Tolley®CPD

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Personal tax

Benefit unless payment within 90 days (Lecture P1026 – 7.41 minutes)

Summary – The taxpayer failed to pay PAYE on deemed payment within 90 days so the tax became a taxable benefit.

On 7 July 2015 HMRC issued a closure notice under s28A(1) and (2) TMA 1970 in respect of Mr Deek's income tax return for the 2008-09 tax year, charging additional tax of £9,201.60. The tax arose due to an additional £23,004 being included in the tax computation under the heading "benefits and expenses received".

Mr Deeks had been awarded shares in his employer's company (National Australia Bank Ltd) that were initially subject to restrictions. When, on 20 November 2008, the restrictions were lifted, S222 ITEPA 2003 deemed his employer to have made a notional payment of employment income and required the employer to account for PAYE on this notional payment. The payment of such tax by the employer was deemed to be a taxable benefit for Mr Deeks unless, within 90 days, he made good his employer for this sum.

Mr Deeks wrote a cheque to National Australia Bank Ltd that they banked on 26 March 2009.

When National Australia Bank Ltd sent HMRC Mr Deek's P11D for the 2008-09 tax year it showed £23,004 as "tax on notional payments not borne by the employee within 90 days of receipt" of each notional payment".

The issue to be decided was whether the payment to his employer was made within the 90 - day time limit. Mr Deeks claimed that he had given the cheque to his employer prior to 18 February 2009 but they had not banked it.

Decision

The Tribunal stated that the burden of proof in such a tax appeal was on Mr Deeks to prove that he had made payment before 18th February 2009 but no evidence was supplied to support his claim. Indeed Mr Deeks wrote to HMRC twice explaining what had happened but included in these letters references to the fact that he did not know exactly when he had given the cheque to his employer.

His employer stated in a letter to HMRC that they did not "hold evidence of when [the appellant's] cheque was received, however cheques are usually banked within 48 hours."

The Tribunal saw evidence of two bank transfers of £16,300 and £8,826.49 into Mr Deek's bank account on 16 and 20 March 2009, so just before the cheque was banked.

The Tribunal found that, on the balance of probabilities, Mr Deeks did not give the cheque to National Australia Bank Ltd by 18 February 2009 and the appeal was dismissed.

Philip Deeks v HMRC (TC05976)

Comment: Had the burden of proof been with HMRC, the Tribunal said that they would have reached the same decision.

Failure to pay national insurance contributions (Lecture P1026 – 7.41 minutes)

Summary – Failure to pay the company's contributions was attributable to the neglect of the director

L Wear Ltd was purchased from administration in April 2006 and traded until being put back into administration on 5 March 2007 owing a national insurance contribution debt of £321,306.60.

Charles O'Rorke was the company's finance director from May 2006, until he was formally dismissed on 22 February 2007. He had stolen £77,902 from the company by three payments, two of which were recorded in the company's accounts as payments to HMRC but were in fact made to his personal bank account. He accessed the accounts system under the name of one of his staff and then signed off the payments himself. He was sentenced to 20 months imprisonment and disqualified as a director for 12.5 years,

Under his supervision, PAYE income tax and NICs were deducted from the payments made to all employees. The relevant PAYE Remittance Paying Book were completed but no payments were made to HMRC.

On the basis of the evidence available to them HMRC issued a Personal Liability Notice (PLN) to Mr O'Rorke as the sole culpable office. He appealed against this notice on two grounds:

1. The PLN should be dismissed under Human Rights Act 1998 and Article 6(1) European Convention on Human Rights on the basis that he was entitled to a fair and public hearing within a reasonable time.

2. The company's failure to pay the Class 1 NICs was not due to negligence on his part as, pursuant to section 172 Companies Act 2006 ("CA") he had only acted in a way he considered to be in good faith and most likely to promote the success of the company for the members as a whole.

Decision

The Tribunal held that:

1. there was no basis for an assertion that there had been an unreasonable delay; and

2. the non-payment of NICs from 19 May 2006 to 19 January 2007 was as a consequence of the neglect of Mr O'Rorke.

The appeal was dismissed

Charles O'Rorke v HMRC (TC06008)

Travel costs and temporary workplaces (Lecture P1027 – 7.17 minutes)

Sections 337 and 338 deal with the deductibility of travel expenses. Under general principles a deduction for the employee's travel costs will be allowed if the expenses are:

- necessarily incurred on travelling in the performance of the duties of the employment; or
- attributable to the employee's necessary attendance at any place in the performance of the duties of the employment.

Section 338 specifically denies a deduction for "expenses of ordinary commuting". "Ordinary commuting" in this context is defined as travel between either:

- the employee's home and a permanent workplace; or
- a place that is not a workplace (e.g. a hotel or someone else's home) and a permanent workplace.

This means that if an employee incurs travel expenses in going from his home to his normal place of work, these expenses will not be allowable, as they constitute expenses of ordinary commuting. You will be aware of this already as your employer does not reimburse you for home to office travelling and you do not get tax relief for these costs.

No deduction is allowed for travel between any two places that is, for practical purposes, substantially ordinary commuting. This means that if an employee, for instance, is required to attend a training college and the journey to the college is substantially the same as that to the usual place of work (and at a similar expense), no deduction will be allowed for travel costs to the college.

However, once at work, if an employee incurs expenses in travelling from his normal place of work to visit a client, that is not "ordinary commuting" but is instead travel to a place where attendance is in the performance of duties and as such these expenses will be deductible. Therefore, office to client travel is allowable.

But what if the employee travels directly from his home to a client's premises and doesn't go into the office first? HMRC accepts that these travel expenses are allowable as they are not ordinary costs of commuting but only providing that the client's premises constitute a "temporary workplace".

A "temporary workplace" is defined as a place which the employee attends in the performance of his duties in order to perform a task of limited duration or for some other temporary purpose.

A workplace will not be "temporary" if the employee attends for a period of continuous work lasting more than 24 months. A period of continuous work is a period over which the duties of the employment are performed to a significant extent at that workplace. HMRC consider the duties to be performed to a significant extent if the employee spends 40% or more of their time at that place.

Therefore, if an employee is visiting a client for a day, or a few days or even a few months, the client premises will be a “temporary workplace” and travel to and from that workplace will be deductible expenses.

A “temporary workplace” may become a “permanent workplace” if either:

- the employee has worked at that location for a continuous period of 24 months; or
- it becomes apparent that the absence from the original permanent workplace will exceed 24 months.

In these instances, travel costs up to the point of “change” are deductible, but costs after that date are not.

Illustration 1

Judith, who lives in Didcot, has worked for her employer for the past 5 years in Oxford. She is sent by her employer to work full time in Bracknell for 18 months, after which time she will return to Oxford.

Judith cannot claim a deduction for the cost of travel between her home in Didcot and her workplace in Oxford because Oxford is her permanent workplace. No relief is available for the expenses of ordinary commuting.

The workplace in Bracknell may be a temporary workplace as Judith's attendance there is for a limited duration. The length of the assignment does need to be considered as Judith will spend over 40% of her time in Bracknell, making it a period of continuous work. If the period exceeds 24 months, the workplace cannot be a temporary workplace. However, as the period in this case is 18 months, Bracknell will be a temporary workplace and the costs of travel will be allowable.

If after 12 months, the secondment is extended to 28 months, Judith will be able to deduct the costs of travel for the first 12 months. After that point, the secondment is expected to exceed 24 months and so Bracknell is now a permanent workplace. No further relief for travel costs will be available.

Illustration 2

Rainer lives in Cleckheaton and works in Leeds 5 days a week. His employer sends him to work in the Manchester office 1 day a week for 3 years.

Leeds is Rainer's permanent workplace and he cannot claim for the costs of travel between Cleckheaton and Leeds. Manchester will be a temporary workplace as Rainer's attendance there is for a limited duration. Manchester is not prevented from being a temporary workplace by virtue of the 24 month rule as Rainer's attendance in Manchester is not in the course of a period of continuous work because he does not spend 40% or more of his time there. The 24 month rule only applies where there is a period of continuous work.

As a result, Manchester is a temporary workplace and the costs of travel between Cleckheaton and Manchester will be deductible.

An “area” could be regarded as a permanent workplace and travel costs to and from that area would not be deductible. An “area based employee” is one whose employment duties are defined by reference to an “area” (rather than a specified site or building) and where the employee attends different places in the area in the course of his job.

Certain “site based” employees will have no permanent workplace and will travel to various different “sites” to perform their duties. Providing that a job at a particular site is not expected to last more than 24 months, costs of travelling from home to site (and back again) will be deductible.

An employee whose employment contract itself is for less than 24 months is by definition not travelling to and from a temporary workplace. Deductions for travel costs in these instances will be denied.

The cost of business travel also includes subsistence costs attributable to the journey in question. Similarly, where an employee has to stay away overnight on business, the cost of the accommodation is part of the cost of business travel. Therefore, the full cost of meals and accommodation whilst travelling or staying away on business is allowable as part of the costs of travel.

Illustration 3

David is required to spend 2 months working at his employer's Edinburgh office. He usually works in the Cardiff office. David flies to Edinburgh on Monday morning and stays in a hotel, travelling home Friday afternoon. He has his meals either in the hotel or a local restaurant.

Explain the deductions David can claim in respect of his travel expenses.

Edinburgh is a temporary workplace so the costs of the journey to and from Edinburgh are allowable, as are the costs of the hotel accommodation and meals.

Some expenditure that an employee might incur whilst making a business journey is not expenditure attributable to the journey. For example, private phone calls, newspapers and laundry. However, if the employer pays or reimburses no more than £5 per night for UK trips and £10 per night for overseas trips, such payments are not subject to tax. If the employer pays more than these amounts, the amounts are taxable in full.

Article supplied by Tolley Tax Training

Payments to a trust were emoluments

Summary - Payments made to the principal trust represented footballers’ emoluments and should have been subject to deduction of income tax and national insurance.

Rangers Football Club was a member of a group of companies. When a group company wanted to benefit one of its employee, rather than paying money direct to the footballer that would be subject to PAYE, the company would take part in a trust scheme where:

- One group company set up the principal trust;
- The employing group company would make a payment to the principal trust and recommend that the trustee resettle the sum on to a sub-trust asking that both

income and capital be applied as the employee wished. The trustee without exception created a sub-trust for the favoured employee;

- The employees could obtain a loan of the sum paid to the sub-trust. which would be greater than the payment net of tax deducted under PAYE if he were to be paid through Rangers Football Club ‘s payroll;

- On the footballer's death, the loans and interest would be repayable out of his estate so reducing its IHT.

Rangers Football Club used the same mechanisms to pay discretionary annual bonuses to employees other than the footballers that Rangers Football Club employed.

HMRC argued that Rangers Football Club should have paid income tax and national insurance contributions on the sums paid to the trusts as remuneration.

The First-tier Tribunal and Upper Tribunal held that the scheme was effective in avoiding liability to income tax and NICs because the employees had only received a loan of the moneys paid to the trusts. However, the Inner House of the Court of Session held that income derived from an employee's work was assessable to income tax, even if the employee agreed that it be redirected to a third party.

Rangers Football Club appealed. The issue to be decided was whether it was necessary that the employee should receive, or at least be entitled to receive, the remuneration for his work in order for that reward to amount to taxable emoluments?

Decision

As a general rule, income tax is payable on money that an employee is entitled to have paid as part of his remuneration, whether it is paid to the employee or to a third party, such a trustee. The money paid to the principal trust constituted earnings from which income tax and national insurance contributions should have been deducted.

The appeal was dismissed.

RFC 2012 Plc (in liquidation) (formerly Rangers Football Club Plc) v Advocate General for Scotland

The Chartered Institute of Taxation (CIOT) have said that HMRC is likely to issue follower notices to employee benefit trusts currently under enquiry, where the circumstances match those in the Supreme Court’s decision in the Rangers case. If the other cases do not settle their dispute and ultimately lose then they will face a penalty of up to 50% of the tax/NICs in dispute.

www.tax.org.uk/media-centre/press-releases/press-release-supreme-court-take-tough-line-rangers-‘landmark-tax-case’

Lifetime allowance protection claims still being made

The lifetime allowance for pensions places a limit on the amount of pension benefit that can be accumulated and subsequently drawn from a taxpayer’s pension fund without triggering an extra tax charge.

Since its introduction in April 2006, the allowance relevant to each tax year has been as follows:

Tax year	Standard lifetime allowance
2017 to 2018	£1,000,000
2016 to 2017	£1,000,000
2015 to 2016	£1,250,000
2014 to 2015	£1,250,000
2013 to 2014	£1,500,000
2012 to 2013	£1,500,000
2011 to 2012	£1,800,000
2010 to 2011	£1,800,000
2009 to 2010	£1,750,000
2008 to 2009	£1,650,000
2007 to 2008	£1,600,000
2006 to 2007	£1,500,000

When the lifetime allowance was introduced in 2006, and in subsequent years when it has been reduced, taxpayers with pensions valued in excess of the lifetime allowance have been able to apply for 'protection'. Such 'protection' ensures that, where the value of their funds now or in the future exceeds the pension lifetime allowance, no additional tax charge arises.

Broadly these protections include

- primary protection;
- enhanced protection;
- fixed protection and;
- individual protection

Each has different conditions attached to them but the aim of this article is not to consider the detailed rules behind each 'protection' but rather to consider what happens where a taxpayer wishes to take advantage of such a 'protection' claim but they are late in doing so.

When introduced in April 2006, the primary and enhanced protection claim deadline was 5 April 2009. Late claims could be permitted but only if the taxpayer had a reasonable excuse for failing to notify their intention to claim ‘protection’ by the closing date and then gave the notification without unreasonable delay after the reasonable excuse ceased. There have been a number of Tribunal cases where taxpayers have appealed against HMRC’s decision to deny the ‘protection’ claim on the grounds of reasonable excuse with varying success.

Ignorance of the 2009 deadline is unlikely to represent a reasonable excuse. When the allowance was introduced, the rules were widely publicised and taxpayers would have been expected to have sought advice. In the case Adrian Platt v HMRC (TC01449), Mr Platt was an unrepresented taxpayer who made his claim some 8 months late. Unsurprisingly he had received relevant information from his pension provider between 2005 and 2008 that meant that he should have been aware that he needed to take action.

Where a taxpayer had been told by advisers that they would need to sign a form, but no form appeared, the onus is on the taxpayer to make sure that they sign the form. In the case Gordon Anthony Yablon v HMRC (TC05539) Mr Yablon’s advisers emailed him in 2006 advising that he would need to sign a form to claim protection and so he was aware that action needed to be taken. When no such form materialised, a reasonable taxpayer should have checked with his advisers that progress was being made and having changed advisors in 2008 he should have checked that the protection election was made.

By contrast, if a taxpayer is told that everything would be taken care of but then wasn’t, the taxpayer is likely to have a reasonable excuse. In John Jackson v HRC (TC05818), Mr Jackson was a chartered accountant, whose advisers believed that they had filed a claim on his behalf. Unfortunately they had not and a late claim was made in October 2014. The Tribunal held that it was reasonable for Mr Jackson to believe that his advisers had submitted the claim as they had told him that they had done so. As soon as the error was identified, they contacted HMRC to rectify the situation.

More that eight years after the April 2009 deadline for claims, we are still seeing cases before the Tribunal. The most recent Tribunal case is Arthur Tipping v HMRC (TC05939). In this case, it took Mr Tipping’s advisers until February 2014 to realise that an enhanced protection claim was needed, and the claim was then not submitted until December 2014. The Tribunal held that Mr Tipping had acted reasonably in relying on a major firm of advisers who had always given sound advice in the past Mr Tipping would have expected his advisers to have contacted him if he needed to take any action regarding his pension. When he discovered the problem, he immediately wrote to his advisers wanting to know what had happened and how the position could be rectified. The delay between February and December 2014 was largely down to his advisers who he trusted.

Finally, it is worth noting that there are no reasonable excuse provisions allowing HMRC to accept a late notification for later protection:

- Fixed protection (2012) had to be claimed by 5 April 2012;
- Fixed Protection 2014 had to be claimed by 5 April 2014;
- Individual Protection 2014 had to be claimed by 5 April 2017;
- Fixed Protection 2016 and Individual Protection 2016 have no late claim deadlines and so the taxpayer cannot be late.

However, people should be aware that the statutory obligation placed on registered pension scheme administrators by the Individual Protection 2016 legislation requires them to provide values for savings as at 5 April 2016 for 4 years (see PTM164120). From 6 April 2020 therefore there is no such obligation and scheme administrators may be unwilling or unable to provide values as at 5 April 2016.

Discovery: Undisclosed income and investment losses

Summary – HMRC were correct to raise discovery assessments in relation to undisclosed rental income.

Mr Lewis owned fourteen properties that were let out as furnished accommodation under Shorthold Tenancy Agreements. He failed to disclose the income he received from the properties for the years 2003-04 to 2013-14. He claimed that rent on the properties only covered expenses and mortgage payments but was unable to produce evidence of expenses as one of his commercial premises contained his paper records that had been lost when the premises were repossessed.

With the exception of certain capital expenses, HMRC accepted the amounts submitted by Mr Lewis' agent. It was also agreed that tax was due only for years 2006-07, 2011-12, 2012-13 and 2013-14. Mr Lewis was unable to settle the outstanding tax and penalties by a contract settlement because of financial difficulties so HMRC issued Notices of Assessment and Penalty Determinations.

Mr Lewis appealed stating in his Notice of Appeal that his agents had not made it clear when producing the schedule of rental income that he had not actually received any income from his property portfolio as it had been used for various investments and repayments to people that he had borrowed money from.

He said that over the last eight years he had not made any money and had been living off his personal bank overdraft. He had borrowed monies from other sources and provided guarantees in excess of £1 million that he was having to repay. He had made substantial losses on the investments and considered that the losses should be set against the net profit income from the rental properties. Whilst he had received a small return on the properties, it had been mainly used to carry out repairs and repay debts.

Decision

Under s 29(3) TMA 1970, if HMRC discover that any profits which ought to have been assessed to tax have not been assessed, or that an assessment to tax is or has become insufficient, HMRC may make an assessment in the amount which ought in their opinion to be charged.

The primary onus of proof is on Mr Lewis. He must prove that the assessments are excessive (s 50(6) TMA 1970). If he cannot prove, on the balance of probabilities, that an assessment is excessive, the assessment must stand good. The Tribunal agreed with HMRC that Mr Lewis had not discharged that burden.

Mr Lewis failed to provide any documentary evidence or meaningful information, whether in the form of business records or otherwise, to show that the property schedule and the discovery assessments are in anyway incorrect. Indeed, Mr Lewis had not made a valid claim for investment losses and so these were not allowable against the income.

The Tribunal found that the penalty determinations were correct and appropriate.

The appeals were dismissed and the penalty determinations confirmed.

Garry Lewis v HMRC (TC05983)

Building society deposits omitted from return

Summary – The First Tier Tribunal found that inaccuracies in a return had been deliberate and that, given the circumstances, the related assessments and penalties were reasonable.

For 2008/09 and 2009/10 Davinder Heaven appealed against assessments to income tax and Class 4 NICs, as well as penalties, relating to deposits into a Nationwide Building Society account in her name totalling just over £20,000.

Davinder Heaven argued that due to her post-natal depression, she had not realised the importance of the inaccuracies in her return. She had submitted her returns in a state of blind panic rather than a deliberate failure to report the deposits.

Decision

The tribunal observed that her postnatal depression had not prevented her from carrying out her legal work for clients to an acceptable standard and so the First Tier Tribunal rejected her argument regarding her post-natal depression. She was unable to prove that it was more likely that the sums deposited in the account were savings of taxed income rather than untaxed receipts from her profession and so the assessments were valid.

The Tribunal found that her behaviour had been deliberate as her evidence was ‘too weak to counteract the inherent improbability' of her assertions and she was a 'person of intelligence with a legal qualification'.

Davinder Heaven v HMRC (TC05992)

Adapted from case summary in Tax Journal (21 July 2017)

Capital Taxes

Partnership CGT (Lecture P1028 – 16.18 minutes)

Tax law does not recognise partnerships, including LLPs, as owning assets for CGT purposes. Each partner in a general partnership or member of an LLP is treated as owning a fractional share of each of the partnership assets and not an interest in the partnership itself.

HMRC issued a statement of practice (D12) in 1975 to explain its position on CGT for the partners of a partnership that is widely accepted as an accurate interpretation of the law. Following a review by the OTS in 2015, this statement was updated to reword certain areas.

Valuation of a partner's share of a partnership asset

Take the appropriate fraction of the value of the total partnership interest in the asset. No discount is applied to reflect the size of the share owned.

Example

If a partnership owns a freehold property worth £3 million and one partner owns 10%, then his share of the value is simple £300,000

No downward adjustment is made just because he has a minority share on the property.

Disposals of assets by a partnership

Each of the partners is treated as disposing of their respective share. If the members agreement states a capital sharing ratio, this will be used, otherwise the actual allocations shown in the partnership accounts will be used.

If the surplus is not allocated to members but, for example, held in an unallocated reserve, HMRC will take account of the profit-sharing ratio in the absence of a capital-sharing ratio.

Each partners is entitled to claim reliefs and exemptions based on their own circumstances on their share of the gains or losses arising.

Assets divided amongst the partners

This commonly occurs on dissolution of the partnership. The partners receiving assets are not treated as making disposals.

We calculate the gains that would have arisen on partners if the asset had been sold to a third party. Partners not receiving the asset are charged their share of the gain when the asset is distributed.

Partner receiving the asset carries it at a base cost equal to

Market value when received

Less:

That partner's attributed gain at the time of distribution

Example

A and B are in partnership and are entitled to 70% and 30% of the assets respectively.

The partnership owns a freehold property that had cost £500,000 and has a market value today of £750,000.

The partnership is dissolved and the property is transferred to Partner A. What are the tax implications of this transfer?

If the asset had been sold to a third party, the gain of £250,000 would have been split

A (70%) £175,000

B (30%) £75,000

B is taxed on a gain of £75,000 (and may be entitled to entrepreneurs' relief if the conditions are met).

A is not treated as making a disposal and carries the asset at a deemed cost of (750,000 – 175,000) £575,000.

Changes in profit sharing ratios

A partner who reduces or gives up a share in asset surpluses is treated as disposing of part or the whole of his share in each of the partnership assets and a partner who increases his share will be treated as making a similar acquisition.

Generally the proceeds will be taken to be the fraction of the <u>current balance sheet value</u>, provided there is no payment outside the partnership (if there is, this is added to the proceeds for the disposer and added to the cost for the acquirer(s)).

The normal part-disposal rules for determining the cost of the asset (A ÷ [A+B]) do not apply in this case.

Gains may arise on the disposing partner if, for example, the asset has been revalued in the accounts

Note that a revaluation of an asset in the partnership accounts does not, of itself, trigger a gain to arise, only if followed by a change in capital sharing ratio.

Example

X (50%) and Y (50%) are partners in a business which owns a freehold property that cost £350,000.

The property was revalued in 2016 to £560,000 with the surplus on revaluation of £210,000 credited to the partners' capital accounts (£105,000 each).

The only other chargeable asset is goodwill but this has no cost.

The capital sharing ratio is now changed to X: 60%, Y: 40% but Y does not receive any consideration from X for this change.

What are the tax implications of the change in ratio?

Analysis

Deemed proceeds for Y:	10% x £560,000	56,000
Acquisition cost:	10% x £350,000	35,000
Gain chargeable on Y	(10% of revaluation)	21,000

X carries forward a cost of (175,000 + 56,000) 231,000

Y carries forward a cost of (175,000 – 35,000) 140,000

If X had paid consideration to Y this would have been added to the proceeds for Y and added to the acquisition cost for X.

Contribution of an asset to the partnership

If a partner brings and asset into the partnership, (s)he makes a partial disposal of the asset to the other partners. Gains will be calculated using similar principals to the example above.

If the transfer is between connected parties or otherwise than at arm's length, proceeds are deemed to equal market value.

Payments made outside partnership accounts

If there is a change in partnership sharing ratios and payments are made between the partners outside the accounts, the payment is treated as consideration for disposal of a share of the reducing partner's interest in the partnership. This might commonly relate to a share of goodwill not recognised in the accounts.

The recipient of consideration will be taxed (with no base cost) and the payer will only get relief on disposal of their interest (e.g. when leaving the partnership).

Annuities paid to former partners

If the remaining partners purchase an annuity and pass the benefit to the former partner, the cost is treated as disposal proceeds for the departing partner. Where annual payments are made by the partnership, this is only treated as capital if more than reasonable recognition of past contribution and effort of retired partner.

If the retired partner was in the business for at least 10 years, the annuity is reasonable if it is no more than 2/3rd of average profit of best 3 of the last 7 years in which they were full-time partner (ignoring capital allowances).

The 2/3rd is reduced if the partner served less than 10 years in the partnership:

1 – 5 years: 1/60 per year
6 years: 8/60
7 years: 16/60
8 years: 24/60
9 years: 32/60

If the retired partner is treated as receiving a capital sum, the amount is allowable expenditure for the remaining partners on acquiring their additional shares from him/her.

Goodwill and CGT reliefs for partners

If goodwill is not recognised as a partnership asset and a partner later disposes of their share of goodwill, it is treated as the same goodwill as when the person became a partner. This might be important in determining eligibility for Entrepreneurs' Relief.

All regular CGT reliefs (Entrepreneurs, roll-over on replacement of business assets and gift relief) are available where relevant when a partner disposes of all or part of their share in a partnership.

Contributed by Malcolm Greenbaum

Partnership property and business property relief?

Summary – Property comprised in the partnership of which Mrs Ross was a partner ("the Green Door Cottages Partnership") did not qualify for business property relief

Mrs Ross died on 7 November 2011. Her estate included a two-thirds share in a partnership, the Green Door Cottages Partnership, which owned eight holiday cottages and two staff flats, known as Green Door Cottages and a property in Weymouth known as UpsideDown House.

During the relevant period:

- The eight cottages were rented out as holiday cottages with numerous services provided by a hotel that had been previously been owned by Mrs Ross;
- The flats were let to staff;
- UpsideDown House was agency managed holiday accommodation.

Mrs Ross' daughter took over running the Green Door Cottages in 2002. She spent every Friday at Green Door Cottages and worked on the business from home for five or six hours per day during the rest of the week.

Mrs Ross' executors claimed business property relief on the whole of Mrs Ross' two-thirds share of the Green Door Cottages Partnership, the business being the running and managing of the properties owned.

HMRC argued that the property was property of a business that mainly consists of investment in land and so consists "mainly of making or holding investments" for which business property relief is denied. HMRC made the point that looking at the Green Door Cottages business as a whole, the profits that it made for the years in question were relatively modest. The real "value" in the business was in the capital value of the cottages that were estimated to have increased in value from £200 thousand when they were acquired to £1.2 million.

Decision

The Tribunal was not convinced by the taxpayer's argument that the "integration" of the Green Door Cottages services with those provided by the Hotel meant that those services should be treated as akin to services provided by a hotel business. Indeed, Mrs Ross' daughter said that her mother sold the Hotel because it was significantly more time consuming and difficult to manage than the self-catering cottages, suggesting that from a practical perspective there is a significant difference in kind in running the two kinds of holiday accommodation.

Looking at the business in the round, the Tribunal agreed with HMRC by concluding that however high the standard of services provided and whatever the level of expenditure incurred on those services, what guests at Green Door Cottages really wanted was access to a property to call their own in a beautiful part of Cornwall to enjoy for a specific period.

The essence of that is the right to rent land in the form of one of the Green Door Cottages for a specific period. That is an activity that consists mainly of the investment in property.

For these reasons the appeal in respect of Mrs Ross' part share of the eight holiday cottages is not allowed. Given that no other evidence was presented to the Tribunal to convince them otherwise, the same decision was reached in respect of the flats and UpsideDown House.

The appeal was dismissed.

Executors Of The Estate Of Marjorie Ross (Deceased) v HMRC (TC05959)

Were gifts of sub-leases a gift with reservation?

Summary – The grant of a sub-lease to her three sons was a gift with reservation of benefit and so taxable on Lady Diana as part of her death estate.

Viscount Hood was the executor of the estate of his mother Lady Diana Hood who had granted a sub-lease to her three sons of premises at 67 and 67a Chelsea Square London SW3. The sub lease was granted out of a lease dated 21 September 1979 of which Lady Hood was the head-lessee and Viscount Chelsea was the head-lessor. The term of the sub-lease commenced on 25 March 2012 and lasted until 22 December 2076, three days before the term of the head-lease was due to expire. The sub-lease included maintenance and repair covenants that mirrored the covenants owed by the grantor under the head-lease.

HMRC argued that the creation of the sub-lease was a gift with reservation of benefit under s102 FA 1986. The maintenance and repair covenants meant that Lady Diana did not need to undertake this work as required under the head lease. As such, this represented a benefit received from the sons. With Lady Diana being beneficially entitled to the premises, it formed part of her taxable estate on death.

Decision

The tribunal referred to the Ingram case which held that as long as covenants are 'more than a few de minimis crumbs of what has been given, the donor is treated as having retained the whole cake.'

The Upper Tribunal concluded that the gift was a gift of the whole sub-lease and that the benefit of the covenants was indeed a benefit Lady Diana received back from her sons. The covenants meant that the property did indeed form part of her taxable death estate.

Viscount Hood, Executor of the Estate of Lady Diana Hood v HMRC

Domicile – UK or Brazil?

Summary – The taxpayers' grandfather had not acquired a domicile of choice in Brazil which meant that they were UK domiciled.

This case serves as a useful reminder of the rules relating to domicile of origin and domicile of choice and how they interact.

The taxpayers' were the four grandchildren of Ian Henderson who appealed against HMRC's determination that they had been domiciled in the UK since birth.

It was agreed that the appeals could be determined by reference to the following questions:

1. Had Ian Henderson acquired a domicile of choice in Brazil when Nicholas Henderson, the taxpayers' father, was born? (If he had not, then he would have had a UK domicile when Nicholas Henderson was born which would have resulted in Nicholas Henderson obtaining a domicile of origin in the UK on his birth. That in turn would result in the taxpayers obtaining a domicile of origin in the UK when they were born, in which case the appeals should be dismissed.)

2. If Ian Henderson had acquired a domicile of choice in the Brazil by the time Nicholas Henderson was born, did he abandon that domicile of choice (so that his UK domicile of origin revived) before Nicholas Henderson turned 16? (If Ian Henderson had a UK domicile when Nicholas Henderson turned 16, then it was common ground that the taxpayers would have a UK domicile on their birth.)

3. If Ian Henderson had acquired a Brazilian domicile of choice by the time of Nicholas Henderson's birth which he had not abandoned before Nicholas Henderson turned 16 (so that Nicholas Henderson had a Brazilian domicile of origin), had Nicholas Henderson acquired a domicile of choice in the UK at the time of any taxpaeyrs' birth? (If he had, then that taxpayer would have obtained a UK domicile of origin on birth and that appeal should be dismissed).

Decision

The First Tier agreed that Ian Henderson resided in Brazil when his son was born but found that two years was insufficient time to form a settled intention to reside permanently there.

By the time his son was 16, Ian Henderson had acquired a property in London and started a business in the UK and so was domiciled in the UK.

Even if Nicholas Henderson had a Brazilian domicile of origin, this wqs lost when he asked the family trust to buy a London property.

The Tribunal found that HMRC had correctly concluded that the grandchildren were all domiciled in the UK from birth

The appeal was dismissed.

Frederick Henderson and others v HMRC (TC6010)

HMRC trusts and estates registration service

April 2017 saw the withdrawal of the paper form 41G(Trust). It has been replaced by HMRC's new trusts and estates registration service.

All trusts and estates with a tax liability must be registered with the HMRC trusts and estates online services. This includes any that have been notified on form 41G.

Self Assessment Trust and Estate Tax Returns must be submitted after the end of each tax year to report each trust or estate's income and gains.

The Estates Online Service should be used to register estates and must be done by 5 October of the tax year after the estate is set up.

The Trusts Online Service should be used to register trusts as well as to pay Income Tax and Capital Gains Tax. For new trusts this should be done by the later of:

- 5 October of the tax year after the trust is set up; or
- when it starts to make income or chargeable gains

www.gov.uk/government/publications/trusts-and-estates-trust-details-41g-trust

Digitised, assessable stamp duty

Stamp Duty Land Tax and Stamp Duty Reserve tax are already digitised. The Office of Tax Simplification (OTS) are looking to modernise and speed up the stamping of paper documents and so has recommended making stamp duty a fully-digitised assessable tax, with territorial scope more closely aligned with SDRT to exclude non-UK shares.

The key recommendations include:

- replacing the process that requires sending a paper document to the Stamp Office to be stamped, with a digital process;
- updating the rules governing company registrars' so that they are able to register transactions on the same day;
- limiting the scope of stamp duty to the transactions it applies to in practice

www.gov.uk/government/news/ots-says-it-is-high-time-to-digitise-paper-stamp-duty-on-shares

Administration (Lecture P1030 – 12.42 minutes)

Too late for negligence claims

Summary – Despite having received negligent advice, the taxpayers' claim failed as they were out of time.

The taxpayers had been advised that by investing in two tax schemes, they would be able to obtain tax relief through gift aid. The schemes worked as follows:

- The investors subscribed for shares in a shell company with a further subscription if the shell was floated;
- The shell company would acquire a target company and the shell company floated;
- On listing, the investor would gift their shell company shares to a charity, claiming tax relief on their value at that time.

The valuation of the shell company on flotation was key to the success of the scheme but there was a risk that HMRC might challenge the valuation after the listing. The claimants were not advised of this but were given '100% assurance that their tax liability would be reduced as a result of this investment'.

Decision

The advisers failed to give sufficient warnings about the risks of the arrangements. The defendants were clearly acting as advisers and the judge said 'no reasonably competent tax adviser' would have given the advice given by the defendants. The advice was negligent.

Sadly, the claims failed as they were out of time; they had not been brought within three years of the parties becoming aware of their losses.

M Halsall and others v Champion Consulting and others, Queen's Bench Division

Reasonable excuse for failing to make a partnership return

Summary - The taxpayer established a reasonable excuse for the late filing and the return was filed within a reasonable time of such reasonable excuse ending such that no penalties applied.

This is an appeal by Mr J Cooney against penalties that HMRC have imposed under Schedule 55 FA 2009 on Mr Cooney and Mr P O'Regan as partners in the Citygate Partnership. The penalties have been imposed for failure to submit a partnership return for the tax year ending 5 April 2012 on time.

The partnership return was submitted during October 2012 but was returned in December by HMRC requesting a missing supplementary page. This information was supplied within two weeks but HMRC returned it for a second time, asking for further information. However, the return was never received and so it was assumed that the return, with the information provided in December 2012, had been accepted.

When a first penalty notice was received it was assumed that this had been issued in error and the agent wrote to HMRC with a copy of the December correspondence, explaining that the return had been filed on time.

When a subsequent penalty notice was received in April 2013, the agent entered into correspondence with HMRC and, in late May 2013, it became clear that a duplicate return would need to be filed. The partnership return was sent to HMRC in July 2013.

Decision

Based on the evidence presented, including a lack of correspondence by HMRC, the Tribunal concluded that HRMC did not send the return back to the partnership and/or their agent in January 2013. Accordingly, they found that the partnership had a reasonable excuse for the failure.

However, a reasonable excuse may cease, in which case the return must be submitted within a reasonable time of that excuse ceasing. The Tribunal found that the reasonable excuse continued until June 2013. The return was filed before the end of July 2013 and so the return was submitted within a reasonable time of the excuse ceasing. The penalties were dismissed.

Mr J Cooney (As Representative Partner Of Citygate Partnership) V HMRC (TC05950)

Failure to report capital gain

Summary – the taxpayer's failure to report a chargeable gain was held to be prompted and careless but not deliberate.

Mrs Lyth had become an owner of shares in a private limited company through her role with an agricultural equipment dealer, Simba International Ltd. She had first joined them in 2000 and been brought in to put IT systems in place and to build up the finance team although in practice her role involved a lot of travel along with the chairman and major shareholder building relationships with customers. Although she was at the time a Fellow member of the Association of Chartered and Certified Accountants her professional role had always been in industry and she had never advised or been involved with tax apart from her own personal returns which were straightforward, consisting mainly of PAYE income and various taxable benefits.

Following the sale of the company to American venture capitalists she resigned her position in the spring/summer of 2011 and was diagnosed with depression. She had been under a great deal of stress during this period, she had two small children her father had passed away, her disabled uncle who her mother had been looking after also subsequently passed away at Christmas in 2012.

On 30 April 2010 Mrs Lyth disposed of her shares in the company for £811,368.74 and on 11 July 2010 for £96,154.66 resulting in a gain of £907,523.40. The share sale was handled through a solicitor who had indicated at the time that there would be a capital gains liability but that entrepreneur's relief at 10% would be available. The amount was not declared on her 2011 return and so key issue in this appeal is whether this error was careless or deliberate.

Decision

Although around the time of the share sales in 2010 Mrs Lyth had been aware of the capital gain, and she may have realised some time after submitting the return there was a capital gains issue which needed to be resolved, at the time she completed and submitted the return, the priority, as far as she was concerned, was to get the return submitted with the PAYE, other benefits and interest figures she was comfortable and familiar with completing. At the time she completed and submitted the return the issue of the capital gain was simply not in her mind at all and that to all intents and purposes she was acting very much on "auto-pilot".

Regarding the fact she had set aside payment for the capital gains liability earlier we accept this suggests there was a point in time at which she was aware of CGT and would in the absence of other evidence point towards the view she was aware of the CGT issue later. But here there is countervailing evidence – her oral evidence was that at the time she was filing her return the capital gain was not in her mind and that she had filled in her return as best she could in the way she had done for previous years.

As an FCAA, Mrs Lyth might be expected to be well aware of the need to deal with and report the capital gain on her return. However, the Tribunal accepted that Mrs Lyth's actual knowledge in relation to CGT generally was very basic and outside her day to day experience.

As regards Mrs Lyth's mental health issues, although not totally incapacitating, the Tribunal believed that they were at a level that meant that the capital gain was not something she thought about.

The Tribunal found that Mrs Lyth was not aware of the inaccuracy when she completed and then submitted the return. Nor did she consciously or intentionally choose not to find out the correct position. The error was not deliberate.

Dorothy Lyth v HMRC (TC05994)

Online filing issues – 'in-year' fix?

As previously reported, 2016/17 has proved to be a difficult year for HMRC when setting its parameters for software providers to use for 2016/17 self-assessment online returns. The cause of the problem has been the set-off of a taxpayer's personal allowance against their various sources of income in the most beneficial manner. Historically not difficult, but with the introduction of the savings and dividend allowances, things have become complicated. (See June and July 2017 notes)

On 19th June 2017 HMRC issued version 4 of 'Self Assessment Individual Exclusions for online filing - 2016/17' which can be viewed at http://www.sa2000.co.uk/2017-exc-indi.pdf. This includes an increasing number of scenarios when the personal allowance setoff is an issue for online filing. In these circumstances, the tax return must be filed on paper to avoid an incorrect tax computation from being generated. HMRC have confirmed that if a paper return is file, the paper deadline has been extended to 31 January 2018.

Historically, so that the problems do not reoccur in the following tax year, HMRC look to fix software issues after the end of each filing season. However this year, it has been reported that HMRC may issue an 'in-year' fix. Once issued, software providers would need time to program and test any changes and so, if the software is to be ready before the 31 October deadline, HMRC would need to issue their 'fix' before the end of the summer.

Both the CIOT and ICAEW Tax Faculty have advised members to delay filing paper tax returns for a few weeks until e have a better idea of what is happening. Whatever the outcome, It will be interesting to see how HMRC intend communicating the issue to affected taxpayers. It is likely that many have already submitted incorrect returns in ignorance of the issues that have been identified.

Employment-related Securities Bulletin No 24

Filing returns

Returns, including nil returns, must be submitted for any schemes registered on the ERS online service.

Once a scheme or arrangement has been registered on the service and remains live, you have a continuing annual obligation to submit an end of year return online by the deadline.

ERS online service – deadline for returns

The deadline for filing annual returns is 6 July following the end of the tax year, so for the tax year 2016 to 2017 ta is normally by 6 July 2017.

However, the ERS annual returns online service has experienced some issues that have prevented some returns from being submitted. in view of these problems HMRC have extended the deadline to 24 August 2017 for the tax year 2016 to 2017.

Penalties for late returns

Returns filed after 24 August 2017 will be issued with the first late filing penalty of £100 on 25 August 2017.

Additional automatic penalties of £300 will be charged if the return is still outstanding 3 months after the original deadline of 6 July, and a further £300 if it's still outstanding 6 months after that date. If a return is still outstanding 9 months after the 6 July, daily penalties of £10 a day may be charged.

www.gov.uk/government/publications/employment-related-securities-bulletin

Agent Update 60 - June/July 2017

Worldwide Disclosure Facility (WDF)

Taxpayers have until September 2018 to use HMRC's WDF to bring their offshore tax affairs up to date. Failure to make a disclosure and pay tax liabilities could lead to tougher penalties, or a civil or criminal investigation.

PAYE webinar

HMRC has produced a webinar to provide employers with additional advice and support about reporting payroll information on time. This webinar explains why it is important for employers to send regular reports to HMRC covering:

- what is a Full Payment Submission
- what is an Employment Payment Summary
- when and how these reports are sent
- exceptions to reporting on time
- how to tell HMRC if you have not paid anyone
- what happens if you don’t send reports including penalties and appeals.

Is your client a Scottish Taxpayer?

If your client lived in Scotland for most of the tax year, HMRC requires they pay Scottish income tax. Your client’s address details must therefore be up to date.

Workplace pension contributions are increasing.

The minimum amount that employers and their staff need to pay into their pension scheme is going up.:

- On 6 April 2018, the minimum amount they will have to pay in will be 2% of their staff’s pay, and the amount their staff put in will rise to 3%.
- On 6 April 2019, this will rise again to 3% contribution from your client and 5% contribution from their staff member.

Automatic enrolment for new employers

From October 2017, all new employers will have automatic enrolment duties from the date they employ their first member of staff. TPR have added new guidance and tools on their website for you and your clients, and will also be writing to them about their new duties.

www.gov.uk/government/publications/agent-update-issue-60

Deadlines

1 August 2017

- Pay corporation tax for periods ended 31 October 2016 if not by instalments.
- Outstanding 2015-16 SA tax returns now subject to higher of £300 or 5% of tax due

5 August 2017

- Quarterly report by employment intermediaries for period 6 April to 5 July 2017.

7 August 2017

- Electronic due date for VAT return and payment for 30 June 2017 quarter

14 August 2017

- Quarterly corporation tax instalment payment for large companies.
- Monthly EC sales list if paper returns used.

19 August 2017

- File monthly CIS return.
- Pay PAYE/CIS for month ended 5 August 2017 if by cheque.

21 August 2017

- Online monthly EC sales list.
- Intrastat — supplementary declarations for July 2016.

22 August 2017

- PAYE/NIC/student loan payments if paid online.

31 August 2017

- Private company accounts with 30 November 2016 year end to Companies House.
- PLC accounts with 28 February 2017 year end to Companies House.
- Corporation tax SA returns for accounting periods ended 31 August 2016.
- Annual adjustment for VAT partial exemption claims, May year end.
- Submit PAYE settlement agreement figures to HMRC to enable final income tax and National Insurance liabilities to be advised for 19 October 2017 deadline.

News

Finance (No 2) Bill 2017: updated draft legislation

The government has published the following 49 resolutions for the second 2017 Finance Bill, scheduled to be moved in the House of Commons on 6 September following the summer recess.

1. Taxable benefits

2. Pensions advice

3. Income tax treatment of certain legal expenses etc

4. Termination payments etc

5. PAYE settlement agreements

6. Pensions: money purchase annual allowance

7. Dividend nil rate

8. Gains from contracts for life insurance etc

9. The “no pre-arranged exits requirement”

10. Venture capital trusts (follow on funding and exchange of shares)

11. Social investment tax relief

12. The “no disqualifying arrangements requirement”

13. Business investment relief

14. Basis of calculation of profits for income tax purposes

15. Trading and property allowances

16. Corporation tax relief for losses etc

17. Corporate interest restriction

18. Museum and gallery exhibitions: tax relief and tax credits

19. Corporation tax relief for expenditure on grassroots sport

20. Profits arising from the exploitation of patents

21. Hybrid and other mismatches

22. Trading profits taxable at the Northern Ireland rate

23. Chargeable gains

24. Domicile
25. Value of certain benefits
26. Inheritance tax (overseas property)
27. Disguised remuneration schemes
28. Disguised remuneration schemes (relevant tax payments)
29. First-year allowance for expenditure on electric vehicle charging points
30. Transactions in land in the United Kingdom
31. Co-ownership authorised contractual schemes
32. Landfill tax
33. Air passenger duty (rates)
34. Petroleum revenue tax: elections
35. Gaming duty
36. Remote gaming duty
37. Tobacco products manufacturing machinery (licensing schemes)
38. Third country goods fulfilment businesses
39. Digital reporting and record-keeping
40. Digital reporting and record-keeping for VAT
41. Partial closure notices
42. Errors in taxpayers' documents
43. Penalties for enablers of defeated arrangements for avoiding tax or NICs
44. Disclosure of tax avoidance schemes: VAT and other indirect taxes
45. Requirement to correct offshore tax non-compliance
46. Penalty for transactions connected with VAT fraud
47. Data-gathering powers
48. Northern Ireland welfare payments
49. Incidental provision etc

Updated draft clauses

The government has published updated draft clauses for a group of provisions to be re-introduced in the second 2017 Finance Bill. These measures, which are due to take effect from April 2017, require amendments to make sure they work as intended:

Carried forward losses and counteraction of avoidance arrangements;

The legislation now allows post-1 April 2017 trading losses to be transferred between companies under common ownership, while ensuring that this ability cannot be used for avoidance purposes.

The group relief rules have been amended to ensure that non-trading loan relationship deficits that arise on or after 1 April 2017 can be surrendered to other companies in a group.

Amendments have been made to the calculation of the 'relevant maximum' for the purposes of group relief for carried-forward losses, so that the rules work as intended.

The oil and gas ring fence expenditure supplement rules have been amended so that companies can benefit from the supplement in respect of losses arising on or after 1 April 2017. In addition, the rules for oil and gas losses have been updated so that where an oil and gas trade becomes small or negligible; its losses lose certain flexibility. This aligns the treatment of oil and gas losses with that for non-oil and gas trading losses.

The commencement rules have been amended to ensure that adjustments as a result of the interest restriction measure in new Part 10 of TIOPA 2010 are apportioned appropriately for the purposes of this Clause, as well as setting out a transitional provision where amendments only have effect from 13 July 2017.

Since March 2017, the clause has been amended to apply to basic life assurance and general annuity business (BLAGAB) losses and to oil and gas losses, and the reference to property losses has been amended so that it applies to in-year losses as well as those that are carried forward. These changes have effect from 13 July 2017.

Corporate interest restriction

This legislation, including these revisions, takes effect from 1 April 2017, as announced in the business tax road map published in 2016 and reconfirmed at Spring Budget 2017.

The main revisions made to the legislation are follows:

- S382 treats amounts as tax-interest where those amounts are deductible under particular tax rules, have previously been disallowed, and those disallowed amounts would be included in tax-interest, for example, as a result of the hybrid rules at Part 6A of TIOPA 2010;

- S402 ensures that the blended net group-interest expense does not excessively limit the operation of the blended group ratio;

- S411 now ensures that amounts in respect of pension schemes are not included in the group-interest figures;

- S 417 now ensures that the reference to capital expenditure includes capitalised interest and other financing amounts included in the carrying value of a relevant asset;

- S 425 now ensures that the provision has effect whenever an employee share acquisition arrangement falls to be treated under Parts 11 or 12 of the Corporation Tax Act 2009;

- S439 now ensures that the grandfathering provision under the public infrastructure rules operates correctly where a company has an interest in another company;

- S443 now ensures that groups electing into public infrastructure rules which would obtain interest deduction below *de minimis* should get a *de minimis* deduction instead of the treatment under the public infrastructure rules;

- S448 now ensures that decommissioning activities can fall to be qualifying infrastructure activities;

- S456 now ensures that this rule operates as a practical alternative to fair value accounting for insurers and that the reference to creditor relationships held by an insurer extends to include loans held in connection with the regulation of underwriting business carried on by members of Lloyd's;

- SS462 to 472 setting out the related-party definition now ensure that:

  - rules excluding certain arrangements from being related parties have priority over the rules bringing additional arrangements into the related party rules;

  - the main definition is limited to equity interests in an entity; and

  - 'normal commercial loans' would not normally make the parties related for the purposes of these rules.

The time limit for appointing a reporting company (paragraph 1 of Schedule 7A) and the filing deadline for an interest restriction return (paragraph 7 of Schedule 7A) have been extended in the first year so that those time limits cannot expire before 31 March 2018 and 30 June 2018 respectively.

Deemed domicile: income tax and CGT

Specific changes have been made to allow transitional protections, including:

- Paragraph 19 making a consequential amendment to ensure that the new rules do not affect the operation of the pre-owned assets tax rules;

- Paragraph 20 making a technical amendment to clarify that HMRC tests to see if income is protected in the year it actually arises;

- Paragraph 22 introducing new section 628C to provide transitional relief for income treated as arising to the settlor before 6 April 2017, but not remitted until later where the remittance is made by the trustees, equivalent to the provision in sections 726 and 727 ITA 2007 (transfer of assets abroad);

- Paragraph 29 introducing new rules defining 'protected income' for the purposes of the S733A charge;
- Paragraph 29 on trust protections, making changes to s721A(3) and (4) to remove references to property originating from the individual to make clear which income is protected where there is a company underlying the settlement;
- Paragraph 31 making a similar amendment to that in s721(3BA);
- Paragraph 32 making similar changes to those in s721A;
- Paragraph 34 making technical changes which limits the tax charge on individuals receiving benefits whilst they are non-resident;
- Paragraph 34 making a technical change to s733(1) to limit deductions to cases where tax has been charged under s731 for an earlier tax year; and
- Paragraph 36 making minor drafting changes to s733A(1)(b)(i) and s733A(9).

There will also be a facility for remittance basis taxpayers to rearrange their overseas mixed funds to allow them to remit clean capital from overseas ahead of income and gains. Further legislative change has been made to enable remittance basis users to cleanse any pre-April 2008 funds they may hold.

Employment income provided through third parties

Six minor technical amendments have been to clarify the application of the legislation.

The changes include:

- an amendment to paragraph 4 to make clear the outstanding loan balance includes money repayments that are subsequently subject to a relevant step and tax is due but unpaid, with a corresponding amendment to paragraph 12 for quasi-loans;
- an amendment to paragraph 23 to make clear the accelerated payment postponement provision applies equally to NICs as it does to tax and that, where tax and NICs are relevant, a joint application can be made; and
- amendments to paragraphs 20 and 24 to set out when a postponement can be withdrawn and the effect of the withdrawal.

Hybrid and other mismatches

The government has decided to make a change in relation to the treatment of local taxes, following further discussion with stakeholders, to ensure that the original policy intention continued to be met. That change is being introduced by subsection 2 of the clause, to put beyond doubt that the regime is intended to apply by reference to the relevant national rather than local tax by providing that local taxes are not treated as foreign taxes for the purposes of the regime. This change will have effect from 13 July 2017.

IHT on overseas property representing UK residential property

Some minor drafting and technical changes have been made to the legislation since it was first introduced in March 2017, including:

- a new paragraph 2(4) introducing provisions to tackle potential avoidance using the 5% rule in paragraph 2(3);

- Paragraph 4(6) introducing a drafting change to make clear that references to a loan include any arrangement under which a debt arises and the references to money or money's worth are to the amount of the debt;

- Paragraph 5(1)(a) introducing a technical change to make clear that the disposal and repayments rule in paragraph 5 applies to the disposal of relevant loans (paragraph 3(a)); and

- Section 237(2A) making a minor drafting change.

Substantial shareholding exemption: institutional investors

The definition of 'qualifying institutional investor' in respect of life assurance businesses in new subparagraph (1) of paragraph 30A has been updated from the draft published in March 2017 to ensure that the legislation works as intended.

www.gov.uk/government/collections/finance-bill-no2-2017

Next steps on Making Tax Digital

The government has listened to concerns about the pace of change and is taking steps to ensure a smooth transition to a digital tax system. The roll out for Making Tax Digital (MTD) has been amended to ensure businesses have plenty of time to adapt to the changes.

Under the new timetable:

- From April 2019, only businesses with a turnover above the VAT threshold will have to keep digital records and only for VAT purposes; as VAT already requires quarterly returns, no business will need to provide information to HMRC more regularly during this initial phase than they do now.

- Other taxes will join the digital world from 2020 at the earliest; This latest announcement means that the government has deferred mandation for at least two years from the original proposed start date of April 2018

- MTD will be voluntary for smaller businesses and other taxes, meaning that businesses and landlords with a turnover below the VAT threshold will be able to choose when to move to the new digital system.

HMRC are fully committed to supporting businesses in this transition. HMRC has already begun piloting the Making Tax Digital services and will continue to do so, testing the system extensively with businesses.

It will start to pilot MTDfB for VAT by the end of this year, with small-scale, private testing, followed by a wider, live pilot starting in Spring 2018. This will allow for well over a year of testing before any businesses are mandated to use the system.

> John Preston, CIOT President, said:
>
> "We are delighted that the government has relaxed the timetable for Making Tax Digital (MTD) and appears to be basing its approach on coaxing rather than compelling businesses into going digital.
>
> "Whilst we are supportive of the government's long term ambitions for digitalising the tax system, we have always called for this to be achieved in a measured and manageable way. This deferral will give much more time for businesses, supported by their advisers, to identify for themselves, at their own pace, the benefits of digital record keeping. It will also ensure that many more software products can be developed and tested before mandation is reconsidered."

The MTD legislation will be introduced in a second 2017 Finance Bill after the summer parliamentary recess. Ministers have confirmed that this will as soon as possible after the summer recess.

Taylor report (Lecture P1029 – 7.58 minutes)

The Taylor report (officially titled 'Good Work, The Taylor Review of Modern Working Practices') provides a review of the balance between employment, self-employment, new flexible forms of 'atypical' work and employment rights in the modern workplace.

The report states:

> 'Over the long term, in the interests of innovation, fair competition and sound public finances we need to make the taxation of labour more consistent across employment forms while at the same time improving the rights and entitlements of self-employed people.'

It recommends retaining the current three-tier approach to employment status, Employee, Worker and Self-employed but proposes introducing a new name, 'dependent contractor', to replace the category of people who are eligible for 'worker' rights without being full employees.

In developing the test for the new 'dependent contractor' status:

- control should be of greater importance, with less emphasis placed on the requirement to perform work personally
- renewed effort should be made to align the employment status framework with the tax status framework to ensure that differences between the two systems are reduced to an absolute minimum;
- the dividing line should be between the new dependent contractor status as outlined and self-employment, so that being employed for tax purposes naturally means an individual is either an employee or a dependent contractor.

The government should develop a free-to-use online tool that provides individuals and employers with an indication of their employment status, similar to the employment status indicator tool for tax purposes.

The report finds the current situation, where a self-employed person doing the same work as an employed person can pay a different amount of tax or NIC despite receiving similar contributory benefit entitlements, is 'not justified, or sustainable, nor is it conducive to the goal of a good work economy'.

The report is supportive of increases in Class 4 NICs. It states that:

> 'The principles underlying the proposed NI reforms in the 2017 spring budget are correct. The level of NI contribution paid by employees and self-employed people should be moved closer to parity.'

In relation to employer NICs, the report states that:

> 'there is a case for companies and others who engage self-employed labour to contribute more to the overall NI payments made by the self-employed, in the same way as they do for employees'.

The report is enthusiastic about making tax digital (MTD). It sees MTD as a key part of the government's plans to make it easier for individuals and businesses to get their tax right. The report expects the government to continue with MTD reforms as soon as possible.

The CIOT has welcomed the Taylor review's recommendation that treating different forms of employment more equally in the tax system would be fairer, but sees the need for further work to ensure fairness and simplicity in tax outcomes. Colin Ben-Nathan, chair of the CIOT's employment taxes sub-committee, said:

> 'Maintaining three different categories of workers (employed, "dependent contractor" and self-employed) for employment law but just two for tax (employed and self-employed) is a mismatch which means confusion and inconsistency among taxpayers and their employers will continue.'

Adapted from Tax Journal (14 July 2017)

www.gov.uk/government/publications/good-work-the-taylor-review-of-modern-working-practices

Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations, SI 2017/692

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 are effective from 26 June replacing the Money Laundering Regulations 2007. The regulations introduce some new requirements and changes to some of the obligations found under the current regime.

They apply to financial institutions, including money service businesses, as well as to other 'gatekeepers' to the financial system, including auditors, legal advisers, insolvency practitioners, external accountants, tax advisers, estate agents, casinos, high value dealers and trust or company service providers.

The new funds transfer regulation, which accompanies the directive, updates the rules on information on payers and payees, accompanying transfer of funds, in any currency, for the purposes of preventing, detecting and investigating money laundering and terrorist financing, where at least one of the payment service providers involved in the transfer of funds is established in the EU.

The main changes are:

- high value dealers cash transaction threshold reduced to €10,000 (down from €15,000) and extended to receiving as well as making payments in cash;
- threshold for inclusion of persons engaged in financial activity on an occasional or limited basis increased to £100,000 (from £64,000);
- simplified due diligence checks for areas of lower risk will be based on a non-exhaustive list of factors;
- enhanced due diligence requirement extended to all financial institutions engaged in cross-border correspondent relationships with non-EEA countries;
- ‘politically exposed persons’ to be risk-assessed on a case-by-case basis for enhanced due diligence;
- estate agents will have to apply customer due diligence checks to both buyers and sellers in a transaction;
- pooled client accounts will be subject to a risk-based approach, rather than automatic qualification for simplified due diligence;
- •customers spending more than €250 in a single month will be subject to due diligence checks;
- low-risk e-money products such as gift cards and store vouchers will be subject to the maximum threshold for simplified due diligence;
- customer due diligence information and transaction data to be retained for five years at the end of a relationship (UK will not require the additional 5-year option allowed under the directive);
- beneficial ownership information for express trusts to be held by trustees (information for trusts with tax consequences to be held through HMRC’s trust register);
- HMRC to act as registering authority for all trust or company service providers (TCSPs) and to require professional body supervisors to provide details of their members who carry out TCSP activity and their ‘fit and proper’ status;
- new requirement for supervisors of TCSPs and money service businesses to carry out fit and proper tests on managers and owners;
- ‘criminality test’ for beneficial owners, officers or managers of supervised businesses will also cover high value dealers; and

- supervisors should be able to demonstrate that they can impose effective sanctions and may consider the use of HMRC/FCA powers where they are unable to impose suitable pecuniary penalties.

www.gov.uk/government/news/crack-down-on-terrorist-and-criminal-financing

HMRC have issued guidance setting out how they will use its enforcement powers as a supervisor under the new Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 from June 2017. Their approach to enforcement will be risk-based and will look to:

- Promote compliance by engaging with businesses and helping them to put in place appropriate controls.

- Prevent non-compliance by making sure that businesses' processes and interactions with customers help them stay on the right side of the law.

- Respond to non-compliance by treating non-compliant businesses in a way that encourages sustained compliance in future.

HMRC's power under the Regulations

HMRC have civil powers under the Regulations to tackle non-compliance and may:

- inspect business premises

- issue a penalty

- refuse or remove fit and proper status from an individual

- refuse or remove an approval from an individual

- refuse, suspend or cancel a business's registration

- issue a notice to request information or attendance at a meeting

- issue a public statement naming and censuring a business or person

- prohibit an individual from holding a managerial role

- seek a court order to enter a premises or to restrain a person from committing a breach.

Most breaches will be treated as civil matters. Any penalties issued must be "effective, proportionate and dissuasive". HMRC may treat breaches as a criminal matter and investigate with a view to prosecution. Non-compliance with the Regulations may also lead to offences under the:

- Proceeds of Crime Act 2002
- Terrorism Act 2000.

www.gov.uk/government/publications/money-laundering-supervision-enforcement-measures

HMRC has also issued guidance to a number of entities detailing their obligations under the new money-laundering act:

- www.gov.uk/government/publications/anti-money-laundering-guidance-for-money-service-businesses
- www.gov.uk/government/publications/anti-money-laundering-guidance-for-trust-or-company-service-providers
- www.gov.uk/government/publications/money-laundering-regulations-2007-supervision-of-estate-agency-businesses
- www.gov.uk/government/publications/anti-money-laundering-guidance-for-high-value-dealers

Equal tax treatment for new pan-European pension

The European Commission has adopted a proposal for a new pan-European personal pension which:

- would have the same standard features wherever they are sold in the EU;
- could be offered by a broad range of providers, such as insurance companies, banks, occupational pension funds, investment firms and asset managers;
- would complement existing state-based, occupational and national personal pensions, not to replace or harmonise national personal pension regimes
- would be portable between member states and savers would have the right to switch providers at a capped cost every five years.

The proposal includes a recommendation that member states agree to match the level of tax relief given to national personal pensions products, even where the pan-European personal pension does not match all the national criteria for relief.

Where member states have more than one type of personal pension, the recommendation asks them to give pan-European personal pension the most favourable tax treatment available.

The Commission expects the first providers to start offering pan-European personal pension on the market approximately two years after the regulation comes into force.

The proposal will be discussed by the EU Parliament and the Council.

ec.europa.eu/info/business-economy-euro/banking-and-finance/insurance-and-pensions/personal-pension-products_en

Simplifying corporation tax computations

On 3 July 2017 the Office of Tax Simplification (OTS) published its final report identifying ways to simplify corporation tax.

The report takes a bold look across four broad themes

1. simpler tax for smaller companies
2. aligning the tax rules more closely with accounting rules where appropriate
3. simplifying tax relief for capital investment
4. a range of further issues affecting the largest companies

The main conclusion is that tax rules should follow accounting rules wherever possible, without the need for adjustments. The smallest companies would use the FRS105 accounting profit as their taxable profit without adjustment, slightly larger companies should only need to consider a list of five or six potential tax adjustments.

The OTS also proposes to explore replacing the capital allowances system with an accounts depreciation approach.

The government should draw up a five-year CT roadmap, to sit alongside the business tax roadmap, providing greater certainty for large businesses in particular.

www.gov.uk/government/news/the-ots-points-the-way-to-simplify-corporation-tax

Business Taxation

Private use too low

Summary – The Tribunal dismissed the taxpayer's appeal, agreeing with HMRC's calculation of private mileage.

On 6 January 2014 HMRC opened an enquiry into Mr Singh's 2011/2012 tax return. They believed that Mr Singh's 10% adjustment for private use of his vehicle was too low and that the actual adjustment should have been 29.25%.

Due to the absence of records maintained by Mr Singh, in raising assessments for tax years 2009/2010, 2010/2011 and 2012/2013, HMRC have used the 2011/12 figures under the "presumption of continuity" described in Jonas v Bamford. Mr Singh did not challenge this approach. As such, the sole matter for the Tribunal to consider was the extent to which the vehicle had been used for purposes outside the trade during the tax year 2011/2012.

Based on the vehicle's MOT records, Mr Singh had covered 23,222 miles in the course of the tax year. Mr Singh had declared taxable income of £13,973 for the year. Based on his assumptions, the average fare in that period was for a journey of 5 miles and for a charge of £8.50. This meant that he would have had to have undertaken 1,643 journeys at £8.50 (13,973/8.5) to achieve the declared taxable income and, using an average of 5 miles per journey, he would have had 8,215 (1,643 x 5) "income-generating miles".

HMRC alleged that an allowance should be made for an equal amount of "dead miles" within the course of the trade. This allowance took into account fare dodgers and miles driven by Mr Singh in returning to his base after dropping off a customer. Taken together, the "income-generating miles" and "dead miles" amounted to business miles of 16,430.

The difference between 23,222 and 16,430 was 6,792 and those were the miles which could be assumed to be private miles, the expenditure on which was not wholly and exclusively for the purposes of the trade. 6,792 expressed as a percentage of 23,222 was 29.25%.

Mr Singh claimed that:

- The 8,215 "income-generating miles" should be increased to 10,500 to take into account fare-dodgers;
- The "dead miles" incurred in returning to base were greater than the miles described above because of the restrictions imposed by dual carriageways and the like and therefore that an additional 11,500 of "dead miles" should be taken into account;
- An additional 1,500 miles should be allowed for driving to MOT testing and servicing.

In total, this amounted to 23,500 miles, which was approximately the same as the 23,222 miles in total for the year. This left no room for private mileage.

Decision

The Tribunal accepted HMRC's submissions considering them, if anything, to be generous to Mr Singh. They were in large part derived from statements made by Mr Singh in the course discussions and correspondence.

The appeal was dismissed

Satnam Singh v HMRC (TC05979)

Note: For completeness, the Tribunal considered the position in relation to penalties for those four tax years of assessment. HMRC wrote to Mr Singh offering to suspend the penalties provided that he agreed to the conditions set out in their letter. The Tribunal urge Mr Singh to maintain accurate records of his private usage in accordance with the suspension conditions going forward in order to avoid future difficulties of this nature.

Partnership losses (Lecture B1026 – 16.23 minutes)

Partnerships, including LLPs, are not taxed in their own right. Each partner/member is allocated a share of the adjusted profit or loss which they deal with in their own tax returns.

Individuals who are partners can generally relieve losses in the same way as sole traders and practitioners will be familiar with these reliefs.

Notional losses allocated to members while the partnership as a whole makes a profit must be reallocated to the profit-making partners (see later).

Anti-avoidance legislation can affect the amount of loss claimable. Some of this legislation affects all partners while other legislation only affects members of LLPs.

Notional losses

If a partnership makes profit but one partner shows loss, we must reallocate the loss to the other partners. To do this, use the ratio in which the other partners have currently share their profits of the basis period.

This means that the partner with the notional loss gets no tax relief for it (and from an accounting perspective has no profit on which to draw).

An agreement should make provision for a compensating payment to the partner with loss reallocated as the other partners benefit from his/her loss by saving tax. In the absence of a specific agreement, the partner has no right to such compensation.

Example – Partners A, B, C

Partner A gets fixed profit share of £50,000

The residue is split 1:2:2 between A, B and C

In year ended 31 December 2016 the adjusted profit was £30,000

		Total	A	B	C
Fixed share		50,000	50000		
Residue	(1:2:2)	-20,000	-4000	-8000	-8000
		30,000	46000	-8000	-8000
Reallocation of B&C's losses			-16000	8000	8000
Final allocation			30000	0	0

A pays tax on £30,000 having received a share of profit of £46,000…..B & C should be compensated for the surrender of their loss shares - but only if the agreement says so.

Anti-avoidance legislation – sideways relief

Commerciality of the trade

- Farmers and market gardeners have a 5 year rule – after five consecutive years of losses, losses from the sixth year cannot be sideways relieved.
- Other trades do not have this 5 year rule, so HMRC may challenge sideways relief if it believes the trade is not being run on a commercial basis.

Non-active partners in an LLP – capital contributed

"Non-active" means spending less than ten hours per week actively carrying on the partnership business.

Non-active partners can only sideways relieve cumulative losses up to the amount of capital contributed. Capital contributed is the actual capital contributed minus amounts received back plus any potential extra liability due from member on winding up.

For individual members of a general partnership (i.e. not an LLP), the capital contribution restriction only lasts for the first four years.

£25,000 annual cap for non-active partners

This cap on sideways loss relief only applies to individual members of a partnership, including LLPs. It applies after applying all other restrictions (so could further limit sideways relief).

General cap on sideways relief

Sideways relief for all individuals limited to greater of

- £50,000
- 25% of adjusted income (total income minus grossed up personal pension payments)

There is no cap on offsetting against profits from same trade (and profits from same trade are also part of adjusted income, so a taxpayer can get more sideways relief than many believe).

Example

Tax-adjusted loss from an unincorporated business were £151,340 in the year ended 30 April 2017

Trade profits in 2016/17 were £82,430 and other taxable income was £150,300.

Personal pension payments in 2016/17 were £24,000 (gross).

There is no restriction on offsetting the loss of 2017/18 against the trade profit of 2016/17, so £82,430 can be carried back.

The cap of sideways loss relief against non-trade income in 2016/17 is the higher of:

- £50,000
- 25% x (82,430 + 150,300 – 24,000) £52,183

This means that a total loss of (82,430 + 52,183) £137,613 can be carried back to 2016/17.

Mixed partnerships – anti-avoidance rules

Mixed partnerships are those with non-individual members (e.g. trusts, LLPs, companies).

Anti-avoidance rules aim to stop over-allocation of losses to individual members and over-allocation of profits to non-individual members (e.g. to corporate members) to prevent 'artificially high' tax savings in both cases.

The non-individual member's share of profits is limited to the value of services provided to the partnership (excluding those provided by individuals who are members themselves) plus notional interest on capital contributed.

Any profit allocated above this limit should be reallocated to the individual members for tax purposes. If this is not done, HMRC has the power to direct a reallocation.

Contributed by Malcolm Greenbaum

What is deductible for corporation tax? (Lectures B1027 – 1029 – 11.57/ 10.25/ 11.18 minutes)

Generally Accepted Accounting Practice

The taxable profits of a trade must be calculated in accordance with generally accepted accounting practice (GAAP), subject to any adjustment required or authorised by law in calculating profits for income tax purposes.

A new financial reporting framework applies to accounting periods beginning on or after 1 January 2015. Essentially three new accounting standards have been developed which together form the basis of a new UK generally accepted accounting practice ('new UK GAAP'). The most important of these new accounting standards is FRS 102 'The Financial Reporting Standard Applicable in the UK and Republic of Ireland' which replaces all existing UK accounting standards.

UK companies that are not required to prepare accounts in accordance with international financial reporting standards will use FRS 102 as will all unincorporated businesses such as sole traders and partnerships.

Although FRS 102 uses different terminology to that used in the Companies Act 2006, FRS 102 does state that other terminology may be used provided that it is not misleading.

Introduction

Each year a trader will prepare a set of accounts in accordance with generally accepted accounting practice. Those accounts will (usually) show a profit.

However, in computing this profit the trader could have deducted expenditure that HMRC does not allow for taxation purposes. Consequently we are required to make a number of adjustments in arriving at the trader's taxable profit.

We start with the profit per the accounts. We then add back certain expenditure which is disallowable for tax purposes. Then we deduct receipts in the accounts which are not taxable as trading income. Finally we deduct capital allowances. This gives the "tax adjusted profit", which is acceptable to HMRC.

Profit per accounts	X
Add: Disallowed expenditure	X
Less: Items not taxed as trading income	(X)
Less: Capital allowances	(X)
Tax adjusted profit	X

It is this “tax-adjusted” profit which is taxable as trading income.

Disallowable expenditure

There are three main categories in this area:

1. Capital expenditure – expenditure which gives an “enduring benefit” to the business.

2. Expenditure which has not been incurred “wholly and exclusively” for the purposes of the trade.

3. Specific disallowables given by tax statute and case law.

Depreciation and amortisation

Depreciation and amortisation are not usually allowed for tax purposes. This is because there are many rates and methods of depreciation, and traders may therefore be encouraged to choose depreciation rates which maximise tax relief.

Instead, businesses are able to claim capital allowances (CAs) on any plant and machinery used in the trade.

Capital expenditure

The purchase of capital equipment should be included on a trader's Balance Sheet, (or Statement of Financial Position per FRS 102) as the Balance Sheet shows all the fixed assets (or ‘property, plant and equipment’ per FRS 102) of the business. These capital items may be eligible for capital allowances.

If the trader has included any capital additions in the Profit and Loss (“P&L”) Account (or ‘Income Statement’ per FRS 102), they should be disallowed and added back in arriving at the trading profits.

Profits or losses on the sale of fixed assets are also disallowed. Losses on sales of fixed assets are not allowable expenses and should therefore be added back. Profits on sales of fixed assets are not taxable as trading income and should therefore be deducted in arriving at trading profits.

Legal fees

A trader may incur legal fees on the acquisition or disposal of capital assets. These are disallowed as they relate to a capital item.

Legal fees incurred on the renewal of a short lease are specifically allowed. A “short” lease is a lease of 50 years or less.

Enduring benefit

In the tax case of *Atherton v British Insulated & Helsby Cables Ltd (1925),* the Judge held that expenditure which provides the business with an “enduring benefit” is not allowable as a trading expense. By “enduring benefit” we mean that the expense will benefit the business not just in the year in which it is incurred, but also in the years that follow.

For example, if a plumber buys a new van, this is a capital expense as the business will have obtained an enduring benefit as a result of the expense. The van will (presumably) be available for use in the business for several years. The purchase of the van is a one-off “exceptional” expense which the trader will not incur year-on-year. The expense should be capitalised via the Balance Sheet rather than deducted as an expense in the P&L account.

However, if a plumber fills his van up with petrol, this does not give an enduring benefit as (a few days later) he may need to do so again. Assuming the van is a business vehicle, petrol costs for the van will go through the P&L account and will be deductible for tax purposes.

Tax law does not give any assistance as to how long an asset needs to be owned for it to be classed as “capital”. In some instances an asset may have a very limited economic life.

HMRC guidance is that where the life of an asset is:

- less than one year the expenditure should be treated as a revenue expense;
- expected to be at least two years it is likely to be capital expenditure.

If an asset has an expected useful life of between one and two years the treatment of this asset is subjective and we must look at the specific facts of the case to make our decision.

Repairs

The cost of a ‘repair’ is normally allowable expenditure for tax purposes whereas the cost of replacing an asset or making a significant alteration or improvement to an asset is capital expenditure and as such is disallowed.

An expense is a repair where it restores an asset to its original condition. The use of modern materials or new technology as part of a repair does not necessarily mean the repair becomes an improvement. For example, HMRC accept that replacing old windows with new double glazed equivalents is a repair rather than an improvement.

If after the work is carried out the asset can do just the same job as before, the work is a repair. If however more can be done with the asset, or the asset can be used to do something that it could not do before, then the work is an improvement and is therefore disallowable as capital expenditure.

Where an expense is a capital improvement, the ‘notional’ cost of what it would have taken to repair the asset is not allowed.

Replacing a part of an asset is a repair to the asset, but replacing the whole or the ‘entirety’ of an asset is capital expenditure. What forms the ‘asset’ is a question of fact. A decision needs to be made whether the ‘asset’ is in fact a separate asset or is part of a bigger asset to determine if the expenditure is allowable for tax purposes.

For instance, fixtures within a building are part of the building and are not an entirety in their own right. Replacing a fixture is a repair to the building. An exception to this rule is where the fixture is an integral feature that is being replaced. If expenditure on an integral feature represents the whole, or more than 50%, of the cost of replacing the integral feature then the whole expenditure is to be treated as capital expenditure and disallowed for tax purposes.

It is common for HMRC to request a breakdown of the trader's 'repair' expenditure in the P&L account as part of an enquiry.

Initial repairs

If a trader purchases an asset and then spends money on it, is this expense revenue or capital?

In *Law Shipping Company v IRC*, a company purchased a ship which needed some immediate repair work as it did not possess a certificate of sea-worthiness. They spent the money and claimed the repairs as a revenue expense in the P&L account. However, the Courts held that the repairs were part and parcel of the acquisition costs of the asset as they enabled the ship to be used for the very first time. As a result, these "repairs" were held to be capital – ie linked to the capital acquisition of the ship.

Could we argue that the costs are revenue?

In the case of *Odeon Associated Theatres Limited v Jones*, a number of cinemas were purchased just after the war in a very run down state. However, Odeon kept them open to the public and continued to show films. Over a period of time they gradually repaired and renovated the cinemas and brought them up to a much smarter state.

As much of the repair work related to dilapidations arising prior to Odeon's purchase, HMRC argued under the *Law Shipping* precedent that the repair expenses were part and parcel of the acquisition cost – ie they were capital.

However, as the repairs took place to useable assets, the Court held that the costs were revenue in nature and therefore allowable. The most important factor with regard to repairs on newly acquired assets is whether the asset was purchased in a useable state and was actually used in that state.

This principle also applies to let properties. For example, if an individual buys a house, undertakes some "repair" expenditure to make it lettable, then subsequently lets out the property to a tenant, HMRC will apply the *Law Shipping* principle and disallow the expense as capital.

Provisions

Provisions are allowable provided that they are properly computed in accordance with FRS 102 and are in connection with genuine revenue expenditure (not capital).

Section 21 of FRS 102 requires that a provision can only be made via the P&L account if:

- the entity has an obligation to make a payment at the reporting date as a result of a past event;
- it is probable (ie more likely than not) that a transfer of economic benefits will be required to settle that obligation; and
- a reliable estimate can be made of the amount of the obligation.

Unless you have any information to the contrary, if a P&L account contains a provision, you should assume that the accounts have been prepared in accordance with FRS 102 and the provision is therefore allowable.

Wholly and exclusively

Expenses are only deductible if they are incurred “wholly and exclusively” for the purposes of the trade.

If an expense is incurred for a “dual purpose” HMRC permits a tax deduction for the business proportion of the expenditure.

Private expenses of employees

Where the business pays a private expense for an employee (eg a gym subscription or medical insurance premium):

- the expense is an allowable deduction for the business; and
- the employee will (usually) have a taxable benefit under the employment income rules.

Accrued wages

Salaries and wages are usually deducted in the period in which the wages are actually paid. However relief is given for accrued wages as long as the wages are actually paid within 9 months of the end of the accounting period.

If the accrued wages are NOT paid within 9 months of the end of the period:

- the accrued amount is added back; and
- relief is given in the period in which the wages are physically paid.

Appropriations to trading stock

If a trader takes an asset which is used in his trade but isn't part of his trading stock, and he then brings it into the business as trading stock, then the “cost” of the stock for the purpose of the accounts is the market value at the time it was introduced. This may be the case where a property developer has a fixed asset which he uses in his trade (eg a building), and then he takes that building as part of his trading stock to be developed.

For CGT purposes, the trader will also be deemed to have disposed of the fixed asset (to himself) at market value so a capital gain will arise. In this instance the trader can elect not to have a CGT disposal but instead to have the cost of the stock reduced by the chargeable gain. This will reduce the gain to nil but will result in the stock having a lower cost (and therefore a higher trading profit when the stock is eventually sold). The election is not possible where a capital loss is in point.

Items not taxed as Trading Income

Not all receipts which a trader includes in his business accounts will be taxed as trading income. Traders might include income in their accounts which is not derived from their trade. Typical examples of non-trading income are:

- rental income;
- bank interest;
- profits on sale of fixed assets;
- sundry miscellaneous income.

This other income will then be brought back in the main tax computation and taxed accordingly.

In exceptional circumstances, rental income from the letting of surplus business accommodation can be treated as arising from the trade as opposed to being treated as property income.

This will be the case where the:

- premises being let are temporarily surplus to requirements;
- let premises are part of a building in which another part is being used in the trade; and
- letting receipts are relatively small.

Compensation receipts

The way in which compensation receipts are taxed depends on what the compensation relates to.

Any compensation received for damages to or depreciation of an asset is a capital receipt and is not taxed as trading income. Such receipts may be subject to CGT.

However, compensation received for the cancellation of a trading contract will generally be taxed as trading income if the contract receipts would themselves have been trading receipts had the contract been completed.

Pre-Trading Expenditure

Expenses incurred in the 7 years before commencement of trade are treated as incurred on the first day of trading. Such expenses will be deducted from profits in the first accounting period, provided they are allowed under normal rules.

Entertaining and gifts

Costs incurred by a trader in providing business entertaining are disallowed for tax purposes. Business entertaining means providing hospitality of any kind.

However costs incurred by an employer in providing entertainment for members of staff are specifically allowable.

Business gifts are also generally disallowed unless the:

- total cost of all assets gifted to the same person in the same basis period is not more than £50; and
- gift bears the business name, logo or a clear advertisement; and
- gift does not include food, drink or tobacco.

Gifts of items which it is the taxpayer's trade to provide (for example, trade samples) are allowed.

Interest payments

Provided the loan is taken out for a business purpose (eg to buy stock, to pay staff wages or to buy an asset to be used in the trade), interest payments will be allowable expenses for tax purposes. This will include overdraft interest (providing the account is a genuine business account and is not used to fund personal expenses).

No deduction is allowed for the repayment of the capital part of the loan itself. Monthly loan repayments will therefore need to be split between the interest and the capital repayment elements.

Incidental costs of obtaining loan finance (eg loan arrangement fees etc) are allowed.

Assets bought on hire purchase

If an asset (eg a machine, car etc) is acquired via a hire purchase (HP) agreement, legal ownership of the asset passes to the trader at the end of the contract either automatically or on payment of a fee, however we treat it as if the lessee owns the asset from the start of the contract, with the trader paying for the asset over a period of time, normally on a monthly basis.

Monthly HP repayments will contain both an interest and a capital repayment element. The capital element is not an allowable deduction. The interest is a deductible expense.

Capital allowances may be claimed on the capital cost of the asset.

Leasing costs

Contrast a HP agreement with a leasing arrangement whereby a trader is borrowing an asset owned by someone else. Costs incurred in leasing or hiring an asset to be used in the trade will be allowable.

There are two ways in which a trader will lease an asset:

1. Operating lease – here the trader simply pays a rental payment (normally monthly) to the owner of the asset and deducts the lease payments via the P&L account; or

2. Finance lease – under Section 20 of FRS 102, the lessee (trader) is required to treat a finance lease in the same way as had he bought the asset by way of a loan. The trader will therefore depreciate the asset over its normal life and will therefore charge depreciation and interest payments through the P&L account.

In both instances, the asset is being borrowed from someone else (ie no legal ownership changes hands), so no capital allowances can be claimed by the lessee using the asset.

There is therefore a difference between an operating lease and a finance lease in respect of what will be charged to the P&L account.

Operating lease		Finance lease	
Charged to P&L:		Charged to P&L:	
Lease rentals	X	Finance lease interest	X
		Finance lease depreciation	X
		Total P&L charge	X

In both instances, the amount charged to the P&L account is an allowable expense. Therefore where an asset is held by a trader under the terms of a finance lease, the depreciation element is an allowable deduction. This is the only time that a trader will get a tax deduction for depreciation.

High emission cars

Relief is restricted for the leasing costs of high emission cars.

A flat rate disallowance of 15% of the leasing costs applies to cars with CO_2 emissions exceeding 130g/km where the lease was entered into on or after 6 April 2013 (1 April 2013 for corporation tax). For leases entered into prior to this date, the restriction only applies to cars with CO_2 emissions exceeding 160g/km.

Therefore the allowable element of the leasing costs is:

Allow: 85% × Lease charge in P&L account

The restriction does not apply to the leasing of:

- cars which are either electrically propelled or low emission; or
- motor cycles.

The disallowance will not apply where the car is only available to the taxpayer for a period of no more than 45 days.

The above restriction only applies to the leasing costs of high emission cars. Any maintenance costs incurred in relation to leased cars are allowable in full regardless of the CO_2 emissions of the car.

There is no adjustment for the private usage of the car by the employee, since the employee will be charged to income tax on an employment income benefit.

Bad debts

Any bad debts written off in the year are deductible.

Any “specific provisions” (ie where the trader can match the debt with a specific debtor or ‘trade receivable’ per FRS 102) are also allowable.

In the accounts of a company this may be referred to as an impairment loss.

The above rules relate to trade debts only. If a trader writes off a money debt (eg a loan), this is not an allowable deduction as it does not relate to the trade (unless the trader happens to be a bank!).

Loans to employees written off will be allowable deductions, as they will effectively be treated as additional salary on which the employee will be subject to tax under the employment income rules.

Accountancy fees

Accountancy fees for the preparation of business accounts are allowable expenses.

Accountancy fees incurred in dealing with a tax enquiry are usually disallowable. However, HMRC guidance states that if the enquiry relates specifically to the trading income and as a result of the enquiry no additional profits are brought within the charge to tax, any costs incurred in dealing with that enquiry will be allowed for tax purposes.

Termination payments

Termination payments are payments made to staff on cessation of their employment contract.

In a continuing trade, a full deduction for termination payments made to staff is given as these expenses will have been incurred wholly and exclusively for the purposes of the trade. This is because redundancy payments need to be made to ex-employees in order to retain the support and motivation of the remainder of the staff.

On cessation of trade, we cannot argue that the redundancy expense will be incurred wholly and exclusively for the purpose of the trade because there will no longer be a trade. However, employment law may specifically require the employer to make redundancy payments. Thus the legislation allows a deduction for statutory redundancy payments made to members of staff on cessation of the trade.

If the business wants to be more generous and pay amounts in excess of statutory redundancy levels, a deduction is available under s.79. However relief is limited to 3 × statutory redundancy level. Therefore when a business is ceasing, it can (in total) obtain a deduction for termination payments up to 4 × the statutory amount – once under s.77 and three more times under s.79.

Restrictive covenant payments – ie payments made to former staff to (say) stop them competing / joining a direct competitor – are always allowed.

Where a termination payment has a direct link to a sale of shares, there is likely to be a dual purpose behind the payment and it will not therefore be allowable as a trading expense.

Training costs

Staff training costs are always allowable as a trading expense whether this is for the staff to acquire new expertise or simply to keep up to date.

Website costs

The cost of setting up a website is treated as capital expenditure because the website will bring an enduring benefit to the trade.

The regular update costs of the website are likely to be revenue expenses and hence be allowable for tax purposes.

Premium on leases

The grant of a lease by a landlord to a tenant for a period of 50 years or less is the grant of a "short" lease. On the grant of a short lease, part of the premium received by the landlord is chargeable to income tax under property income rules. The part of the premium which is not charged to income tax will instead be charged to capital gains tax.

To calculate the income tax charge we take the premium (P) and we deduct the amount which will be charged to capital gains tax (C).

Premium	P
Less: 2% × P × (n−1)	(C)
Property income	A

where 'n' is the number of years in the lease.

This amount ("A") is chargeable to income tax as property income in the year in which the premium is received by the landlord.

Alternatively the premium chargeable as property income is calculated as:

$$P \times (50 - Y)/50$$

where P is the amount of the premium and Y is the length of the lease minus one year. This formula is found in s.277 of ITTOIA 2005.

If the lease provides for rent to be paid by the tenant to the landlord for the duration of the lease, these rents are charged on the landlord in the normal way using the accruals basis.

If the tenant is using the property for the purposes of his trade, he will be entitled to tax relief on part of the lease premium paid to the landlord.

The part of the lease premium which is allowable for tax purposes in each accounting period is calculated as:

$$\text{Allowable deduction for tenant} = \frac{\text{Property income assessment on landlord (A)}}{\text{Period of lease}}$$

Unlike the landlord, who is charged to income tax on the premium in the year that the premium is received, the tenant receives tax relief over the life of the lease.

Any rents paid by the tenant to the landlord for the duration of the lease are deductible using the accruals basis.

Fines and penalties

HMRC do not normally offer a tax incentive for breaking the law, so fines and penalties are generally disallowable.

A breach of the rules imposed by a professional body cannot be viewed as part of the trade, therefore any resulting penalty imposed by that professional body will be disallowable. In *McLaren Racing Ltd v CRC (2014)* the Upper Tribunal found that the penalty paid by McLaren to the World Motor Sport Council for spying on Ferrari, a rival Formula One team, arose as a result of activities which were not in the course of McLaren's trade and therefore was not an allowable deduction for tax purposes.

If a business reimburses personal fines of an employee, the reimbursement will give rise to a taxable benefit for the employee. As this benefit will be taxed as part of the employee's remuneration, the employer will receive a trading deduction.

Post cessation receipts and expenses

Accounts are prepared on the accruals basis, so any post-cessation receipts are normally accounted for in the final period of trading. Such profits have been earned in that final period and therefore they should have been recorded in that final period.

Essentially the receipts of trade arising after the trade ceases are brought into the charge to tax if they would otherwise escape tax.

These receipts can be relieved by expenses that would have been deductible in arriving at trading profits except where the expense arises from the cessation itself.

The company can elect for receipts within the first 6 years after cessation to be related back to the date of cessation.

The election must be made within 2 years of the end of the accounting period of the receipt. This could permit receipts to be sheltered by otherwise unused trading losses that had accrued.

Pension contributions

The employer will usually obtain relief for contributions in the accounting period that they are paid, not accrued.

HMRC may seek to disallow a contribution where they believe that it is not a revenue expense or incurred wholly and exclusively for the purposes of the trade. For example where the contribution is considered to be part of an excessive remuneration package or the contribution is linked to the sale or cessation of a trade.

In addition, where contributions exceed £500,000, there are provisions for spreading the expenses over up to 4 years.

Spreading will apply where the increase in contributions is more than 110% of the contributions paid in the previous period (‘the excess’) and the excess is £500,000 or more.

These are summarised in the table below:

Excess contribution	Spreading
< £500,000	No spreading
£500,000 to £999,999	1/2 in current period, 1/2 in next period
£1,000,000 to £1,999,999	1/3 in current period and each of next two periods
> £2,000,000	1/4 in current period and each of next three periods

Sundry allowable expenditure

<u>Removal Expenses</u>

Allowable unless the move is “expansionary” – ie the business is moving to significantly larger premises such that some of the removal costs will be an “enduring benefit” for the trade.

In particular, when a trader removes to new premises, the expenses of removing trading stocks, stores, tools, and office or other equipment will be allowable.

In addition, the expenses of removal of machinery and plant, including the dismantling and re-erection, will be allowed except where the removal was essentially part of a scheme for expansion of the business, as distinct, for example, from a removal merely to re-site the machinery or plant to secure greater efficiency within the scope of an existing, even though increasing trade.

Note that the “£8,000 limit” applies to employees for taxable benefit purposes only – it does not affect the trading income deduction for the payer.

Thefts and Defalcations

Allowed as a trading income deduction provided such thefts etc are by employees (ie not directors). These expenses are seen as an every day risk of running a business (see *Curtis v J & G Oldfield Ltd (1925)).*

Donations to charities

Donations made by a company are allowed as a deduction in arriving at the taxable total profits of the company (rather than as a deduction in arriving at trading profits).

Article supplied by Tolley Tax Training

Consortium relief and application for a closure notice

Summary - The First-tier Tribunal found that HMRC had sufficient information and directed HMRC to issue closure notices in relation to consortium relief claims,

Hutchison 3G UK Limited (Hutchison 3G) is a member of the Hutchison Whampoa group. It provides mobile phone services under the 3 brand and developed the 3G mobile network in the UK. It incurred significant expenditure resulting in considerable losses that, in principle, could be surrendered to other members of its group or to other companies that are connected for consortium relief. The total relief being claimed was £939,000,000.

UK Power Networks Holdings Limited (UKPNHL) was incorporated as a shell company in June 2010. It had three shareholders who owned the company in equal shares:

- Devin International Limited (Devin), a company owned by Hong Kong Electric Holdings (HKEH);
- Eagle Insight International Limited (Eagle), a company owned by the Li Ka-Shing Foundation; and
- CKI1, was owned by CKI2, which in turn was owned by CKI3 and ultimately owned by the holding company of the Cheung Kong group. CKI1 had an interest in HKEH. The Hutchison Whampoa Group had a significant interest in the Cheung Kong group of companies.

For consortium relief purposes, the surrendering company was Hutchison 3G and the original consortium members were Devin, Eagle and CKI1, with CKI1 being the link company. Following a restructuring, CKI2 and CKI3 became consortium members and Devin and Eagle ceased to be consortium members. The voting rights of the new consortium members (CKI1, CKI2 and CKI3) totalled 74.6%. However, CKI13 and HEH entered into a voting agreement by which CKI3 contracted not to exercise its vote without the consent of HKEH.

The consortium members argued that they possessed 74.6% of the votes between them. HMRC argued that the voting agreement resulted in CKI3 not “directly possessing” its votes (S144(3)(d)) so that the proportion was, in fact only 49.86%.

HMRC wanted to examine whether the purpose of the restructuring was to exploit the consortium relief rules so as to maximise the relief available. They enquired into the companies' consortium relief claims and had information notices outstanding. The companies claimed that the information requested by HMRC in the notices was not relevant to their claims and so argued that HMRC should have closed the enquiry.

Decision

The issue was whether the voting agreement deprived CKI3 of its voting power (S144(3)(d)), so that the CKI companies no longer held 74.6% of the voting rights. The Tribunal thought not.

The Tribunal held that the information requested in the information notices were not reasonably required to understand the companies' tax position.

The questions all related to the purpose of the arrangements put in place by the taxpayers but they concluded that the construction of the voting agreement was a question of law, which should be addressed as part of a tax appeal.

The tribunal noted that s 146B CTA 2010 includes a purpose test to ascertain whether the arrangements form part of a scheme the main purpose, or one of the main purposes, of which is to obtain group relief. Whether the purpose test was relevant depended on whether the arrangements were 'of the relevant sort'.

The Tribunal found that although the arrangements were of the type set out in s 146B(3)(a), they did not have the effect set out in s 146B(2). This was because the relevant arrangement was the increase in the voting threshold to 75% and no person was able to prevent the CKI companies from exercising control over UKPNHL as a result of them.

Eastern Power Networks and others v HMRC (TC05948)

Deductible group options

Summary – The FIrst Tier Tribunal found that share options granted by the parent to employees of its subsidiaries were deductible trading expenses.

The Smith Williamson Holdings Limited group provided tax, accountancy and wealth management services. Smith & Williamson Corporate Services Limited and NCL Investments Limited were part of that group. They employed staff who were made available to other group companies in return for a fee.

Smith Williamson Holdings Limited granted share options under various schemes to employees of Smith & Williamson Corporate Services Limited and NCL Investments Limited through an Employee Benefit Trust whose trustee was a company incorporated in Jersey. Many options lapsed. Whenever employees of Smith & Williamson Corporate Services Limited and NCL Investments Limited were granted share options, the companies paid Smith Williamson Holdings Limited an amount equal to the option price. In each of the accounting periods ended 30 April 2010, 2011 and 2012, both companies claimed deductions against trading profits for accounting debits relating to the grant of share options to their employees.

HMRC have raised four arguments as to why those amounts are not deductible:

1. Were the debits incurred wholly and exclusively for the purpose of their trade (CTA 2009 s 54)?

2. Were the debits capital in nature as, on the issue of the options, the companies had recognised accounting credits as a capital contribution from Smith Williamson Holdings Limited?

3. Given that many options had lapsed, was relief available under S1038 CTA 2009?

4. Did S1290 CTA 2009 apply? Did the company obtain relief for an employee benefit contribution before the time at which the employee receives their qualifying benefits from that contribution?

Decision

The Tribunal concluded that the debits had been incurred wholly and exclusively for the purposes of the appellants' trade. Their employees were skilled and motivated professionals in a nosiness where the grant of share options was commonly part of their remuneration package.

The accounting treatment did not determine whether the options were capital in nature. The capital contributions arose as a result of the grant of share options on a regular basis for the purpose of the group's trade.

The First Tier Tribunal rejected the argument that under S1038 expenses are only deductible when the option is exercised as the debits arose when the options were granted.

In this case, as soon as the options were granted, the company made the contribution and the employees received their benefit and so S1290 CTA 2009 did not apply.

The deductions were allowed.

NCL Investments and another v HMRC

FRS23 and functional currency

Summary - The First Tier Tribunal found that accounts had not been prepared in accordance with UK GAAP and so the tax loss was not established. The fact 'that a number of accountants had misapplied the standard did not mean that the accounts were in accordance with UK GAAP'

Ball Corporation was a US publically listed company, owning an international group of companies including, indirectly, Ball UK Holdings Limited.

Ball UK Holdings Limited, traded in sterling, making and receiving loans to and from its subsidiaries and other Ball group companies. Interest rates were determined by UK prime rate or LIBOR. The only exception was that in 2002, it made a short-term loan in euros and a derivative detailed later.

At the end of 2006, on advice from PwC, Ball UK Holdings Limited implemented a scheme to change its functional currency to dollars.

This would enable the company to move from SSAP 20 to the FRS 23 and so create a large foreign currency tax loss. Ball UK Holdings Limited made no secret that its motive behind entering into the derivative contract was to put Ball UK Holdings Limited in the position to adopt FRS 23 and a dollar functional currency so that it would on paper, make a loss and obtain tax relief. The scheme was promoted to it by PwC and was a disclosed tax avoidance scheme with a DOTAS number.

The scheme required Ball UK Holdings Limited to enter into a derivative contract, which it did with a group member just before the end of the year. Under accounting rules, doing so gave it a choice as to whether to apply fair value accounting, which it chose to do. Applying fair value accounting triggered a requirement to comply with FRS 23 (which determined functional currency). Triggering this requirement to change from SSAP 20 to FRS 23 was the reason why Ball UK Holdings Limited entered into the speculative investment of the derivative contract.

Both parties were agreed that the issue to be decided was whether Ball UK Holdings Limited's accounts for the year ended 31 December 2006 were prepared in accordance with UK GAAP. When adopting FRS 23, what was the company's functional currency? Ball UK Holdings Limited adopted US dollars while HMRC argued that the functional currency was Sterling.

Parties were agreed that the derivative, while it had triggered the application of FRS23, was irrelevant to the determination of Ball UK Holdings Limited 's functional currency under FRS23. Functional currency is the currency of the primary economic environment in which the entity operates which is normally the one in which it primarily generates and expends cash. Ball UK Holdings Limited generated cash in the form of dividend and interest receipts in sterling.

However, Ball UK Holdings Limited argued that decision-making was controlled by Ball Corporation and that Ball UK Holdings Limited did not have 'autonomy' in the sense of the ability to make its own decisions. HMRC accepted 'autonomy' included free decision-making, but they considered that in the context in which it is used in FRS 23 it had a wider meaning more akin to economic or functional independence from the company's parent.

Decision

The Tribunal held that to be GAAP- compliant, the accounts must be prepared using a reasonable application of a correctly interpreted standard and that their decision was based on expert opinion as well as the manuals drafted by Deloitte, E&Y and PwC.

They found that Ball UK Holdings Limited's approach to FRS 23 ignored the fact that FRS 23 considered functional currency to e linked to primary economic environment, which would have supported a wider meaning of the word 'autonomy'. It's activities were carried on with a significant degree of autonomy (in the sense of economic independence) from its US parent. Dividends from subsidiaries were used to fund its loans and its cash flows were not readily available to its parent. Ball UK Holdings Limited had not shown that its interpretation led to a true and fair view being presented by the accounts.

Its functional currency was sterling and the appeal was dismissed.

Ball UK Holdings v HMRC (TC09520)

Future of disincorporation relief

The Office of Tax Simplification has published a paper asking for comments by 15 September on whether there is still a demand amongst businesses for disincorporation relief.

The paper aims to:

- remind businesses that relief will end on 31 March 2018 if no action is taken; and
- find out why take-up of the relief has been relatively low.

The OTS observes that the proposed reduction in the dividend allowance from April 2018 may increase the number of small companies wishing to disincorporate.

Tax on disincorporation

On a disincorporation, there are potentially two tax charges.

1. Corporation tax on:
    - chargeable gains on the market value of its chargeable assets (pre-2002 goodwill and land/buildings); and
    - gains on post-2002 goodwill, which are taxed as income.
2. Personal tax (CGT or Income tax) on the shareholders when the company's assets are distributed to them on liquidation.

The disincorporation relief allows transfers of interests in land and goodwill to be made at cost or written down value (unless the market value is lower), so that no gain is chargeable on the company. The relief is limited to businesses with qualifying assets (goodwill or interests in land) valued at less than £100,000 at the time of the transfer.

Take-up of the relief

As of March 2016 less than 50 claims had been made. There are a number of possible reasons for this, including the following:

- few businesses actually wish to disincorporate
- there may be insufficient awareness of the relief
- it is too much trouble, or too costly for businesses to take this step
- the relief is too limited, either because
    - £100,000 limit is too low, or
    - the charge on the shareholder is not also relieved.

The OTS would like to hear views by 15 September 2017.

www.gov.uk/government/publications/disincorporation-relief-what-of-the-future

OECD additional guidance on country-by-country reporting

On 18th July 2017 OECD published additional regarding country-by-country reporting (BEPS action 13):

1. How to treat an entity owned and/or operated by two or more unrelated MNE Groups;

2. Whether aggregated data or consolidated data for each jurisdiction is to be reported in Table 1 of the CbC report.

The complete set of guidance related to CbC reporting issued so far is presented in the document which will continue to be updated with any further guidance that may be agreed.

www.oecd.org/tax/oecd-releases-further-guidance-for-tax-administrations-and-mne-groups-on-country-by-country-reporting-beps-action-13-july.htm

Tax implications of new UK GAAP - FRS 105 overview paper

HMRC has published a paper that provides an overview of the key accounting changes and tax considerations that arise for companies transitioning from the FRSSE and old UK GAAP to FRS 105.

HMRC will generally accept profits calculated under FRS 105 for unincorporated businesses if they meet the relevant size criteria. This guidance may therefore apply both to companies within the charge to corporation tax and to individuals and other entities within the charge to income tax.

The main section of this paper is split into 2 parts:

- Part A: compares the accounting and tax differences that arise between Old UK GAAP, the FRSSE and FRS 105

- Part B: provides a summary of the key accounting and tax considerations that arise on transition from Old UK GAAP or the FRSSE to FRS 105

www.gov.uk/government/publications/accounting-standards-the-uk-tax-implications-of-new-uk-gaap

VAT

Were welfare services exempt?

Summary – The Tribunal found that UK law discriminated between suppliers situated in different devolved areas of the UK and was therefore unlawful under the Principal VAT Directive. The exemption was allowed.

On 15 August 2014, The Learning Centre applied to be deregistered for VAT with effect from 1 September 2009, the date that they had first registered, on the basis that they considered their supplies to be exempt. However HMRC disagreed and refused the application. The Learning Centre appealed.

The Learning Centre provided day care to vulnerable adults with learning difficulties. The education provided was geared towards teaching the students independent living. They argued that their welfare services were exempt under Item 9, Group 7, Schedule 9 of VATA 1994.

Such services are only exempt if supplied by a specified type of entity:

- A charity;
- A state-regulated private welfare institution or agency, or
- A public body.

The Learning Centre was neither a charity nor public body; it was a privately owned company looking to make a profit. So did the company qualify as ‘a state-regulated private welfare institution or agency’?

HMRC accepted that The Learning Centre provided welfare services but they argued that these services were not regulated. However, the company argued that it was regulated because:

- its staff were DBS checked; and/or
- the company was regulated in the sense that it could only employ persons who were DBS checked.

The Learning Centre also argued that its services were exempt under the Principal VAT Directive art 132(1)(g). This directive referred to 'other bodies <u>recognised</u> by the member state concerned as being devoted to social wellbeing'.

Decision

The First Tier Tribunal observed that the question was whether the <u>company</u> was regulated, not its employees. They found that there was no licensing of The Learning Centre, nor was there any registration; it was not state regulated.

Under the Principal VAT Directive art 132(1)(g), the CJEU had consistently read 'recognised' to mean that a discretion was given to each member state to decide which bodies would be entitled to the exemption. The UK is entitled to differences in its devolved laws as between one devolved area and another. But the UK is not entitled to regional differences where the EU does not permit regional variations, such as with VAT law.

The UK's welfare services exemption did not correctly transpose Art 132(1)(g) of the Directive because the UK did not have regard to the need for fiscal neutrality and the need for all private bodies in the UK providing the same service to be treated in the same manner for VAT purposes. In Scotland and Northern Ireland the supplies were exempt, while in England and Wales they were not.

As the UK's implementation of the welfare services exemption was unlawful, the appellant is entitled to rely on the direct effect of Art 132(1)(g) and as a body devoted to social wellbeing its supplies were and always have been exempt.

The Learning Centre (Romford) v HMRC (TC05946)

Holiday accommodation - Agent or principal?

Summary – The First Tier Tribunal found that an online provider of holiday accommodation was acting as agent and therefore outside the scope of the Tour Operators' Margin Scheme.

Lowcost was a travel agent offering holiday accommodation in other EU member states, and other countries, for the most part to customers based in the UK.

The issue between the parties was whether Lowcost provided holiday accommodation to customers as a principal, dealing in its own name, under article 306 of Directive 2006/112, the Principal VAT Directive, and therefore came within the Tour Operators Margin Scheme, or whether it acted solely as an intermediary or agent applying the principles set out in SecretHotels2 [2012] EWCA Civ 1571

From the outset Lowcost's founder and CEO had been determined that the group would not take any risk as a principal in any commercial arrangements. He had 25 years' experience within the industry and this experience had persuaded him that travel agents should not take any risk as a principal. This had been the governing principle in all Lowcost's activities.

Lowcost dealt with customers via a website and before making an online booking, customers had to agree to the company's Terms and Conditions. These Terms and Conditions state in a number of places that Lowcost was acting as an agent for the hotels, villas and apartments featured on the website.

Decision

The First Tier Tribunal observed that there was no suggestion that the agreements entered into by Lowcost were shams and so they should be used to determine the nature of Lowcost's legal relationships. The contracts with customers made it clear that Lowcost was acting as agent. The fact that customers paid funds into Lowcost's bank account did not affect the analysis.

The contracts with accommodation suppliers also provided that Lowcost was acting as agent. Despite various aspects indicating a possible principal relationship, it found that, as in SecretHotels2, this did not affect the company's agency relationship.

In conclusion, Lowcost was acting as an agent under UK law and therefore did not fall within the Tour Operator Margin Scheme.

However, several other appeals exist of a very similar nature (the "hotel appeals") on which there may be a referral to the CJEU "regarding the proper interpretation of article 306 and in particular the term "act solely as intermediaries". The determination in the Lowcost case is subject to this referral and its outcome.

Lowcost Holidays Ltd v HMRC (TC05926)

Long-term leasing of caravans

Summary – The company supplied caravans which were zero rated rather than supplying accommodation in caravans.

C Jenkin and Son Ltd supplied caravans to 'the travelling community' on long term leases for use as their homes on sites under separate pitch agreements between occupiers and site owners (usually, local authorities).

Item 1, Group 9, Schedule 8 VATA 1994 listed certain caravans, such as those supplied here, as being zero-rated. The company treated their supplies accordingly.

However in 2013, HMRC decided that the company's supplies were supplies of accommodation in caravans that were excluded from zero-rating (see Note (b) to Group 9). They considered that the supplies had been grants of an interest in or right over land or a licence to occupy land and were therefore exempt under Item 1 of Group 1 of Sch 8 to the Act. HMRC looked to recover input tax that had been incorrectly claimed.

The taxpayer appealed to the First-tier Tribunal. At the hearing:

- All agreed that there was no legal basis on which the supplies could be exempt;
- The Tribunal held that the caravans were 'used, and intended to be used, as peoples' homes to live in as residential accommodation' and, as such, were excluded from zero-rating.

If neither exempt not zero rated, the Tribunal stated that, the only possible conclusion was that the supplies were standard rated. However, no one had argued that the supplies were standard rated. The decision was not authority for that conclusion.

The Tribunal concluded that, as it had not been established that the company made exempt supplies, the assessments lacked any legal basis and must therefore fail.

Both parties appealed.

Decision

The Upper Tribunal said that the question was whether the company made a supply of caravans or a supply of accommodation.

A supply of a caravan without the right to occupy it on a site was not a supply of accommodation but of the caravan which would be zero rated.

The caravans were on a site and physically connected to electricity, water and mains drainage. However, the pitch and services were provided by a third party over which the company had no control. Without these, it would not be possible to occupy the caravans for residential purposes and it could not be a supply of 'accommodation in a caravan'.

The judge concluded that the company was not providing accommodation in caravans; it was making zero-rated supplies of the leasing of caravans. The company had been entitled to the full amount of input tax claimed which HMRC sought to recover by assessment

The taxpayer's appeal was allowed and HMRC's dismissed.

CRC v C Jenkin & Son, [2017] UKUT 239 (TCC) Upper Tribunal

Self service coin counter

Summary –'Self-service coin kiosks,' which counted customers' coins and then issued them with a cash voucher that they could exchange for cash or set it off against their supermarket bill was an exempt financial supply.

Coinstar Ltd provided kiosks in major supermarket into which customers would place their loose change for counting. In return for a 9.9% fee, the machine counted the coins, issuing a voucher that the customer could exchange at the supermarket for cash or have it set off against their supermarket bill.

Third parties emptied the kiosks and then reconciled the amounts with Coinstar's internal accounts and deposited the coins into Coinstars bank accounts.

Under its separate agreement with the supermarket, Coinstar Ltd was obliged to pay the supermarket the face value of the vouchers presented to it.

HMRC had previously informed Coinstar that it considered its services to be exempt financial services. However, in July 2015, HMRC informed them that they were supplying taxable coin counting services.

The First Tier Tribunal decided that Coinstar Ltd had made a single overarching supply which was an exempt financial supply within Item 1, Group 5 , Schedule 9 VATA 1994. This gave exemption for the 'issue, transfer or receipt of, or any dealing with, money, any security for money or any note or order for the payment of money'.

The Tribunal held that a customer would not pay a 9.9% commission just to have their coins counted and returned. The service provided by Coinstar Ltd was to issue of a more convenient and functional form of money, namely the voucher. Payment of the commission entitled them to a voucher to spend.

HMRC appealed.

Decision

The Upper Tribunal concluded that the First Tier Tribunal had not failed to take account of the contractual arrangements between Coinstar Ltd and its customers. They had taken account of all evidence before tem and had reached their conclusion as to the economic reality of the transaction on the basis of that evidence.

The nature of a supply takes into account the essential features and purpose of a transaction as well as the commercial reality. The Tribunal's conclusion had been correct. Issuing the voucher was the main aim of the transaction but to do so the coins needed to be counted.

The appeal was dismissed.

Revenue and Customs Commissioners v Coinstar Ltd ([2017] UKUT 256 (TCC)

Non-compliance by overseas sellers

When overseas businesses sell goods that are in the UK, regardless of the level of sales, they must register and account for VAT on their sales. However, many sellers are not VAT registered or where they are, they do not always account for the correct amount of VAT.

HMRC is considering a new measure called a split payment model that will result in VAT being accounted for in real time using the latest card payment technology and then paid over to HMRC.

Alan McLintock, Chair of CIOT's Indirect Taxes Sub-committee, said:

> "HMRC should continue to engage with the tax profession and other stakeholders on this measure so that the many unanswered questions about this radical change can be addressed before legislation is drafted.
>
> "While split payment might accelerate and secure the payment of tax to HMRC, thus reducing non-compliance, it will inevitably bring complexity for businesses, payment handlers, advisers and indeed HMRC. While the CIOT supports in principle ensuring the correct tax is paid, it is vital that these complexities, and costs are fully understood before the split payment method is progressed by HMRC, to ensure that the benefits significantly outweigh the costs."

Supply of emergency ambulance services

Summary – The supply of ambulance services qualified as both exempt and zero rated and so, in accordance with s30 VATA 1994, the supply was zero rated.

Jigsaw Medical Services Ltd was incorporated on 24 February 2012 and had been registered for VAT from 1 April 2012. Its intended activities at the time of registration were stated to be First Aid training, event medical cover and ambulance services.

In December 2015, Jigsaw informed HMRC that it had taken on a large contract with the NHS to provide ambulance services and had therefore purchased a number of vehicles to supply these intended services.

The vehicles that were bought needed to be adapted to lawfully transport persons in wheelchairs and Jigsaw argued could be adapted for the lawful carriage of ten or more persons.

As such their supplies were zero rated supplies within Item 4 and importantly Note 4D of Group 8, Sch 8 VATA 1994 that states that Item 4(a) includes the transport of passengers in a vehicle -

(a) Which is designed, or substantially and permanently adapted, for the safe carriage of a person in a wheelchair or two or more such persons, and

(b) Which, if it were not so designed or adapted, would be capable of carrying no less than 10 persons.

When Jigsaw filed its VAT return for the period to 01/2016 this showed a repayment claim of £100,954.64, which prompted a visit by HMRC to Jigsaw's premises. HMRC believed that the services were exempt services as they fell_under Item 11 "The supply of transport services for sick or injured persons in vehicles specially designed for that purpose."

It was acknowledged by both parties that, under s30(1) VATA 1994, where a supply may be either exempt or taxable, the taxable rate takes precedence. In this case this means that if the supply can be properly regarded as being both exempt and zero-rated then it is deemed to be zero- rated.

The key question therefore was whether or not the supplies complied with the provisions of Note 4D(b).

Decision

To answer this question the Tribunal needed to answer the theoretical question: if the vehicle was not designed or adapted to carry wheelchairs, would it be capable of carrying no less than 10 persons?

The Tribunal held that the correct approach was to look at the vehicle and to determine whether or not that vehicle can, without complete rebuilding, be converted into a vehicle capable of carrying ten or more persons. It was clear to them that the vehicles could be so converted. Indeed a mini-bus version of the vans was a standard product. Therefore they found that the vehicles fell within Note 4D(a) and Note 4D(b).

The Tribunal found that the services provided by Jigsaw could be both zero-rated and exempt and, in accordance with s30 VATA they are therefore zero-rated.

The appeal was allowed.

Jigsaw Medical Services Limited V HMRC (TC05986)

Choosing the correct VAT registration date (Lecture B1030 – 14.17 minutes)

Compulsory registration

In basic terms, if your taxable sales have exceeded £85,000 in the last 12 months, or you expect them to exceed this figure in the next 30 days alone, then you need to register for VAT. In the case of exceeding the £85,000 figure on a historic basis, you must register from the first day of the second month that you go over the limit. In the case of the forward looking test, you must register at the beginning of the 30 day period. And as far as deregistration is concerned, you must come out of the VAT club if you have ceased to trade and have no intention to make future supplies. And if you expect taxable sales to be less than £83,000 in the next 12 months, you can deregister on a voluntary basis.

Voluntary registration

The key point to highlight in this session is that a business can choose to register for VAT at any time if it intends to make or makes taxable supplies – and there is scope to backdate this date by up to four years.

Example 1

John is a computer consultant with only one customer, a business based in Canada. John uses the services of a UK based subcontractor who charges him VAT on his fees at 20%. John has been trading for eight years and never registered for VAT.

John has no obligation to register for VAT – his services to the Canadian business are outside the scope of UK VAT under the general B2B (business to business) rule ie the place of supply is where the customer is based. However, he could go back four years and register for VAT, which will produce an input tax windfall:

- The services of the subcontractor – the subcontractor's VAT charge is correct because this is a UK to UK service.

- Other input tax incurred in the last four years subject to normal rules.

- Pre-registration input tax – services incurred in the six months before registration and goods up to four years ago (stock and assets) as long as they were used in the business and are still owned on John's first day of VAT registration.

Note – if a business makes sales that are outside the scope of VAT but would be taxable if made to a UK based customer, then it can register for VAT and claim input tax on related costs.

Example 2

Jane bought an empty building on 1 April 2017 (no VAT on purchase price), which she intends to refurbish and trade from as a restaurant. The building works will take six months so her first taxable sale will not be made until 1 October 2017.

In this situation, Jane could register for VAT as an intending trader on 1 April 2017 to reclaim input tax on the building repair costs (and other costs). It is possible that HMRC could ask for proof of her trading intentions before issuing a VAT number eg planning consent for the use of the building as a restaurant; builder quotes; business plan etc.

Tribunal case - misunderstanding of registration rules

Mr Dhaliwal, the sole director of *Onyx of Leicester Ltd* (TC5773) did very well to win a recent case in the First-tier Tribunal about his particular VAT registration. Here are the facts of his particular case:

He applied for VAT registration on a voluntary basis on 2 January 2013, asking for an effective registration date of 1 December 2012.

However, his objective was to show "foresight in readiness to charge VAT" from 1 May 2013 ie the beginning of his new financial year (the quote is from the accountant's appeal letter). He had read that he could claim input tax on expenses for the six month period before registration so thought he could delay charging output tax on his sales for six months as well.

Needless to say, the omission of output tax for the period 1 December 2012 to 30 April 2013 was picked up by HMRC, which issued an assessment for £7,814. Mr Dhaliwal appealed on the basis that he had made a genuine error in registering for VAT too soon ie the correct date of registration should be 1 May 2013.

HMRC guidance

HMRC have clear guidance about how officers should deal with requests to amend a taxpayer's effective date of registration (EDR) – guidance note VATREG25350 in the Registration manual. There are four tests they expect a taxpayer to pass before an amendment is considered, although the note does stress that the reviewing officer should "look at each case on its own merits" and "take account of all the relevant factors." This was the problem: the tribunal judge was not happy that the reviewing officer had weighed up all the relevant factors, including the fact that there was no loss of tax to HMRC as a result of Mr Dhaliwal's confusion because any VAT he would have charged would have been reclaimed as input tax. He ordered HMRC to appoint a different reviewing officer to reconsider the facts and clearly expects HMRC to cancel the assessment and amend the date of registration to 1 May 2013.

Second case - request to backdate deregistration date

Another basic rule is that if you are a member of the VAT club and still trading, you can only cancel your registration from a current or future date ie not retrospectively. I still get accountants who are doing a set of accounts to, say, 31 March 2017, often in January 2018 when the self-assessment deadline is approaching, and note that the business turnover has fallen below the VAT threshold. Can we go back and cancel his registration on 31 March they ask? The answer is negative.

The case of *Inspired by Service Ltd* (TC5537) was unusual and was always going to result in a taxpayer defeat. The company took over a café in November 2011 and chose to register for VAT from 1 November 2011 on a voluntary basis. However, the directors thought that no VAT was payable or chargeable on sales until trading exceeded the annual VAT registration threshold, which was £77,000 at the time. So they did not submit VAT returns until problems emerged with default surcharges and central assessments being raised by HMRC. The business eventually deregistered on 12 August 2014 but one year late in July 2015, the company's advisers asked for the deregistration to be backdated to November 2011 on the basis that the company never had an obligation to register in the first place.

Defeat for taxpayer

The problem is that the company was ‘entitled to be registered’ (para 18, Sch 1, VATA1994) on a voluntary basis and had chosen this option in 2011.

The law is very clear that deregistration can only apply when an application has been received by HMRC to cancel the registration ie there is no scope to backdate the cancellation date unless the business had ceased to trade at the earlier date, which was not the case.

The tribunal report said “In my view, HMRC did not and does not have any power to cancel the appellant's registration retrospectively. Had it done so, it would have been acting in clear contravention of Paragraph 13(1) of Schedule 1 and therefore acting unlawfully”.

Conclusions

In both of the above cases, honest taxpayers made genuine mistakes about the basic rules of VAT registration, and then had to backpedal to resolve the problems they had created.

If a taxpayer makes a genuine ‘typo’ error when completing form VAT1, then HMRC will usually allow the date of registration to be amended. But apart from this situation, they usually take the view that if a taxpayer asks for a specific registration date and gets it, he should not be allowed to change his mind at a later date.

The Onyx case suggests it is worth challenging situations where a genuine misunderstanding has arisen. The lesson for Mr Dhaliwal is that he should probably have taken professional advice before applying for his registration.

The key lesson from the Inspired case is to be clear that a business dealing with the general public (ie customers unable to claim input tax) should only register for VAT on a voluntary basis in advance of the compulsory registration date if it has a lot of input tax to claim on capital expenses or if most of its sales are zero-rated as cold take away food, so it would be in a repayment situation on its VAT returns.

Contributed by Neil Warren

Exempt services linked to sport

Summary - The CJEU found that supplies of services by public bodies linked to sport and physical education were an exempt supply.

The London Borough of Ealing operates sports facilities and between 1 June 2009 and 31 August 2012, it had accounted for VAT on admissions to those facilities. In 2013, it claimed that those charges should have been exempt under the principal VAT directive art 132(1)(m). The article provides that member states may exempt certain supplies of services closely linked to sport or physical education made by non-profit making organisations.

HMRC rejected the claim under Schedule 9, Group 10, Note 3 VATA 1994.

Decision

The CJEU found that art 132(1)(m) extends without distinction to all non-profit making organisations. It added that the possibility made available to member states of excluding the exemption under art 133(d) (risk of distortions to competition) is more closely circumscribed for non-profit making organisations governed by public law than for other non-profit making organisations. This is designed to place bodies governed by public law at an advantage as compared with other bodies in relation to the exemption of supplies of services closely linked to sport or physical education.

The CJEU concluded that the exclusion from the exemption for services linked to sport or physical education provided by non-profit making organisations governed by public law was precluded by the principal VAT directive in circumstances where the exclusion did not apply to other non-profit making organisations.

London Borough of Ealing v HMRC (Case C-633/15)

Adapted from case summary in Tax Journal (21 July 2017)

Exclusion from the flat-rate scheme

Summary - the CJEU found that HMRC could not exclude farmers from the farmers' flat-rate scheme those farmers who could recover substantially more under the scheme than outside it.

Shields & Son was a farming partnership and since 2004/05, covered by the common flat-rate scheme for farmers. The amounts recovered under the scheme varied significantly after 2004/05. HMRC revoked the certificate authorising participation in the flat-rate scheme on the ground that it was recovering substantially more as a flat-rate farmer than it would have recovered if it had been registered for VAT in the normal way.

The European Parliament had relinquished the idea of full fiscal neutrality in respect of each specific flat-rate farmer in favour of overall neutrality of the scheme in respect of all farmers. It thus accepted that farmers may receive compensation which was higher or lower than the amount of input VAT that they would have been entitled to outside the flat-rate scheme.

Decision

The CJEU concluded that a farmer fulfilling the criteria for participation in the scheme can expect to have the right to access and remain in the scheme, irrespective of the actual financial results achieved in each tax year. The principal VAT directive art 296(2) does not allow member states to exclude a category of farmers defined as farmers who are found to be recovering substantially more as members of that scheme than they would recover otherwise.

Shields & Sons v HMRC (Case C-262/16)

Adapted from case summary in Tax Journal (21 July 2017)

Removal of 'use and enjoyment' for B2C mobile services outside EU

With effect from 1 November 2017, the government is to remove the ‘use and enjoyment’ rule in VAT legislation for supplies of mobile telecommunications services to non-business users when outside the EU. The place of supply for private customers using mobile phones outside the EU becomes the place where the customer lives.

Currently VAT is charged when UK consumers use their mobile phones within the EU (Place of supply is where the customer lives) but, because of the ‘use and enjoyment’ rule, not when they use them outside the EU (Place of supply is where the services is consumed).

The agreed international approach is now to tax mobile phone use in the country where the user of the phone lives which means that a ‘use and enjoyment’ rule is no longer necessary and may result in double taxation.

www.gov.uk/government/publications/vat-telecommunication-services-used-outside-the-eu