# Types of payment

Personal tax

01 May 2018

*Bill Dodwell* considers the impact of the *Hargreaves Lansdown* case on whether payments by an online platform to its investors should be subject to income tax

The *Hargreaves Lansdown* case is important for many of us – as it covers tax issues relevant to modern financial services, used by millions. The case involved payments made by one of the UK's leading online platforms to its investors – and whether those payments should be subject to income tax, as HMRC asserted. Hargreaves' business is to provide a platform for the distribution to investors of investment products offered by different fund providers, including administration services. In common with many platforms, it aims to offer better pricing to its investors by negotiating better terms with fund managers for investments in their funds. The regulatory regime for financial advisers changed in April 2014. Prior to that date, fund managers would commonly rebate some of the annual management charge to the platform, which would pay part of it to investors. From 2014, all rebates need to be paid in full to investors and platforms (and other advisers) must make a separate charge for their services to investors.

HMRC announced in 2013 (Brief 2013/04) that it regarded payments made to investors as liable to income tax. It acknowledged it had not given guidance before on the issue and so agreed not to seek tax for earlier years. Nonetheless it required platforms to withhold basic rate tax for 2013-14 and subsequently.

The issue before Judge Tom Scott in the First Tier Tribunal was whether payments made by Hargreaves Lansdown were annual payments, from which basic rate income tax should be withheld (and higher rates of tax paid by individuals, as appropriate). Hargreaves paid pre-2014 amounts in cash; thereafter additional units were allocated in funds and cash only paid if less than £10.

The issue at the heart of this and other similar cases is the nature of the relationship between the individual investor and the financial institution. The judge noted that ‘Annual management charges or AMCs are monthly fees paid (or more accurately borne) by investors to investment providers in return for managing their investment in a given fund…In the retail market, AMCs are generally collected directly from the relevant fund rather than being paid by an investor as a separate fee.’ HMRC however asserted that the AMC is paid by a fund entity to the fund provider, rather than being paid by the investor. They treated the monies rebated to the platform as trail commission, thus leading to their claim that the payment to the investor could be income, as an annual payment.

The judge noted that the (rather old) authorities ‘…establish that an annual payment is a payment which has four characteristics, as follows:

1. It must be payable under a legal obligation.
2. It must recur or be capable of recurrence, although the obligation to pay may be contingent.
3. It must constitute income and not capital in the hands of the recipient.

4. It must represent ‘pure income profit’ to the recipient.’

The company conceded the income point and judge concluded that the legal obligation and recurrence conditions were also met. The issue of pure income profit thus was determinative.

The judge reviewed all the terms and concluded that the annual management charge was indeed borne by the investor out of the investments. It was true that this was not especially transparent to the investor which no doubt was part of the regulatory reason for changing the rules in 2014. Judge Scott declared ‘In my judgment, the evidence makes it plain that the nature and quality of a Loyalty Bonus payment is that it is not a ‘profit’ to an investor, but a reduction of his net cost…HMRC’s analysis seeks to recharacterize and unpick the various payment flows taking place on a fund investment in order to isolate the Loyalty Bonus and treat it as pure profit. That approach is not the way to establish objectively the nature and quality of the payment; the Loyalty Bonus is a mechanism for reducing net cost, nothing more and nothing less.’

This isn’t the only type of case where it seems to me that HMRC have misunderstood the commercial position. A number of bank accounts now offer rebates to holders who typically have to pay a fee to earn the rebate. For example, Barclays set up a ‘Blue Rewards’ scheme where participants paid £3 per month and in turn received rebates according to services they purchased from the bank e.g. insurance, a mortgage etc. HMRC initially ruled that the rebates were liable to income tax, without a deduction for the monthly fee. However, Barclays modified the documentation, but not the payments, and HMRC now accept the net rebates are not taxable at all.

Interestingly, HMRC has a published practice of treating credit card ‘cashback’ payments as not being annual payments.

It seems highly unlikely that any proper understanding of rebates would suggest these are payments of income, taxable to recipients. Rather, they are much more likely to be refunds of costs, where there will either be no tax consequences (since the costs were not deductible expenses) or reflected in the net capital gain/loss from investments. Let us hope HMRC accept the position.