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#### LIVERPOOL TOPICAL TAX UPDATE 13<sup>TH</sup> NOVEMBER 2019

#### Alan McCann CTA ATT Head of Tax Dispute Resolution, DTE Business Advisers

#### About Alan...



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- Over 40 years of experience in taxation dealing with clients and HMRC alike
- Specialises in tax investigations ranging from relatively straightforward local enquiries to serious fraud issues.
- Hands-on style greatly appreciated by clients and a solid reputation of working with HMRC on reaching settlements.
- Also works in partnership with accountancy firms which do not have in-house taxation expertise
- A member of the Chartered Institute of Taxation and lectures extensively to the accountancy profession on taxation issues

**Specialisms:** tax investigations, money laundering, compliance and HMRC time to pay arrangements





#### AGENDA

- IR35 Off payroll working in the private sector
- Termination payments
- Alphabet shares
- Dividend waivers
- Benefits in kind topical items



# OFF PAYROLL WORKING IN THE PRIVATE SECTOR

# Background to the proposed rules for private sector off-payroll working

- Off-payroll working rules introduced in the public sector in April 2017
- HMRC & HM Treasury Consultation Document published May 2018 closed August 2018
- Summary of response to the consultation published in October 2018
- HM Treasury Budget 2018 confirms private sector will brought in line with the public sector from April 2020
- HMRC publish the draft legislation (FB 2019/20) and the 'Rules for offpayroll working from April 2020 in July 2019'



#### Background to IR35 rules (s49 ITEPA 2003)

- Combat the wave of individuals leaving companies and circling back as independent contractors
- Back in the late 1990s, HMRC wanted to place risk on the end client given corporate to corporate engagement. However, there was push back by end clients and HMRC backed down
- Risk of PAYE exposure falls on PSC (s55 ITEPA 2003)



#### Cost of estimated non-compliance with IR35 rules

- HMRC suggests non-compliance with IR35 widespread
- HMRC estimate that only a third of individuals working through PSCs should be categorised as employees
- But estimates that only 10% of PSCs that should apply IR35 actually do so
- Lost revenues £726m in 2017/18 rising to £1.26bn in 2022/23
- Difficult for HMRC to challenge all PSC/intermediaries as have to enquire into each of them



#### Why bring private sector in line with public sector?

- Evidence from public sector suggests compliance has improved since new rules introduced in 2017
- Marked increase in public sector operation of PAYE withholding
- HMRC estimates public sector reforms have raised £550m in tax and NICs in the first year
- HMRC wish to ensure a level playing field for workers/employees in similar roles in the public and private sectors
- The new rules do not apply to the self-employed and only impact those working like employees through a PSC – but the liability following recategorisation where the self employed are used falls on the company not the individual



# Responsibility for "worker employment status categorisation"

- From 6 April 2020, <u>medium</u> and <u>large</u> businesses are required to decide whether the rules apply to an engagement with individuals who work through a PSC
- Where it is determined that the new rules do apply, the business, agency or third party <u>paying the PSC</u> will need to deduct tax and employee NIC and pay employer NIC
- The existing rules will continue to apply to the 1.5m smallest businesses for now
- Definition of 'small businesses' is as stated in Companies Act 2006 i.e. i) annual turnover of not more than £10.2m; ii) balance sheet total of no more than £5.1m; or iii) average number of employees no more than 50
- HMRC to work with "stakeholders" to improve the Check Employment Status for Tax (CEST) service and guidance to help businesses comply



# **Using Personal Service Companies**

- New rules will not stop people working through PSCs
- Concerns that if the new rules are applied HMRC will be inclined to challenge historic engagements
- The rules are not retrospective
- HMRC have stated that they will focus its efforts on ensuring businesses comply with the new rules and not on challenging historic cases – Good News
- HMRC claim that evidence from the public sector reforms shows compliance increasing without impacting market flexibility



#### IR35 and the case law derived "status tests"

- An employment contract cannot exist where one company engages another for services – hence introduction of IR35 in 2000
- As with IR35 new rules apply where the <u>hypothetical</u> contract between the worker and end-user/engager is determined to be a 'contract of services' (i.e. employment) rather than a 'contract for services' (i.e. self-employment)
- The hypothetical contract is determined by reference to the so called 'status tests' derived from case law



## The "Status Tests"

- Personal service
- Mutuality of obligation
- Right of control (& supervision and direction)
- Right of substitution
- Provision of own equipment
- Financial Risk
- Opportunity to profit
- Length of engagement
- Number of engagements



## The "Status Tests" continued...

- Integration or 'part and parcel' of the organisation
- Employee type benefits
- Right to terminate contract
- Personal factors
- Mutual intentions



# Critical importance of contractual terms and conditions

- Need to consider the hypothetical contract as well as the actual contract
- IR35 works on an engagement by engagement basis (often not appreciated)
- Christa Ackroyd Media 2018 (HMRC won but taxpayer appealed) owing to unhelpful terms and clauses around control that pointed to employment – Ms Ackroyd has lost the appeal at the Upper Tier Tribunal\*
- Need to ensure the contractual terms and clauses reflect the actuality of the working arrangements in place
- Businesses inclined to try cover all business risks resulting in contracts that infer or give a right to control as to how work is rendered
- Even if a 'right to control' clause is not exercised it can be fatal

\*In addition 3 other BBC news presenters have lost at the First Tier Tribunal – 16 months to reach a decision

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# Critical importance of contractual terms and conditions (continued...)

- Typically unhelpful terms and clauses include
  - Exclusivity
  - Rights of control
  - Length of contract
  - Working hours
  - Termination terms
  - Substitution when clearly inappropriate
- In essence a 'contract for services' should be devoid of any rights of control over how the work is rendered and kept very simple e.g. "I'll do that in return for this"



#### Recent IR35 cases

- Christa Ackroyd Media (2018) v HMRC [2019] UKFTT 69 (TC) HMRC won
- MDCM Ltd v HMRC (2018) TC06400 HMRC lost
- Jensal Software Ltd v HMRC (2018) TC06501 HMRC lost
- Albatel Ltd v HMRC (2019) UKFTT 195 (TC) HMRC lost
- Atholl House Productions Ltd (2019) UKFTT 0242 (TC) HMRC lost
- Paya Limited/Tim Willcox Limited/Allday Media Limited v HMRC (2019) UKFTT 583 (TC) – HMRC won



# Christa Ackroyd Media Ltd

- BBC news presenter (Look North) dismissed in 2013 partly because of the tax (IR35) enquiry
- HMRC win on two key points:
  - length of contract (7 years)
  - control
- Control aspect of judgement based on BBC's editorial guidelines/OFCOM regulations seems suspect
- Represented by tax adviser rather than tax counsel
- Appealed to the Upper Tribunal re control and whether BBC was in reality contracting with her and not the PSC



### MDCM Ltd

- Construction industry case site manager
- Decision that degree of control exercised by client no more than would be expected for an 'independent contractor'
- HMRC argued employment entitled to pension, sick pay, holiday pay. Tribunal said this was wrong approach and necessary to consider 'hypothetical contract'



## Jensal Software Ltd

- IT consultant (Mr Wells) working for central government (DWP)
- Mutuality of Obligation (MOO) no obligation on DWP to provide work
- Right of substitution accepted by Tribunal
- Degree of control insufficient for employment



## Albatel Ltd

- Well known TV presenter Lorraine Kelly
- Control key:
  - OFCOM regulation unhelpful as all broadcasters impacted
  - Degree of control not sufficient
- ITV buying into Lorraine Kelly's brand/image
- A 'theatrical artist'



# **Atholl House Productions**

- BBC journalist and Kay Adams programme
- Decision that degree of control exercised by client no more than be expected for an 'independent contractor'
- Shorter term contracts 1 year in contrast to CAM 7 years
- Ratio of non-BBC income to BBC income 30%-50% over a 2 year period
- Tribunal said important to look at her career as a whole
- BBC did not have first call on her services (contrast CAM)
- Degree of control insufficient for employment
- No sick pay, maternity leave or pension



# Paya Ltd and others

- HMRC won on substantive issues of;
  - degree of control exercised by BBC (under framework of control) as to 'what', 'where', 'when' and manner over 'how' sufficient for employment
- Presenters engaged by BBC continuously for over 5 years sufficient mutuality
- Extensive restrictions on the presenters to undertake activities outside of the BBC
- Tribunal rejected presenters' advisers had been careless by simply acting for the PSCs. The fact that HMRC's contract review service not consulted not relevant
- Split decision by tribunal Judge Morgan had deciding vote and found for HMRC



# What should clients do now?

- Identify individuals engaged via a PSC or intermediary and review to determine whether impacted by the new rules
- Consider, in light of numbers involved, whether changes to the way you engage contracts is required
- Decide who has responsibility for determining employment status, i.e. HR, hiring management, tax function to ensure training for the new rules
- Update or put in place systems for identifying assessing and documenting off-payroll status e.g. onboarding, invoicing, payment or payroll processes
- Keep an eye out for HMRC guidance as they have promised to support businesses and use HMRC's on-line status tool "Check Employment Status for Tax" (CEST)



# What should contractors and their advisors be doing now?

- Be aware of the new rules and engage with clients/end users to discuss impact
- Concerns that the public sector reforms are encouraging engagers to put everyone on the payroll to mitigate the risk of getting it wrong (very unfair for the genuinely 'self-employed')
- Review contractual terms if imposed by larger businesses very likely to include unhelpful terms and conditions and should be reviewed
- Seek suitable professional advice regarding both the contractual terms and conditions to ensure any 'fresh' contract reflects self-employment
- Ensure the actual arrangements between contractor and engager are reflected in the contract





#### **CHANGES TO TERMINATION PAYMENTS**

### Termination payments – What changed?

- The concept of post employment notice pay from April 2018
- Employer's NIC is to be charged on all termination payments over the £30,000 threshold where income tax is payable from April 2020.
- Payments for injury to feelings will not qualify for the exemption for death, injury or disability payments.
- The Foreign Service Relief rules restricted
- Sporting testimonials



# Post Employment Notice Pay (PENP)

- The PENP rules apply to all payments in lieu of notice from 6 April 2018
- PENP must be calculated
- The part of the termination award that must be treated as earnings for tax and Class 1 NIC purposes is:
  - The entire termination award (disregarding statuary redundancy pay and approved contractual pay) if PENP is equal to or more than the termination award; and
  - PENP if it is less than the termination award



#### How is PENP calculated?

The calculation of the PENP follows a formula. The basic formula is: **BP x D – T** 

- BP is basic pay for the last pay period to end before the day notice is given. Basic pay is defined in the new legislation.
- D is the number of months in the post-employment notice period (the unworked notice period)
- T is the amount (other than holiday pay and termination bonuses) paid on termination but already taxable as earnings

A more complicated formula is applied if an employee is not paid monthly, or if the employer's notice period is not expressed in months.



#### Example

An employee is paid £4,000 monthly and has a 3 month notice period. She hands in her notice on 1 May 2019. She works one month of her notice period and then her employment is terminated. Her employer makes an ex-gratia termination award of £10,000. There is no contractual or customary right to a PILON.

The PENP = BP ( $\pounds$ 4,000) x D (2 months) – T (nil) =  $\pounds$ 8,000.

As the PENP is less than the termination award of £10,000, £8,000 is treated as earnings (liable to tax and Class 1 NIC) and the balance of £2,000 can be paid free of tax and NIC.

#### Currently the whole amount could be paid free of tax and NIC.



## Termination payment problem areas?

- PILON
- Contractual payments
- Understanding NIC is different
- Benefits provided after termination
- Death and injury payments





#### **ALPHABET SHARES**

### Alphabet Shares

Alphabet shares are different classes of shares denominated by a letter (e.g. 'A' ordinary, 'B' ordinary, 'C' ordinary shares, etc.). Such shares can be used as a method by which dividends are paid at different rates or not at all. They can also be used to permit different voting and other rights or restrictions (e.g. redeemable or non-redeemable) to be assigned to different classes of shareholders as required (although when intending to gift the shares the rights must be the same of those gifted or grant differing rights on winding up).

#### HMRC's View of Alphabet Shares

HMRC have never liked Alphabet shares, especially if the share mix is changed post incorporation. Dividends are a return on capital invested and HMRC may look to see whether the allocation of dividends is really an employment reward taxed under PAYE as salary rather than as an investment dividend.

If the dividend can only be paid if one class of shares receives no dividend then HMRC could always seek to apply the 'Settlement' legislation as a 'bounteous *arrangement*'.



#### To consider:

- Do not create 'Alphabet' shares just before a dividend is due or as soon as the company has posted large reserves, as income transfer could be viewed as being the only reason for creations of the shares
- Should HMRC decide to look further into the dealings of the company they will check as to where the dividends are actually paid.
- If it is intended to sell the business in the future, it should be remembered that a share holding of at least 5% of the total number of shares in issue is required in order to claim Entrepreneur's Relief on any Capital Gains Tax charge
- To minimise the risk of HMRC claiming that the dividend could not have been paid unless one class of share was not allocated any dividend, it would be preferable for at least some dividend to be paid to each type of share rather than none.





#### **DIVIDEND WAIVERS**

#### **Dividend Waivers**

Dividend waivers if used correctly and all legalities are complied with can be a useful tool in tax planning.

Should a shareholder not wish to receive the dividend, he/she may voluntarily 'waive' the payment, such that no payment is received but the remaining shareholders still receive.

Dividend waivers can be an effective way of reducing the director-shareholders' overall income tax bill but it is important to ensure that the dividend declared per share, multiplied by the number of shares in issue, does not exceed the amount of the company's distributable reserves.

#### HMRC's View of Dividend Waivers

HMRC can try to invoke the 'Settlements' legislation. They will look to see whether:

- The level of retained profits is insufficient to allow the same rate of dividend to be paid on all issued share capital.
- If there has been a succession of waivers over several years where the total dividends payable in the absence of the waivers exceeded accumulated realised profits.
- The same rate of dividend could not have been paid without the waiver because the reserves would not have been sufficient
- The non-waiving shareholder would pay less tax on the dividend than the waiving shareholder

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#### Please note:

- The shares must be of the same class, as in some cases HMRC has shown that they deem the use of different classes, with dividends being voted separately on one or more classes so as to benefit particular shareholders, to constitute a 'settlement' arrangement
- If a dividend waiver is to be a regular method of enabling surplus profit to be distributed disproportionately to the same class of shareholder then a permanent alternative solution would be the 'Alphabet' shares route
- The shareholders must give their consent every time a dividend waiver is made
- The waived funds must be retained by the company and not simply divided up amongst the other shareholders receiving the dividend
- Dividend waivers are only effective if executed by deed because there is no consideration to support a contract. All waivers/deeds should be drafted by solicitors.





#### **BENEFITS IN KIND – TOPICAL ITEMS**

# A/ Vehicle – battery charging

- Company cars and vans are exempt from a benefit in kind charge
- Section 237A ITEPA 2003

No liability to income tax arises in respect of the provision, at or near an employee's workplace, of facilities for charging a battery of a vehicle used by the employee (including a vehicle used by the employee as a passenger)

- The facilities must be made available generally to the employers employees at that workplace
- Facilities must be made available 'at or near' the workplace. It is understood HMRC will adopt the same approach as they do for parking provision (within a reasonable distance from the place of work having regard to the nature of the locality)

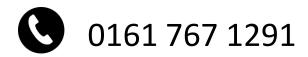


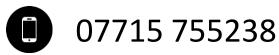
# B/ Subsistence Expenditure

- Expenditure incurred on a work trip can be reimbursed by an employer tax free.
  Provided the employer believes it represents an expense incurred wholly, exclusively and necessarily in performance of the employees duties
- Benchmark rates:
  - £5 where the employee is away from his workplace for a minimum duration of 5 hours. Plus an additional £10 if still away at 8.00pm
  - £10 where the employee is away from his workplace for a minimum duration of 10 hours. Plus an additional £10 if still away at 8.00pm
  - £25 where the employee is away from his workplace for a minimum duration of 15 hours and is still away at 8.00pm
- Employee must be absent from his normal place of work for a continuous period of at least 5 hours <u>and</u> must have incurred the cost of a meal of food and drink after starting his journey
- Alternatives
  - Employer can pay a more generous amount but must seek HMRC approval. If no approval obtained, excess must be processed through payroll
  - Pay by reimbursement of actual vouchers/receipts
- Employers <u>must</u> check that the employees <u>were</u> engaged in qualifying travel in relation to the amount paid or reimbursed.

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Offering a range of services including auditing, accounting and tax advice to a diverse range of clients, we are a forward-thinking company who can help you realise the full potential of your business.

With 2 offices situated in the heart of Bury and Manchester, we have over 80 years' experience aiding a variety of businesses. Our expertise extends to working with owner-managed businesses, small to medium sized companies, business start-ups, and UK subsidiaries of large international groups.

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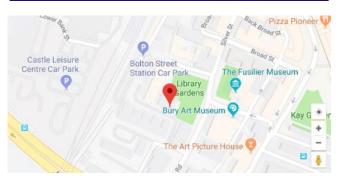
At DTE Group, we believe you should only leave your finances in the hands of the best. Contact our accountants and tax consultants in Manchester to ensure your business is being well looked after.

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