of the ordinary share capital enabling them to qualify for the relief.

Section 989 of the Income Tax Act 2007 provides the definition of ordinary share capital as follows: "All the company's issued share capital (however described) other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits."

The Tribunal had to decide whether shares which had no right to any dividend was the same as having a right to a dividend at a fixed rate—that is to say zero.

Zero attention

A matter which engages a great deal of academic attention is whether zero is a number—or whether it is the absence of a number. Regrettably, we do not need to get into that—nor the even more interesting question of whether zero divided by zero is infinity, zero, or unity. Life as a tax lawyer is just so much fun.

Anyway, moving on. The taxpayer said that the non-voting shares had the right to a dividend of 0% which was a dividend at a fixed rate and therefore those shares should be excluded from the class of ordinary share capital.

HMRC argued that the shares simply had no rights to dividend. They did not have a right to a dividend at a fixed rate—they did not have a right to a dividend at all—and should therefore not be excluded from the definition of ordinary share capital. It is on such distinctions that very substantial tax liabilities arise.

If the shares had been issued with the specific term that the shareholders shall be entitled to a dividend at the rate of 0%, one can see the argument that this could be described as having a right to a dividend at a fixed rate of 0%. However, where the shares simply have no dividend rights at all, the answer would seem to be different. It is difficult to see how the absence of a right should be equivalent to a right at 0%. For example, if I buy a car, the purchase would obviously not give me the right to a refund of my TV licence fee. However, it would hardly be appropriate to say that my purchase of the car gives me "a right to TV licence fee refund at a rate of 0%".

World of difference

Perhaps more relevant in terms of tax, there is a world of difference between being outside the scope of VAT and therefore having no right to charge VAT, and charging VAT at a rate of 0% (ie zero rating). This is a very profound difference for VAT purposes with lots of implications. Admittedly, VAT has some very special rules which complicate the argument but that would not seem to affect the general principle.

The tribunal concluded this difficult question by saying that a right to no dividend is a right to a dividend at a fixed rate for the purposes of this definition. Accordingly, these shares could be excluded from the definition of ordinary share capital and the taxpayer was entitled to entrepreneurs' relief.

While this represents a triumph for common sense given the configuration of the share capital in this case—there may be a number of people who have difficulty accepting the underlying analysis.

New DOTAS hallmark

The new financial products hallmark for disclosure of tax avoidance schemes (DOTAS) is going to make your eyes water.

There are many people who are not involved in any kind of tax scheme, merely undertaking conventional tax planning techniques which HMRC happily (well, almost happily) accept. All these marketed tax schemes with premium fees, confidentiality and transactions of byzantine complexity, are things dealt with by other people. However, they may need to think again.

DOTAS applies to notifiable arrangements with one of the prescribed hallmarks which might be expected to enable a person to obtain a tax advantage. The new financial product hallmark brings an enormous number of transactions within its scope.

The new hallmark is one that contains at least one specified financial product (which includes a loan or a share) and it would be reasonable to expect an informed observer to conclude that the arrangements might be expected to give rise to a tax advantage (or contain contrived or abnormal steps).

The "informed observer" is a concept which seems to be exclusively applicable to DOTAS. We used to have the man on the Clapham omnibus, then we had the moron in a hurry, and more recently we had the intelligent businessman. Goodness knows what characteristics the informed observer is supposed to have. (I think the Office of Tax Simplification could do some good work here.)

Anyway, this new hallmark is unbelievably wide. It obviously includes arranging for a corporate bond (on a bona fide sale of a company) to be either a qualifying corporate bond (QCB) or a non-QCB depending upon the particular requirements—which of course will be tax driven. It will be specifically drafted for that purpose and include a term (such as a non-sterling redemption clause) and will be bang in the middle of this new hallmark.

How about arrangements to ensure that you have five per cent of a company's shares (rather than four per cent) or that you have a modest employment, so that you qualify for entrepreneurs relief. A share is a financial product and there is at least one term which will be specifically included to ensure that the relief (and therefore the tax advantage) is obtained. End of.

And what about employee shares under the Employee Share Scheme (ESS)? An ESS scheme has to be deliberately drafted to include all the necessary conditions for the purpose of qualifying for the relief. That is clearly dead in the water.

Ridiculous

This is obviously ridiculous. HRMC clearly realise that the provisions are too wide and specifically go out of their way to say that investing under the Enterprise Investment Scheme (EIS) or in a self-invested pension plan or an ISA will be excluded. But for the legislation to be so wide that these things are included in the first place just emphasises the unacceptable scope of these new provisions.

However, instead of making the legislation sensible they compound the absurdity by providing such things with a specific exemption. But they can't give an exemption for everything—not unless somebody does a lot of work and gives them a very long list, thereby adding to the absurdity—so there will be a whole load of completely benign commercial transactions which will be caught.

And of course if you have a notifiable arrangement under DOTAS you are liable for an accelerated payment notice (APN). An APN means that you have to pay tax up front, before any tax liability has been established—and worse, before HMRC have even considered the position at all. This is not an attractive prospect.

Restricted securities

In the recent case of *UBS and DB v HMRC* [2016] UKSC 13, [2016] 3 All ER 1 the Supreme Court struck down a scheme involving restricted securities which was designed to avoid the payment of income tax on employees' bonuses. The issues were inevitably complex but one interesting element which caught my eye was their judgment on the meaning of "restricted securities" in s 423 of Income Tax (Earnings and Pensions) Act 2003, about which the Supreme Court said: "Applying s 423 to the facts, viewed from a commercially realistic perspective, it follows that the condition to which the UBS shares were subject should be disregarded with the consequence that the shares are not "restricted securities" within the meaning of that section."

This followed a good deal of analysis of the Ramsay doctrine and a purposive construction of s 423. Their Lordships concluded that the introduction of commercially irrelevant conditions whose only purpose was the obtaining of the exemption, should be disregarded.

It would be nice if this reasoning could work the other way round. I recall the position of poor Mr Finn (see *Finn v HMRC* TC 3555) who was denied EIS relief on some shares because he was not an original subscriber to the Memorandum of Association when the company was formed, an interpretation which meant that on a reorganisation, there was a condition for EIS relief which in reality could never possibly be satisfied.

The Tribunal made reference to this interpretation making absolutely no sense, and that it was inconceivable to have been what Parliament intended.

In the light of the Supreme Court judgment, a taxpayer in a similar position might be able to say that if the construction makes no sense, has no commercial relevance and could not be what Parliament intended, a purposive construction should be available to assist the taxpayer. Or using the words of the Supreme Court, an appropriate purposive construction could be adopted to interpret the legislation in the light of the transaction that took place.

Maybe HMRC would agree to adopt such an approach. Or maybe they wouldn't.

Careless conduct

The case of *Anderson v HMRC* TC 5092 provided a helpful review of what represents carelessness in the context of a person's tax affairs—which really means whether he had failed to take reasonable care.

The issue was whether HMRC could raise a discovery assessment because (in this case) they needed to show that the taxpayer had been careless. The relevant test is to consider what a reasonable taxpayer, exercising reasonable diligence in the completion and submission of his tax return would have done. Furthermore, it is now well established that a taxpayer who takes appropriate professional advice with a view to ensuring that his tax return is correct, and acts in accordance with that advice (providing it is not obviously wrong), will not be negligent. The Tribunal concluded that Mr Anderson had not been careless, but the arguments were somewhat surprising.

Mr Anderson had transferred some shares and when completing his tax return he computed the capital gain on this disposal using a value of £72m. This was the price at which there was an extant offer from an independent third party and which was likely to be accepted by the shareholders. He also relied on the advice of PwC who confirmed that in their opinion the market value of the shares was £72m.

Two years later the shares were sold for a higher figure and HMRC sought to challenge the £72m value placed on the shares and to charge capital gains tax on a higher value on the grounds that the taxpayer had been careless in using the £72m figure.

Leaving aside the obvious issue surrounding the prohibited use of hindsight, the stance taken by HMRC was to say that the taxpayer acted unreasonably in basing his conclusion on the existence of a bid from a single party and that he should have obtained a professional valuation.

"Excuse me" said the taxpayer. "We not only had a bona fide bid for the shares from an unconnected third party for £72m, we also took professional advice from PwC who advised us that the value was £72 m".

"Er, um", said HMRC. "Well, in that case, reliance on a third party cannot be a reasonable excuse."

I suppose we should welcome the vigour with which HMRC like to place every possible argument before the court. **NLJ**

Peter Vaines, Field Court Tax Chambers (*pv@fieldtax.com; www.fieldtax.com*)