Briefing

Private client review for October

Speed read

This month, we comment on the *BlueCrest* salaried members case, with the Upper Tribunal's decision offering reassurance to LLP members who have significant autonomy in managing aspects of their business. Three further victories for HMRC in relation to SDLT (*Kozlowski*, *Espalier Ventures* and *Henderson Acquisitions Ltd*) serve as a reminder that any taxpayer claims for lower rates will be scrutinised very carefully. Three recent taxpayer wins (in *Magic Carpets (Commercial) Ltd*, *Gopaul* and *Derrida Holdings Ltd*) illustrate the importance of causation and procedure in the context of penalties. Finally, we look at the IFS' recent report on inheritance tax and consider the possibility of future reforms.

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BlueCrest: salaried member rules

The Upper Tribunal (UT) has dismissed HMRC's appeal and the taxpayer's cross-appeal in the BlueCrest salaried members case (*HMRC v BlueCrest Capital Management (UK) LLP* [2023] UKUT 232 (TC)). The decision will be of particular interest to LLP members in the investment management industry, but is also relevant in any other business where individual LLP members have significant independent responsibility.

The salaried member rules are intended to ensure that individuals cannot escape employment income taxes where their working arrangement is effectively one of employment simply by becoming an LLP member instead of an employee. The rules treat an LLP member as an employee for tax purposes if all of three conditions (A, B and C) are met. Condition C relates to capital contributions to the LLP and was not considered in BlueCrest.

Condition A: Condition A is that it is reasonable to expect that at least 80% of the amount to be paid to the taxpayer by the LLP over the period is 'disguised salary'. Here, disguised salary can include all remuneration where any variation in the amount paid is not substantially affected by the overall profitability of the LLP.

In BlueCrest, bonuses for portfolio managers were based on the performance of the portfolios they managed, and *not* the overall profitability of the LLP. These were paid subject to sufficient profits being available.

The UT agreed with the First-tier Tribunal (FTT) that these bonuses were disguised salary: to avoid disguised salary status, it is not necessary for individual remuneration to 'track' LLP profits; however, the link between remuneration and LLP profits must be stronger than the inevitable link between the profits of the LLP and the size of the pool available for distribution to all members.

Condition B: Condition B is that the rights and duties of the LLP members do not give the taxpayer 'significant influence' over the affairs of the LLP.

HMRC's approach in recent years, and reflected in their arguments in this case, has been to treat only those LLP members with an important central management role (e.g. executive committee members) as having significant influence.

However, the UT followed the FTT in categorically rejecting this approach, finding that significant influence is not limited to managerial influence, but could include significant influence over any of the activities of the LLP. Here, the portfolio managers had significant influence over how the LLP managed their particular portfolio, which was the core activity of the business, notwithstanding that they might not have had influence over the entire business.

The *BlueCrest* decision is encouraging for LLP members with significant autonomy in managing aspects of their business, even where their remuneration is not closely linked to the LLP profits

The UT decision restates that any Condition B analysis will be entirely fact dependent, so other LLPs cannot necessarily rely on the decision without a thorough analysis of the workings of the LLP in question. That said, this decision may be helpful in determining how their own facts should be interpreted, so it is encouraging for LLP members with significant autonomy in managing aspects of their business, even where their remuneration is not closely linked to the LLP profits.

SDLT: continued success for HMRC

HMRC have been successful in several recent cases on the application of non-residential rates of SDLT.

In *Kozlowski v HMRC* [2023] UKFTT 711 (TC), the taxpayer purchased a property which included a garage. On the day of completion, he let the garage out for £50 per month to a company in which he owned a minority stake, using a lease agreement prepared by his SDLT advisers. The lease provided for a tenancy which could be terminated at any time and did not confer exclusive possession of the garage. He then claimed an SDLT refund on the basis that mixed-use SDLT rates should have applied.

The FTT found that although the legislation refers to the 'date of completion', the point in time at which to apply the mixed-use test is the moment of completion, and not the end of the day. Accordingly, adding a non-residential use only after purchasing the land is not sufficient to attract mixed use SDLT.

It also found that the lease was not a genuine commercial arrangement and therefore the land was not mixed use in any event. This is an interesting contrast with the decision in *Suterwalla*, discussed in our July column, where a grazing lease over a paddock (granted on the completion date) was found to be sufficiently commercial to make the associated property mixed use for SDLT purposes.

In *Espalier Ventures v HMRC* [2023] UKFTT 725 (TC), the taxpayer simultaneously acquired a leasehold flat, a share of the freehold in the associated building, and three garages detached from but very close to the building. The garages had separate legal title and had been intermittently used by third parties, but planning permission had been sought to integrate the garages into the living space. The FTT found that the intention was to occupy the garages 'with' the dwelling, such that their purchase was part of a wider acquisition of a single residential dwelling for SDLT purposes, and so mixed-use rates could not apply.

In *Henderson Acquisitions Ltd v HMRC* [2023] UKFTT 739 (TC), the taxpayer purchased a house, intending to renovate and sell it on. Following the purchase, part of a ceiling collapsed, which limited safe access to about half of the house. The electrics and heating were also not up to modern regulatory standards. The taxpayer, through an SDLT refund business, claimed an SDLT refund on the basis that the property was non-residential. The FTT found that the relevant question was suitability for use as a dwelling and not readiness for immediate habitation. A house would need either to lack the facilities for living (e.g. washing and cooking) or be wholly (not just partially) structurally unsound in order to qualify for non-residential SDLT. Accordingly, the taxpayer failed to secure their refund.

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Penalties: recent taxpayer wins

Three recent taxpayer victories remind us of the importance of causation and procedure in the context of penalties.

In *Magic Carpets (Commercial) Ltd v HMRC* [2023] UKFTT 700 (TC), it was common ground between the parties that the use of a tax avoidance scheme involving an employee benefit trust and loans to the directors of Magic Carpets had not given rise to the intended tax saving. Accordingly, only two points were in issue: (i) whether the determinations issued by HMRC had been raised in time, and (ii) whether Magic Carpets was liable to pay a penalty on the grounds that there was an inaccuracy in its PAYE return which was brought about carelessly. We focus here on the second of these issues.

The FTT considered the legislation governing the imposition of penalties for inaccuracies set out in FA 2007 Sch 24 para 1, which provides that a penalty is payable where certain documents are provided, and (i) the document contains an inaccuracy which amounts to, or leads to, an understatement of a liability to tax, or a false or inflated statement of a loss or claim to repayment, and (ii) that the inaccuracy was careless or deliberate. On carelessness, the parties agreed that the taxpayer's conduct must be assessed by reference to a prudent and reasonable taxpayer in his/her position. The burden of proof on both issues is on HMRC.

The scheme had been recommended to the directors of Magic Carpets by their accountants (and it was noted that the accountants received commissions from the creator and marketer of the scheme). The directors gave evidence that they had been told that the scheme was supported by a leading tax counsel and that it had been approved by HMRC.

However, the directors did not receive written advice or ask to see counsel's opinion (or seek a second opinion) on the scheme, had not engaged with the documents and did not really understand how the scheme worked. It was clear that the directors had placed their trust in their accountants, and that the only real advice they had received was at a relatively brief meeting with those accountants.

The FTT noted that, normally, it would be reasonable for Magic Carpets to rely on the advice of its professional advisers in compiling tax returns, and wouldn't normally be considered careless in following such advice. However, in the context of the scheme, whilst the FTT was not entirely unsympathetic, it found that, on balance, the company had been careless in, at the very least, not making further enquiries of their accountants or another advisor.

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Having found that there was carelessness, the FTT nonetheless found that there was no causal link between that carelessness and the tax loss or inaccuracies in the company's PAYE returns. The FTT noted that HMRC would have to show that if advice had been sought from an independent adviser at the time, that adviser would have advised that the arrangements did not work. The FTT found it far from certain that such an adviser would have advised that PAYE income tax was due, and that on the basis of case law at the time such an adviser would likely have taken the view that the arrangements were successful, albeit controversial. The criteria for imposing penalties were therefore not met.

In our September column, we discussed the FTT's decision in *Strachan v HMRC* [2023] UKFTT 617 (TC), where the tribunal concluded that, although the taxpayer had been careless, HMRC had not proved that this carelessness had caused a loss of tax. These two decisions both emphasise the importance of causation, that is, carelessness is not enough: it must also lead to a loss of tax. However, in this context, readers should also note another recent case on the use of an employee benefit trust (*Delphi Derivatives Ltd v HMRC* [2023] UKFTT 722 (TC)). Here, the FTT once again found that the taxpayer was careless in failing to obtain separate advice from independent tax counsel on the scheme. However, in contrast with the decision in *Magic Carpets*, the tribunal did not feel able to make a finding of fact in support of the taxpayer's argument that a second opinion from tax counsel would not have differed from the advice already received. It also took the view that the nexus required to be established between the careless behaviour and inaccuracy should be one of attribution, rather than a stronger link of 'but for' causation. Accordingly, the tribunal concluded that the inaccuracies in the taxpayer's returns were attributable to its carelessness, and so upheld the penalties.

In *Gopaul v HMRC* [2023] UKFTT 728 (TC), HMRC sought to impose penalties on the basis that Gopaul Ltd had deliberately suppressed its turnover and profits. The company had been assessed to additional VAT, as well as to corporation tax on undisclosed profits and amounts due under the loans to participators provisions at CTA 2010 s 455.

The burden of proof was on HMRC to show that the company had acted deliberately. The FTT found that HMRC had satisfied this burden in relation to the assessments to VAT and to corporation tax on undisclosed profits. However, proving this deliberate suppression of turnover and profits did not automatically mean that HMRC satisfied its burden of proof in relation to the s 455 liabilities. Section 455 is an anti-avoidance provision aimed at preventing participators from disguising distributions as loans. The FTT said that HMRC needed to prove that Mr Gopaul knew the company had a s 455 liability and intentionally omitted it from the corporation tax return. No evidence had been provided to show that Mr Gopaul knew about this charge. This case is a useful reminder that deliberate behaviour must be proved in relation to each charge to tax.

Finally, the FTT also found in favour of the taxpayer in *Derrida Holdings Ltd v HMRC* [2023] UKFTT 715 (TC), again refusing to uphold penalties. The taxpayers had submitted an ATED return to HMRC after the deadline, and as a result HMRC sought to impose late filing penalties. However, it transpired that the value of the property in question was beneath the £500,000 threshold for ATED, and so there was no requirement to file. The FTT was sympathetic to the taxpayer, saying that 'all [the taxpayer] wanted to do was to comply with what she wrongly perceived as being a requirement in terms of having up to date paperwork for HMRC'. The FTT found that since no return was necessary, the appellant had a reasonable excuse for late filing (noting that was somewhat circular).

Inheritance tax: reform in the pipeline?

On 27 September, the Institute for Fiscal Studies (IFS) published a report on reforming inheritance tax, a tax which they described as the 'UK's most disliked tax'.

The report notes that around 4% of deaths resulted in inheritance tax in 2020/21, but an increasing proportion of the population is affected by inheritance tax; the IFS estimate that around 12% of people will pay inheritance tax on their death or their spouse's death by 2032/33. This is unsurprising, given announcements in the 2022 Autumn Statement that the nil rate band amount and the residence nil rate band will remain at £325,000 and £175,000 respectively until April 2028 (representing a 19-year freeze of the nil rate band).

The report finds inheritance tax to be in need of reform, and makes a number of possible suggestions, including scrapping (or limiting) agricultural and business property reliefs, bringing pension pots within the scope of inheritance tax, or abolishing the residence nil-rate band, with such reforms used to fund a cut in the tax rate or an increase in the nil-rate band.

The IFS says its focus is on 'incremental reforms which build on the current structure of inheritance tax'. This stands in contrast to recent media reports suggesting that the Conservative government might go so far as to scrap the tax altogether, and it will be interesting to see whether the incremental or abolitionist model wins out. ■

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- Other cases that caught our eye: *Henderson Acquisitions Ltd* (22.9.23)
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