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The Milestone Outlook

Well who would have thought it? Future England soccer boss, Harry Redknapp was acquitted of tax fraud in what must have been the biggest own goal by HMRC for many a year. It takes me back to the days when Sir Ken Dodd and Lester Piggott's tax evasion antics were front-page news. Lester, the Champion Jockey, was rightly brought to task, but only after he made the fatal error of settling his tax bill with a cheque drawn on a bank account that he had failed to disclose to HMRC during the investigation – doh! Sir Ken, on the other hand, was acquitted of tax evasion much to the dismay of many, including no doubt Brian Leveson QC (who as many readers will be aware is chairing the Leveson enquiry). Doddie's counsel, George Carman famously said of his client: "Some accountants are comedians, but comedians are never accountants." The lesson surely to be learnt from Ken and Harry's cases is that HMRC should be cautious about trusting the average Joe to use their brain when asked to sit on a jury in a case involving Britain's 'beautiful game'.

The Redknapp verdict was handed down on the same day as Miles was giving Expert Witness testimony in the First Tier Tribunal in a residency matter involving the Spain/UK DTA. He's written a short summary of some of the technical aspects of the case that throw up some interesting questions.

Just recently Conor was providing a client with a potted history of his tax career, including the time he spent at GE Aviation finance in Ireland. The client chirped up that he knew GE and that they were famous for deploying "Six Sigma Black Belts" to increase productivity. Management speak is the *bete noire* of the Milestone office and any reference to black belts or gurus is strictly forbidden!

But back to football and the Glasgow Rangers FC debacle… the architect of the EBT arrangement that has landed Rangers in the mire is (allegedly) none other than Paul Baxendale-Walker who came to prominence in a BBC Panorama programme a couple of years ago. PBW likened tax to cancer (offensive to cancer sufferers I would have thought) and himself to a doctor in that tax *"will kill your business if it's not treated. So I see myself as a doctor too."* Given the parlous state Rangers have found themselves in PBW is more like Dr Nick Riviera from the Simpsons than Ambroise Paré!

In addition, there are all the usual goodies in this MTN from around the world…

Happy reading!
The Milestone Tax Team

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HOUSEKEEPING

PRESS AND MEDIA

We have added a new section to the milestonetax.com website dedicated to Press and Media. Take a look to find out what we've been saying and additional articles we have been writing.

AVIATION CONFERENCE

Conor and Miles are speaking at a conference hosted by Gates and Partners LLP. The conference is dedicated to the acquisition of bizjets and the boys are naturally filling the tax slot. If you would like a copy of the slides please contact Conor **conor@milestonetax.com**.

OUR BURGEONING AVIATION PRACTICE

Following the arrival of Conor Delaney from GE Aviation, Milestone has been engaged in structuring a number of private jet acquisitions. Critical issues on any jet acquisition will include minimising any import VAT, ensuring that private usage does not trigger deemed income and providing a tax efficient financing structure. For further advice on structuring your jet acquisition contact Conor **conor@milestonetax.com**

DEAL OF THE WEEK

As many readers know we have a penchant for skiing at Milestone and are regulars in the Austrian resort of Lech. We have been instructed by a client to consider ways in which he, as a non-resident of Austria, can acquire a piece of land in Lech on which he will build a chalet (the thought of asking for payment in kind hasn't crossed our minds Guv!). Now you might think that Austria, as a member state of the EU, would have no barriers to entry when it comes to property acquisition. But you'd be wrong. Lech, which is in the Vorarlberg region, has rules designed to prevent the local real estate market being taken over by what in Yorkshire we refer to **"offcumdens"**.

The system works such that properties are designated as principle or secondary residences. Secondary residences are essentially holiday properties and anyone can buy one. By contrast, principal residences may be bought only by individuals who intend to use it as their principle residence. By definition this means that they live there for at least 6 months a year. The Austrian tax residency rules are quite unusual in that, in addition to the 183-day rule (present in most other countries) there is also a property based rule such that ownership of a property in Austria automatically gives rise to residency status. This applies even to holiday home ownership. Ordinarily this does not give rise to tax issues because ownership can be structured through appropriate entities and more often than not the tie-breaker article in a relevant double tax treaty can be relied on to shift the taxing rights away from Austria. However, principle residences by definition create a tax headache because they require the owner to certify that they live in Austria for 6 months a year. The tie-breaker test then comes into its own. However, our client is resident in Monaco and hence no treaty with Austria.

You might think that these laws, which essentially restrict the acquisition of holiday homes, are contrary to the freedoms enshrined in the Treaty on the Functioning of the European Union (see MTN 21). However, you'd be wrong. The free movement of capital may be restricted provided that:

i) it pursues an objective in the public interest;

ii) that it is applied in a non-discriminatory way; and

iii) that it is proportionate or, more specifically, is appropriate for ensuring that the objective pursued is achieved and does not go beyond what is necessary for that purpose.

The case of *Burtscher v Stauderer* is directly in point as it relates to the acquisition of a second home in Vorarlberg. In this case the purchaser failed to make a declaration that the property was not a holiday home within the two year time limit. The result of which, claimed the vendor, was that the contract for sale became retrospectively invalid. The purchaser, Mr Stauderer claimed that the rule was discriminatory. The court agreed, albeit only in relation to the automatic retrospective invalidation of the contract for sale.

Needless to say, extracting our client from the realms of Austrian tax while fulfilling his urge to live in the Arlberg has created a few headaches for us, but, we're nearly there!

AUSTRALIA

Project Wickenby

Anyone who doubts that tax enforcement is toothless needs to look at the ATO's Project Wickenby. Established in 2006 it brings together Australia's eight government agencies in order to protect the tax base by tackling evasion, avoidance and crime. The main target: "secrecy havens".

A secrecy haven is defined on the Project Wickenby website as *"a country, region or state that does not divulge information about an individual's financial/banking affairs or structures. These arrangements may be exploited to conceal income and evade tax because they do not have effective information exchange arrangements with Australia."* No prizes for the usual suspects that the ATO are referring to…

Wickenby is revered in Australia not least for the ferocious way in which the authorities have pursued their targets. Paul Hogan, otherwise known as Crocodile Dundee, felt the full force of Wickenby in August 2010 when he was grounded in Sydney and prevented from leaving Australia until his tax case (the ATO claim he owes A$37mn) was settled.

Hogan isn't the first and certainly won't be the last high-profile "cobber" to have his collar felt.

UK

Summary of Y, a First Tier Tribunal Case

As highlighted in the MO, Miles was asked to act as an expert witness in a First Tier Tribunal case on the Spain / UK DTA. The case was interesting for a number of reasons and the brief facts are as follows:

- the taxpayer had left the UK on medical grounds in early 2001;
- in 2003 her husband who remained resident in the UK throughout gifted her shares in a UK company; and
- in 2003/4 she sold the shares.

In the UK, gifts between spouses are exempt from capital gains tax – the receiving spouse receives the assets with their historic base cost. However, under Spanish law the receipt is deemed to be at fair market value. Hence, in the present case, the shares were sold with no liability to Spanish tax. Now comes the wrinkle… HMRC claimed that Mrs Y hadn't left the UK at all, that there had been no clean break and that she had remained UK resident throughout. Her advisers argued that she had in fact made a clean break and that she was resident in Spain and would rely on the tie-breaker if push came to shove.

The first point in applying the DTA was to establish that she was resident in Spain in the relevant years. She did spend more than 183 days per tax year in Spain and as such this bright-line test was met and she was, prima facie, liable to Spanish tax on a worldwide basis. Because she was liable to tax therein she is resident for the purposes of the DTA.

One of HMRC's main arguments was that because she hadn't filed a Spanish tax return she was not able to rely on the DTA. They argued that tax had to be paid in Spain in order to rely on the DTA. This raises an interesting question: if an individual is clearly tax resident in Spain (or other country for that matter) and liable to tax therein, but does not file a tax return because their income is below the relevant threshold, or as in the case I was involved in, there was no gain to report, does it mean that individual is not "liable to tax therein"? Furthermore, could one argue that in an extreme case, for example, where an individual has failed to report a taxable gain, that the individual is precluded from relying on the relevant DTA?

HMRC then argued that the purpose of the treaty was to avoid double taxation and prevent fiscal evasion (i.e. it does what it says on the tin) and that the treaty had been used such that it gave rise to double non-taxation. The literal and purposive interpretation of Art 13 of the DTA (referring to the language used in Art 31 of the Vienna Convention on Treaties) is to grant one of the states sole taxing rights and as such the DTA does contemplate double non-non taxation. Whether Spain taxes the gain is a matter for Spain. If by operation of a domestic exemption or provision means that no tax is payable then that is a result of the DTA and its interaction with domestic law.

The tie-breaker test in the Spain/UK DTA was then examined in light of small number of cases on the subject, two being *Lingle and Yoon*. HMRC put considerable weight on an article by John Avery-Jones and various collaborators written nearly 25 years ago in which they considered the meaning of habitual abode. The OECD Commentary narrowly defines habitual abode and essentially it boils down to where one spends most of their time. The authors considered the test should not simply be a day count but should take into account where taxpayer resides regularly, customarily or usually. In *Lingle* the Court adopted this extension, contradicting, in our view, the Commentary approach.

Finally, Miles was asked to explain the difference between the habitual abode test and the centre of vital interests. Miles explained that "habitual abode" is akin to ordinary residence in the UK and needs to be determined over a period of, say, 3 years. By contrast, an individual's centre of vital interests may change from year to year and therefore should be determined on this basis.

We are eagerly awaiting the Tribunal's decision.

UK

Personal Services Company

During the last month or so the UK's press (redtops and broadsheets alike) have been ranting about the use of personal service companies (**PSC**) by taxpayers seeking to minimise their tax exposure. The papers' ire has been focused on the use of PSCs by consultants to the Department of Health and the former Mayor of London (and devout socialist) Ken Livingstone. The use of PSC's is, according to the press, tax avoidance: instead of paying upwards of 50% tax on employment income the "tax cheats" pay only 21% corporation tax.

In reality, the two main reasons why PSCs are used are:

- the company can deduct a much wider range of business expenses; and
- PAYE and NIC can be mitigated to a large degree as earnings can be 'stored' within the company achieving tax deferral.

However, only half the story is being reported and, as much as we'd love to rub Red Ken's nose in it (apart from the contentious additional 'deductions' he's claimed), we can't. What the press fails to mention is that a tax charge arises as soon as profits are distributed out of the PSC and whilst the corporation tax rate varies between 20%–26% for the tax year 2011/2012, dividends are taxed at up to 42.5%.

It often serves to refer back to the heady days of 1936 and *IRC v. Duke of Westminster* and the dictum of Lord Tomlin who said *"that every man is entitled, if he can, to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be."*

The use of a PSC might mitigate tax and might defer tax, but it is not tax avoidance. It is a crying shame that so many tax related stories are so badly reported in the press.

POLAND

Hungary / Poland Permanent Establishment Case

On 9th November 2011 the Polish Supreme Administrative Court held that the losses of a liquidated Hungarian permanent establishment (**PE**) of a Polish company could be set against the profits of the Polish company.

Somewhat surprisingly the Polish revenue, at the court of first instance, forgot that Poland was a member state of the EU and claimed that EU law did not apply to the present case. The Supreme Administrative Court concluded otherwise and overturned the judgment on the basis that:

- European law and its freedoms are applicable to Polish domestic law and, in the case of conflict European legislation reigns supreme;
- where a company established in a Member State cannot deduct from its tax base losses relating to a PE situated in

another Member State, as in this case, there is a breach of the freedom of establishment;

- that the *Marks and Spencer* [C-443/06] and *Lidl Belgium* [C-414/06] cases were good authority; and
- because of the fact that the PE was in liquidation, the Court stated that the restrictions imposed by the domestic legislation cannot be justified by the danger that the losses may be taken into account twice.

The judgment is of a value for all companies with their foreign PE's being not profitable and facing liquidation.

For more details on the European fundamental freedoms please see MTN 31.

SCOTLAND (rather than UK to appease our Scottish readers who eagerly await independence!)

Rangers FC

The Rangers HMRC dispute is another sorry tale of greed, football clubs and lousy tax planning. It is fair to say that most clubs don't pay corporation tax because they're all broke but tax is nonetheless important in a club's ability to attract world class talent. The 50% tax rate in the UK is a significant issue for clubs – to attract world class players they are having to take the tax hit for the player, many agents now negotiating deals on a net basis.

One strategy adopted by many UK clubs (and thousands and thousands of businesses) to soften the tax hit for the players is the establishment of offshore employee benefit trusts (**EBT**) and pension schemes (or EFRBS). Since most clubs are loss making they aren't concerned about a tax deduction for contributions into such schemes so, on the face of it, they aren't as 'hooky' as other wheezes we have seen.

Most readers will be aware of what an EBT is and how is designed to operate. From a basic policy perspective, EBTs have benefitted from tax friendly legislation that allows contributions to be made by a sponsoring company as a means of providing motivation and financial incentives for the benefit of employees generally. The extraction of benefits from EBTs and EFRBS attracted HMRCs attention because players would access "their" fund by way of loans – the terms of which were soft as putty. This resulted in the enactment of the Disguised Remuneration Rules (Part 7A ITEPA 2003) last year which has left many EBT 'beneficiaries' in a right old pickle.

Rangers have been targeted because of the way in which their EBT operated, in particular (as reports would have it) the use of side-letters effectively giving the players a contractual right to the funds within the EBT. With payments being a contractual right the EBT loses its discretionary status and the funds are essentially employment income of the player. Whether the tax bill faced by Rangers (i.e. the PAYE and NICs relating to the sums paid in to the scheme) is sufficient to put an historic club down remains to be seen. One thing is certain though: EBTs and EFRBS are very much under the microscope and if you have established one or are a beneficiary you can expect an enquiry sometime soon.

One final footnote to this sorry state of affairs is the critical role that the "football creditors rule" plays in ensuring HMRC remain out of pocket in situations like the Rangers case. At present, when a football club enters administration it can park 'normal' creditors and instead prioritise the payment of players' wages and sums owed to other clubs (transfer fees and so on). This rule is unique to the UK and unique to football: it is a rule invented by the Football League and the Premier League and, surprisingly, is a rule neither created by Parliament nor supported by statute. This absurd state of affairs means that, even if HMRC were to succeed against Rangers, it is unlikely, given the state of the Rangers coffers, that HMRC will ever recover the tax due.

Surely, as the 'beautiful game' has moved from a provisional pastime to a large money go-round so too should this legal oddity be removed.

IRELAND

Application of Irish GAAR – Revenue Commissioners v O'Flynn Construction & Others

The Irish Supreme Court delivered judgment on 14 December 2011 in the O'Flynn Construction case. The case is of general interest since it is the first Irish Supreme Court decision on the application of the Irish general anti-avoidance rule (**GAAR**) introduced by Finance Act 1989. With a GAAR potentially looming on the UK's statute books, *O'Flynn Construction* provides an insight into how a GAAR might play out in practise.

The case related to an Irish company (**Mitchelstown**) that carried on export activities which qualified for Export Sales Relief (**ESR**). Profits qualifying for ESR could be distributed, directly or indirectly, to individual shareholders without triggering personal income tax. However, Mitchelstown was not able to pay a dividend (since presumably it had no distributable reserves). So instead it entered into a series of transactions that effectively allowed dividends benefitting from ESR to be paid to the shareholders of O'Flynn Construction.

On the one hand, the scheme was highly engineered and tax driven involving *"more than 40 individual steps…over a period of 50 days."* However, on the other hand Mitchelstown had clearly been carrying on export activities qualifying for the ESR and the legislation allowed ESR dividends to be paid to indirect shareholders. The result: a split decision 3:2 in favour of the Revenue.

So what can we conclude from *O'Flynn Construction*? First, if a tax authority is choosing a test case for its GAAR then it will certainly look for a case that is highly tax driven and at the aggressive end of the scale. Therefore, in the meantime, tax planning in relation to general business decisions should be on relatively safe ground. Second, aggressive highly engineered tax planning may always be vulnerable to attack under a GAAR and it will then be a matter of judgment whether the GAAR will be applied.

MILESTONE

No responsibility can be accepted by Milestone for action taken as a result of information provided or opinions expressed in this publication. Readers are strongly recommended to take advice on their particular situations.

Milestone. Registered office: 45 Clarges Street, London W1J 7EP
Registration number: OC 342622
VAT Reg no. 944 478291

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LONDON

Milestone International Tax Partners LLP
45 Clarges Street
London
W1J 7EP

Phone: +44 (0)20 7016 5480
Fax: +44 (0)20 7016 5481
Email: info@milestonetax.com
www.milestonetax.com

DUBLIN

Milestone International Tax Partners Ltd
4th Floor
Ulysses House
Foley Street
Dublin 1

Phone: +353 (0) 1 876 4550
Fax: +353 (0) 1 888 1171
Email: info@milestonetax.com
www.milestonetax.com

UK Alliance Partner