Tolley®CPD

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Personal tax

IR35 and mutuality of obligation

HMRC has published its considered response to concerns raised at the IR35 forum that the 'check employment status for tax' (CEST) online tool does not include mutuality of obligation among the factors to consider.

The reason given is because the CEST tool assumes a contract exists, or is contemplated, and the tool is designed principally to determine whether such a contract will be one of employment or self-employment. HMRC's uses case law, including the recent Pimlico Plumbers [2018] UKSC 29, to support its view that mutuality of obligation is required for a contract to exist and must therefore already have been established.

SAYE temporary postponement of contributions

The Autumn Statement 2017 announced an extension to the SAYE savings holiday for employees from 6 to 12 months without causing the savings contract to be cancelled.

From 1 September 2018:

- All employees with a savings contract in place on 1 September 2018 can delay the payment of monthly contributions on a maximum of 12 occasions over the life span of the savings contract;

- If the employee has already delayed the payment of contributions on 6 occasions, they can only delay payments on a further 6 occasions. They cannot delay payments on a further 12 occasions;

- From 1 September 2018 the maximum number of months an employee can delay payments over the lifespan of their SAYE contract is 12 months in total.

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

The Scottish rates of income tax (Lecture P1086 – 16.24 minutes)

Introduction

When the new devolved Scottish Parliament was set up in 1999, it was given the power to set different income tax rates to those which would apply in the rest of the UK.

Following the Scotland Act 2016, the Scottish Parliament now has full control over income tax rates and bands via the Scottish Rate of Income Tax (SRIT). The Scottish Government has power to vary the basic rate, higher rate and additional rate of income tax for non-savings income. The SRIT rates accordingly apply to non-savings income only – i.e., employment income, rental income, certain trust income and pension income. They do not apply to savings and dividend income.

The Scottish Parliament has no power to or alter, create or abolish income tax reliefs or change the personal allowance (these remains reserved by the UK Government).

Tax receipts from the SRIT are collected by HMRC and paid to the Scottish Government.

Definition of a Scottish Taxpayer

Scottish rates are paid by “Scottish Taxpayers”.

Only individuals can be Scottish Taxpayers so the rules do not extend to trusts or estates in administration, all of whose income will continue to be taxed at UK rates.

To be a Scottish taxpayer, an individual must be resident in the UK for tax purposes. An individual who is non-UK resident cannot be a Scottish Taxpayer. Non-UK residents who pay income tax on UK source income will therefore pay at the normal UK rates (even if they are domiciled in Scotland or the income arises from a Scottish source).

A UK resident individual will be a Scottish taxpayer for a tax year if they have a “close connection” to Scotland. “Close connection” is determined by one’s “place of residence”. An individual has a close connection to Scotland if:

- They have one single place of residence which is in Scotland; or
- They have more than one place of residence in the UK but their ‘main place of residence’ is in Scotland.

A place of residence means a place used by the individual with a sufficient degree of regularity and permanence that would lead a reasonable onlooker, with knowledge of the material facts, to consider that to be the place in which that person habitually lives. This definition bears a similarity to that used by HMRC in the “home” test of the SRT. So in other words, one’s main place of residence is one’s “home”.

This means that an English person living in Dumfries but working in Carlisle would be a Scottish Taxpayer whereas a Scottish person living in Northumberland but working in Edinburgh would not.

That residence does not have to be owned by the individual. A property which is let (and not available to use) cannot be a place of residence. Neither is a holiday home which is used occasionally.

If an individual changes residences part way through the tax year, his close connection will be determined as a question of fact typically by looking at the time he has spent during the tax year at each of those residences. So, an individual living in England who then moved to Glasgow in July 2018 would have spent more time at his Scottish residence in 2018/19 than his English one. He would therefore be a Scottish Taxpayer in 2018/19. There is no provision for the Scottish rates to apply for part of a tax year. [Although PAYE could already have been applied in the early part of the year at the UK rates thereby leading to a potentially under/over payment at the year-end.]

An individual must tell HMRC if they move address to or from Scotland. In this case the new rate will be backdated to the start of the tax year in which they moved.

Where a taxpayer has two residences in the UK at the same time and one is in Scotland, the main place of residence is determined as a question of fact. There is no election. The main place of residence is the place with which the individual has the greatest degree of connection. This may not always be the residence where the individual spends most of their time.

Factors to consider in determining the main place of residence include (but are not limited to):

- The place where the individual's family (spouses, children etc) spend their time;
- Where the children go to school;
- The address used for main correspondence;
- Where most of the individual's possessions are kept;
- The place which is the centre of the individual's social life;
- The place the individual is registered to vote / has a doctor or dentist etc.

For example, assume that Kevin has a house in Glasgow but works in Manchester. He rents a flat in Manchester and works in Manchester from Monday to Thursday. On Thursday night he gets the train back to Glasgow, works at home on Friday, spends the weekend in Glasgow then gets the train back to Manchester on Sunday night. His wife and family live in Glasgow and the children go to school in Glasgow. He is registered to vote in Glasgow.

In this case even though Kevin spends more than half his week in England, his main place of residence will be in Scotland so he will be a Scottish Taxpayer.

If a UK resident individual does not have a place of residence (which is unusual), to determine whether he is a Scottish Taxpayer we compare the amount of days spent in Scotland to the amount of days spent in other parts of the UK. The 'midnight rule' applies when counting days.

Scottish Members of Parliament (or Members of the European Parliament representing a Scottish constituency) are always Scottish Taxpayers regardless of the place of residence rules. The reverse is true of Westminster MPs.

Scottish rates

In 2017/18, the only notable difference between Scotland and the rest of the UK was that the higher rate limit in Scotland was frozen at £31,500 (it was £33,500 for the rest of the UK). Middle earners in Scotland therefore paid slightly more income tax than their English counterparts. The additional rate limit was as for the UK (£150,000).

The position for 2018/19 is far more complicated. There are five Scottish income tax bands in force from 2018/19 onwards (again only applying to non-savings income of Scottish Taxpayers with savings and dividend income remaining taxable at UK rates and bands). These changes are expected to increase the overall tax contribution by Scottish Taxpayers by around £220 million.

These new Scottish bands are:

Name of the tax band	Tax band	Tax rate
Starter rate	£1 – £2,000	19%
Basic rate	£2,001 – £12,150	20%
Intermediate rate	£12,151 – £31,580	21%
Higher rate	£31,581 – £150,000	41%
Top rate	> £150,000	46%

The income tax higher rate threshold for Scottish Taxpayers (after personal allowances) will therefore be £43,430 in 2018/19 (compared to the UK higher rate threshold of £46,350).

The Scottish Government's calculations indicate that individuals with taxable income (above the personal allowance) under £33,000 will pay less income tax in 2018/19 than they did in 2017/18. 30% of Scottish Taxpayers will pay more income tax in 2018/19 than they did in 2017/18.

Due to a combination of higher tax rates and a lower basic rate threshold, taxpayers with total income of over £26,000 in 2018/19 will pay more tax if they live in Scotland than elsewhere in the UK. Very low earners will benefit.

All payrolls must operate the Scottish rates of income tax for Scottish Taxpayers, regardless of where the employer is based. This means that an English business would have to apply Scottish rates to an employee who lives in Scotland. HMRC issue PAYE codes with an 'S' suffix for individuals believed to be Scottish taxpayers. The PAYE system has been amended to incorporate new tax codes for Scottish Taxpayers, such as extra 'D' codes (SD0, SD1, SD2 etc.) to reflect the new five-band system.

The online SA return contains a tick-box for taxpayers to notify HMRC if they will pay tax at Scottish rates.

Mismatches for Scottish Taxpayers

There are a number of mismatches for Scottish Taxpayers in relation to their counterparts in other parts of the UK.

Interest income and dividend income:

The income tax rates and thresholds for interest and dividend income of Scottish Taxpayers are the same as for taxpayers in the rest of the UK. This means that the starting rate for savings, the savings nil rate band and the dividend nil rate band are all available for Scottish Taxpayers. Scottish Taxpayers could therefore be higher rate taxpayers for non-savings income (at Scottish rates) but basic rate taxpayers for savings income (at UK rates).

The UK tax bands will apply to determine the amount of the savings nil rate band. For example, Scottish Taxpayers with total taxable income, after the personal allowance, of (say) £34,000, would be a Scottish higher rate taxpayer but a UK basic rate taxpayer, so the savings nil rate band (based as it is on UK rates) would be £1,000.

Benefits

If benefits are taxed on a "grossed-up" basis (either via a Taxed Award system, or under a PAYE Settlement Agreement or a tax equalisation agreement), the employer will need to consider the marginal rate of the relevant employees to ensure the amount of the benefit is grossed-up correctly. The five-band structure makes these calculations potentially very complex.

Trust income

Some trusts are opaque (e.g., discretionary trusts) while others are transparent (e.g., IIP trusts, bare trusts and settlor-interested trusts).

Income from opaque trusts is treated as non-savings income and will therefore be fully taxed at the Scottish rates.

Income from transparent trusts retains its character in the hands of the beneficiaries. So non-savings income received from (say) an IIP trust would be taxed at Scottish rates whilst savings and dividend income from the trust would be taxed at UK rates. The same applies to income distributions from estates in administration. This could mean that a single income distribution from an estate could be taxed at 9 different rates – 4 Scottish rates and 5 UK rates. Someone should tell the Office of Tax Simplification.

Income distributions should be certified by the Trustees on the form R185 given to the beneficiary and Trustees should ensure that the income is properly and correctly separated.

Partnership / LLP income

Under tax law, a partnership itself is not taxed on its profits. Instead the individual partners are taxed on their share of the partnership income. The same is true of LLPs.

Partnership / LLP income is non-savings income so the allocated partnership profits of Scottish Taxpayers will be taxable at Scottish rates of income tax. The fact that a partnership is a legal entity in Scotland but not in England is irrelevant here.

This means that a partner who lives in Scotland will pay income tax at different rates to his/her English partners. Remember that the rates are determined by the main residence of the partner (not the business address of the partnership).

Capital gains tax

The CGT rate depends on the remaining basic rate band for income tax. As CGT is reserved by the UK Government, the higher rate threshold for CGT for Scottish Taxpayers continues to be aligned with the higher rate threshold for the rest of the UK. Therefore, it is possible to be a higher rate taxpayer in Scotland but to still have some basic rate band remaining for the purposes of calculating CGT.

Class 1 and Class 4 NICs

NICs are not devolved. The upper earnings limit for Class 1 and the upper profits limit for Class 4 are therefore aligned with the higher rate threshold that applies in the rest of the UK. Therefore, employed Scottish Taxpayers will face a marginal rate of 53% on earnings between £43,431 and £46,350 (being the Scottish higher rate of 41% plus the Class 1 primary rate of 12%). The marginal rate for the self-employed at this profits level will be 50% (being the Scottish higher rate of 41% plus the Class 4 main rate of 9%).

Contributions to personal pension schemes

These continue to be paid net of 20% basic rate tax with tax relief given to higher rate taxpayers by extending the basic rate band. The Scottish basic rate remains at 20% in 2018/19, so the relief at source rules should not be affected. However, for Scottish Taxpayers paying tax at a rate above 20%, the relevant tax bands (i.e., the basic rate, intermediate rate and higher rate bands) need to be extended by the gross pension contribution. The Scottish starter rate (19%) is not extended as this rate is lower than the Scottish basic rate.

As Scottish rates only apply to non-savings income, the UK basic rate threshold may also need to be extended to determine the rates which apply to savings and dividend income.

Scottish Taxpayers earning over £24,000 (personal allowance £11,850 plus basic rate band £12,150) will need to claim any extra relief to which they are entitled either via their SA return, their Personal Tax Account, or by telephone or post. For those in the intermediate rate (21%) band, this will mean claiming an extra 1% tax relief (which many might not bother with).

Donations to charity under Gift Aid

These are deemed to be paid net of 20% basic rate tax, with higher rate relief given by extending the basic rate band (and in the case of Scottish Taxpayers, the intermediate rate and higher rate bands). This will mean that unless the Scottish donor is a basic rate taxpayer (with taxable income falling into a narrow band between £2,000 and £12,150), the relief at source will not match the relief entitlement.

Where the taxpayer has not paid sufficient tax to cover the relief at source, this is collected via a tax charge under Self-Assessment. This has the unfortunate consequence that Scottish Taxpayers paying tax at the starter rate of 19% who make Gift Aid donations may find themselves needing to complete a Tax Return to pay over the 1% difference! It is hoped that HMRC would take a common-sense view on this in view of the amounts involved.

As with personal pension contributions, anyone paying tax at a rate above 20% will need to extend the relevant tax bands to obtain marginal rate relief thereby increasing the number of people who will need to complete a Tax Return. Again, many in the intermediate band will simply not bother.

The Transferrable Marriage Allowance

Where the necessary conditions are met, the Marriage Allowance allows taxpayers to transfer 10% of their personal allowance to their spouse/civil partner, who then receives a tax reduction equal to 20% of the transferred amount.

The Marriage Allowance is not available to non-Scottish taxpayers where either partner pays tax at a rate other than the basic rate (or the dividend ordinary rate).

However, for Scottish taxpayers, an election for the Marriage Allowance can still be made where one of the partners pays tax at the intermediate rate of 21% (as well as the starter rate of 19% and the basic rate of 20%).

Setting-off reliefs

A Scottish Taxpayer is likely to have income subject to various different rates of tax. Where a taxpayer is entitled to claim a relief by way of a deduction against income, he can choose the relief method that results in the highest reduction of tax.

Although Scottish Taxpayers now have more bands – and by definition more choice – the principle remains unaltered and a claim for relief against income subject to a 21% Scottish rate will be more beneficial than a deduction against income liable to a 20% UK rate.

Conclusions

The five-tier structure of rate bands seems to have been designed by the Scottish Government such that it can be easily manipulated in future to make the regime more progressive (for example by increasing the Starter Rate band at the expense of squeezing the basic, intermediate or higher rate bands). It could also signal a move to increase higher tax rates in small increments (although unsurprisingly this has not been either stated as a policy or ruled-out).

From a Scottish Taxpayer's perspective, an extra tax burden has been placed on the shoulders of higher earners, but at the moment this is pitched at a level which the politicians in Scotland believe is unlikely to trigger significant behavioural changes such as incorporation or emigration (either to England or elsewhere). It might however affect the decision of overseas assignees to the UK who – if they are a higher earner who is not tax equalised – may decide against living and working in Scotland. It could also have an effect on the recruitment of well-paid workers.

What is certain is that tax practitioners will find their Scottish clients' income tax increasingly difficult to deal with and those who companies which produce our tax software will have some nasty programming headaches to look forward to. Checking these calculations by hand before advising Scottish clients of their liabilities (and checking any sent to us by HMRC who have a habit of taking at least a year to get these things right) will be recommended.

Contributed by Steve Sanders

Scottish taxpayers' income tax examples (Lecture P1087 – 9.25 minutes)

Here are 4 numerical illustrations to show how the new Scottish rates will work.

Illustration 1

Kirsty is a Scottish Taxpayer. In 2018/19 she received the following income:

	£
Salary from job in Dundee	42,000
Rental profit from flat in England	2,500
Interest from Bank of Scotland	1,250
Dividends on UK share portfolio	8,000

Kirsty's income tax liability for 2018/19 is:

		Non-savings	Interest	Dividends
		£	£	£
Earnings		42,000		
Rental profit (N1)		2,500		
Interest			1,250	
Dividends				8,000
Total income		44,500	1,250	8,000
Less: Personal Allowance		(11,850)		
		32,650	1,250	8,000
Tax:				
2,000	@ 19%			380
10,150	@ 20%			2,030
12,150				
19,430	@ 21%			4,080
31,580				
1,070	@ 41%			439
32,650				
500	@ Nil			0
750	@ 20%			150
600	@ Nil			
34,500	(N2)			
1,400	@ Nil			0
6,000	@ 32.5			1,950
41,900	Tax liability			9,029

Note:

N1: Even though the rental profits arise from the letting of land outside Scotland, Scottish rates still apply as this is non-savings income received by a Scottish Taxpayer.

N2: When calculating tax on savings and dividend income, we use the UK basic rate threshold of £34,500. Therefore even though the non-savings income is above the Scottish higher rate threshold (leaving Kirsty liable to Scottish higher rate tax), she still has some of her UK basic rate band remaining to use against her savings income.

Illustration 2

Assume in Illustration 1 above that Kirsty makes personal pension contributions of £300 per month (net) in 2018/19.

Pension contributions are made net of basic rate tax (20%) so the gross contributions in 2018/19 will be £300 x 12 x 100/80 = £4,500.

Higher rate relief for pension contributions is given by extending the relevant Scottish bands as follows:

	Basic rate	Intermediate rate
	£	£
Scottish limit	12,150	31,580
Add: Gross pension contribution	4,500	4,500
Revised limit	16,650	36,080

The UK basic rate band will also need to be extended for the purpose of taxing savings and dividend income (where Scottish rates do not apply):

	£
UK basic rate threshold	34,500
Add: Gross pension contribution	4,500
Revised limit	39,000

Kirsty's tax liability is therefore:

	Non-savings	Interest	Dividends
	£	£	£
Total income	44,500	1,250	8,000
Less: Personal Allowance	(11,850)		
Taxable income	32,650	1,250	8,000

2,000	@ 19%		380
14,650	@ 20%		2,930
16,650			
16,000	@ 21%		3,360
32,650			
500	@ Nil		0
750	@ 20%		150
2,000	@ Nil		0
3,100	@ 7.5%		232
39,000			
2,900	@ 32.5%		942
41,900		Tax liability	7,994

Illustration 3

Robert is a Scottish Taxpayer. In 2018/19 he received the following income / gains:

	£
Self-employed profits	35,000
Rental profits	1,000
Interest on RBS Account	1,250
Capital gain on sale of buy-to-let property	25,000

Robert's tax liability is therefore:

		Non-savings	Interest
		£	£
Self-employed profits		35,000	1,250
Rental profits		1,000	
Total income		36,000	
Less: Personal Allowance		(11,850)	
Taxable income		24,150	1,250
2,000	@ 19%		380
10,150	@ 20%		2,030
12,150			
12,000	@ 21%		2,520
24,150			
1,000	@ Nil		0
250	@ 20%		50
25,400	Income tax		4,980
Capital gain		25,000	
Less: Annual exemption		(11,700)	
Taxable gain		13,300	
(34,500 – 25,400) = 9,100 @ 18%		1,638	
(13,300 – 9,100) = 4,200 @ 28%		1,176	
CGT due			2,814
TOTAL TAX LIABILITY			7,794

Note: UK basic rate threshold of £34,500 is used to calculate the basic rate band remaining for CGT.

Illustration 4

Shirley (aged 50) is a partner in a livery business. The practice is based in Castle Heaton in Northumberland but Shirley and her family live on a farm near Kelso in Scotland and Shirley commutes daily. Shirley's allocated partnership profits for 2018/19 were £13,650. She had taken out a loan to buy into the partnership and interest of £500 was paid on the loan in 2018/19.

Shirley's father died in March 2017 and the estate was finally administered in September 2018 at which point Shirley received an income distribution of £26,500 certified as follows:

R185 (Estate Income):	Net	Tax
	£	£
Interest income	8,000	2,000
Dividend income	18,500	1,500
	26,500	3,500

Shirley's only other income is £2,400 of interest on a joint bank account with her husband Duncan.

Shirley is a Scottish Taxpayer as she lives in Scotland. She will only be liable to the Scottish rate of income tax on her partnership profits as this is her only source of non-savings income.

Her tax liability for 2018/19 will therefore be as follows:

	Non-savings	Interest	Dividends
	£	£	£
Partnership profits	13,650		
Building society interest (x 50%)		1,200	
Estate interest (8,000 x 100/80)		10,000	
Estate dividends (18,500 x 100/92.5)			20,000
	13,650	11,200	20,000
Less: Loan interest (S.398 ITA 2007)	(500)		
Total income	13,150	11,200	20,000
Less: Personal Allowance	(11,850)		
Taxable income	1,300	11,200	20,000

Tax:		Notes:	
1,300	@ 19%		247
3,700	@ 0%	N1	0
1,000	@ 0%	N2	0
6,500	@ 20%		1,300
2,000	@ Nil	N3	0
18,000	@ 7.5%		1,350
32,500		Income Tax liability	2,897
		Class 4 NIC: (13,650 – 8,164) @ 9%	494
		Total tax & NIC liability	3,391
		Less: Tax credits on estate income	(3,500)
		Repayment due	(109)

Notes:

N1: A 0% starting rate applies where taxable non-savings income is less than £5,000. In this case £3,700 of the starting rate band is available against the interest income. Note here that by allocating the loan interest payment and the personal allowance fully against the non-savings income, we are increasing the amount of the 0% starting rate band which can then be released against the interest income and which would otherwise be taxed at 20%.

This gives a better result than allocating some of the loan interest payment or the PA against savings income. [Again, programming these idiosyncrasies into a software package is likely to be difficult!].

N2: The savings nil band is £1,000 as Shirley does not pay tax at the UK higher rate. Note here that we use the UK higher rate threshold (£34,500) to determine whether Shirley pays at the higher rate, not the Scottish higher rate threshold of £31,580.

N3: The dividend nil band is available as Shirley is treated as receiving dividend income from the estate (which is transparent for tax purposes).

Contributed by Steve Sanders

Using venture capital reliefs **(Lecture P10188 – 11.56 minutes)**

Over recent years, restrictions on the tax reliefs for pension contributions have meant that more and more high net worth individuals have started looking at venture capital investments as an alternative to the hitherto conventional forms of provision for retirement.

The purpose of this article is to outline the main tax attractions of three venture capital reliefs, viz:

- the Enterprise Investment Scheme (EIS);
- the Seed Enterprise Investment Scheme (SEIS); and
- Venture Capital Trusts (VCTs)

The EIS legislation, which has been available for many years, offers significant tax incentives to investors in the unquoted trading companies that qualify. These will typically be young high-risk businesses. It should be emphasised that there are stringent conditions associated with this and the other venture capital reliefs. In summary, the principal EIS tax benefits are:

- income tax relief of up to 30% of the amount invested;
- no CGT if EIS shares are disposed of at a profit after three years;
- a form of CGT deferral which allows investors to hold over gains on any kind of chargeable asset against subscriptions in EIS shares;
- losses on EIS shares may be eligible for income tax relief under S131 ITA 2007; and
- EIS investments should attract 100% business relief under IHT after two years of ownership.

The SEIS regime was introduced in FA 2012 as a special relief to encourage investment in new start-up companies. The rules are largely based on the EIS and contain many of the same features.

As far as the SEIS is concerned, the key differences in the reliefs available are:

- an income tax reduction of 50%, regardless of the investor's marginal income tax rate; and

- gains arising on the disposal of any kind of chargeable asset can be exempted from CGT (up to a maximum of one half of the SEIS investment) by virtue of a targeted reinvestment relief.

This means that an investor could receive 50% income tax relief and 10% CGT relief (i.e. ½ x 20%) on a £100,000 SEIS investment, reducing his net cost to just £40,000. However, while the SEIS reliefs may appear to be more attractive in percentage terms, the overall amount of relief available is substantially less, given that the maximum SEIS investment in any one tax year is limited to £100,000. On the other hand, with an annual limit of £1,000,000, which can rise to £2,000,000 for 2018/19 onwards if investments are made in 'knowledge-intensive' companies, £600,000 of relief is potentially available through the EIS.

The background rationale for the introduction of VCTs has been explained as follows:

> 'To overcome the expected difficulty of some investors meeting the conditions for relief under the EIS, an investment vehicle similar to an investment trust (known as a VCT) was devised in 1994. An individual investor can acquire shares in a VCT whose professional managers will use the funds to make and manage investments in a range of unquoted companies.'

A VCT is a quoted company that has been approved as such by HMRC. There are currently three forms of tax relief available to an investor in a VCT:

- an investment relief, given by way of a 30% income tax reduction, can be claimed on the amount subscribed for new shares in a VCT, up to a maximum of £200,000 per tax year;

- a dividend relief provides an exemption from income tax on dividends received from shares in a VCT (it should be noted that this relief applies to shares acquired by purchase as well as by subscription, provided that the annual value limit of £200,000 was not exceeded); and

- disposals of shares in a VCT which qualified for investment relief are CGT exempt.

As a final point, it should be borne in mind that investment relief can be clawed back in whole or part if VCT shares are disposed of within five years.

Contributed by Robert Jamieson

Minimum investment under the SEIS

Summary – When investing under the seed enterprise investment scheme no minimum investment is required.

Oxbotica Ltd was founded to 'spin out' technology from Oxford University's department of engineering. Under a licence granted by the university, the company was to develop and distribute 'highly innovative products' invented by university professors. The company applied for Seed Enterprise Investment Scheme compliance certificates for the issue of shares to three professors.

HMRC refused the claim stating that to be eligible, subscriber shares must be fully paid for in cash by the time they are issued. They later accepted that the shares had been issued as fully paid but still denied the certificates on the basis that the amount raised by the company on subscription, £316, was not 'enough to be of meaningful use to the company in its business'. HMRC accepted that there was no statutory minimum investment under the SEIS legislation but maintained that the purpose of the legislation was to encourage crowd funding and that Parliament could not have envisaged a share issue for £316.

The issue was therefore whether the shares issued to the three professors had been issued 'in order to raise money for the qualifying business carried on, or to be carried on, by the company' (ITA 2007 s 257CB).

Decision

The First Tier Tribunal observed:

> 'What really lay at the heart of the present case was HMRC's belief that the reason for the share issue was to derive a CGT advantage.'

It added that the statutory provisions for SEIS are highly prescriptive and almost formulaic in their application and that Parliament had chosen not to impose a minimum level of investment. In this context, to add a requirement that the level of investment should be 'meaningful' opened up 'impossible uncertainty'.

HMRC's case failed.

Oxbotica Ltd v HMRC (TC06538)

Adapted from Tax Journal case summary (13 July 2018)

EIS and VCT changes

The EC has notified its decision to approve the changes that were announced at Autumn Budget 2017 and are contained in FA 2018 s 14 and Schs 4 and 5 which include:

- certain 'grandfathering' provisions enabling VCTs to invest in companies under rules in place at the time funds were raised will be removed from 6 April 2018;
- from 6 April 2018, 30% of funds raised by a VCT in an accounting period must be invested in qualifying holdings no later than 12 months after the end of that period;

- for accounting periods beginning on or after 6 April 2019, the proportion of VCT funds that must be held in qualifying holdings will increase from 70% to 80%; and

- a new anti-abuse rule is introduced from royal assent to FA 2018 (15 March 2018), to prevent loans being used to preserve and return equity capital to investors.

To encourage investment in knowledge intensive companies under the EIS and VCT schemes:

- the limit on the amount an individual may invest under the EIS in a tax year is doubled to £2m, provided any amount over £1m is invested in one or more knowledge intensive companies;

- the annual investment limit for knowledge intensive companies receiving investments under the EIS and from VCTs is doubled to £10m (but the lifetime limit will remain at £20m); and

- greater flexibility will be provided when determining whether a knowledge intensive company meets the permitted maximum age requirement.

These changes apply to EIS shares issued on or after 6 April 2018 and to qualifying investments made by a VCT on or after that date.

The state aid approval is valid until 5 April 2025.

http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_49923

Capital Taxes

CGT exemption when no EIS income tax relief claimed

Summary – HMRC were correct to deny CGT exemption on shares where no EIS income tax relief had been claimed but the decision not to allow the taxpayer's late claim for EIS income tax relief had been flawed as they had misapplied HMRC guidance.

In January 2005, Robert Ames invested £50,000 in shares in a qualifying EIS company but, because his taxable income was covered by his personal allowance, he did not claim EIS income tax relief.

Some 6 years later, he sold his shares for £333,200, submitted his tax return, made a late claim for EIS income tax relief. As a result of this claim, he did not include any gain in relation to the shares because he believed that the gain was now exempt from CGT.

HMRC opened an enquiry into Mr Ames tax return, believing that he was only entitled to CGT exemption if he had obtained EIS income tax relief on the acquisition of the shares. His claim for this relief was late and so he was liable for CGT on the gain.

Mr Ames appealed the amendment to his return. The Tribunal found that it did not have jurisdiction to allow the taxpayer to make a late claim for EIS income tax relief and held that the CGT exemption depended on there having been a valid claim for EIS income tax relief The legislation could not be interpreted to exempt the gain even in a case where no liability to income tax had arisen.

Mr Ames asked HMRC that his request for a late claim for EIS relief be reconsidered on the ground that he had had a reasonable excuse including his unfortunate personal circumstances during and after the tax year in question and the medical treatment that he had undergone.

HMRC's response was to refuse the taxpayer's request, stating that that HMRC's officer had given incorrect information at the hearing and that reasonable excuse was not something that HMRC considered when deciding whether to accept late claims. HMRC's decision letter referred to HMRC's care and management powers under CRCA 2005 s 5 Act and that those permitted it to consider, in exceptional circumstances, whether late applications could be accepted. In making that decision, HMRC considered Guidance Note SACM10040, which contained points one, two and three. The decision maker considered that the three exceptional circumstances justifying admission of a late claim were limited to those three cases. However, that Guidance stated that there were exceptional cases that did not meet those conditions and were not covered by guidance concerning the particular claim or election where it might still be unreasonable for HMRC to refuse a late claim or election. HMRC wrote to the taxpayer informing him that it had decided to refuse his request to admit his late claim.

Mr Ames appealed against the Tribunal's decision and applied for judicial review of HMRC's refusal to allow his late claim for EIS income tax relief. In summary, his case was that the decision maker's methodology was flawed, and in the alternative, that the decision was irrational and/or conspicuously unfair.

Decision

The language of S150A(2) was clear and 'an amount of relief is attributable' meant that, at the time that the CGT exemption was claimed, a claim for EIS income tax relief had to have been made and given effect. In the absence of a claim for EIS income tax relief, the individual had no right to the CGT exemption on any subsequent disposal of the shares. It could not be considered that 'attributable' could be interpreted as 'available but not claimed'. Had that been the draftsman's intention then s 150A(2) and s 150A(11) would have been worded differently and s 150A(3) would have been unnecessary .

It was clear that HMRC had wrongly fettered their discretion, by treating the relevant Guidance as if it comprised only points one to three. As a result, there was no consideration of whether Mr Ames' case was an exceptional case that did not fall within points one to four, but where it might still be unreasonable for HMRC to refuse a late claim. Accordingly, the decision-making process had been flawed. However, there would not be a declaration that the decision had been irrational.

The First Tier Tribunal's decision was dismissed and HMRC's decision to refuse the taxpayer's late claim would be remitted to HMRC for re-consideration.

Robert Ames v HMRC [2018] UKUT 0190 TCC

Property in need of up-dating

Summary – The property sold had not been the taxpayer's 'only or main residence' and so the gain was chargeable.

Patricia Lam and her husband lived in a rented property in London. In August 2011, she bought a property in Hertfordshire for £265,000 that needed up-dating but habitable. In January 2012, she received planning permission for a single storey rear extension and roof alterations to accommodate two upstairs bedrooms.

Between August and December the couple said that they lived in the property, sleeping in sleeping bags, five days a week to get 'a feel for the place' before deciding how to renovate it. They returned to London at weekends to be with their children.

In mid December, bad weather damaged to the roof and the property had been flooded when a water pipe in the loft, causing a ceiling to collapse. The property became unsafe and uninhabitable. The couple moved out and applied for empty property relief.

Building work commenced in early March 2012 and was completed in March 2013. The property was sold for £410.000.

The issue in this case was whether the property had become her main residence with their occupation showing a degree of permanence and expectation of continuity.

HMRC concluded that, although initially the couple had intended to occupy the property as their main private residence, the few nights that the couple had spent in the unfurnished property did not constitute occupation of the property as a residence within the meaning of Ss222 – 224 TCGA 1992. Capital gains tax was payable. The review officer had reduced the penalty from 'deliberate' based on 52.5% of the culpable tax, to 'careless' based on 20.5% of the culpable tax.

Patricia Lam appealed the review conclusion to the First-tier Tribunal.

On the facts presented, the First Tier Tribunal concluded that the property had not been the taxpayer's 'only or main residence' (s222(1)(a) TCGA 1992. There might have been some expectation of continuity of residence, but that had been subject to the couple getting a feel for the property and the neighbourhood. The aspirations to make the property their new home had never been realised.

The Tribunal agreed with HMRC that Patricia Lam had acted carelessly when she had failed to declare the capital gain arising on the disposal of the property. It was accepted that it had been a simple error, arising out of her mistaken belief that the property had become her principal private residence. However given the very brief period of her occupation of the property, that belief had not been based on considered reasoning and had amounted to carelessness.

The taxpayer's appeals were dismissed.

Patricia Lam v HMRC (TC06540)

Entrepreneurs' relief and dilution **(Lecture P1089 – 21.35 minutes)**

Gains made on the disposal of shares may attract the 10% rate of CGT under entrepreneurs' relief, provided that the following conditions are met by the claimant and his company throughout the 12-month period prior to the disposal:

- the claimant held at least 5% of the company's ordinary share capital;
- the claimant was able to exercise at least 5% of the company's voting rights;
- the company was a trading company or the holding company of a trading group; and
- the claimant was an officer or employee of the company (or of another company which was a member of the trading group).

In his Budget Speech on 22 November 2017, the Chancellor announced that changes would be made to these entrepreneurs' relief rules so as to ensure that owner managers are not discouraged from seeking external investment to finance business growth in circumstances where their own shareholding may become diluted.

Following the Spring Statement on 13 March 2018, a detailed HMRC consultative document ('Allowing Entrepreneurs' Relief On Gains Before Dilution') was published. This seeks views on a new process outlined by the Government by which individuals may remain entitled to claim entrepreneurs' relief on share gains relating to a time before their shareholding fell below the critical 5% parameter, but only where the fund-raising event occurs on or after 6 April 2019.

In essence, this will be achieved through:

- a special facility which allows individuals to make an election to be treated as having disposed of and reacquired their shares at what was market value immediately prior to the dilution; and then

- permitting those individuals to defer the taxation of the resulting gain until an actual disposal (e.g. a sale) of their shares takes place.

The Government says:

> 'To ensure this extension of the relief remains targeted, the dilution of the individual's shareholding must be a consequence of an issue of shares made by the company for genuine commercial reasons.'

Individuals will be required to make the election in their tax return for the year in which the shareholding is diluted. The normal self-assessment time limit for elections will apply. This should ensure that the claimant achieves certainty of tax treatment at an early stage when important data such as valuations should be readily available.

Illustration 1

In March 2022, Steven subscribes £40,000 for 40,000 ordinary shares of £1 each in a new trading company of which he is a director. He holds 10% of the company's ordinary share capital and voting rights.

15 months later, the company raises working capital by issuing 3,600,000 ordinary shares of £1 each. Immediately prior to this issue, Steven's shares were worth £3.50 each. He does not take up any of the new shares. His proportionate interest in the company therefore falls from 10% to 1%.

If Steven had sold his shares immediately before the latest issue, he would have been able to claim entrepreneurs' relief on his gain of £100,000, which is computed as follows:

		£
Market value (40,000 @ £3.50)		140,000
Less:	Cost (40,000 @ £1.00)	(40,000)
		£100,000

Under the Government's proposals, Steven will be able to elect in his 2023/24 tax return to be treated as having made a disposal and an immediate reacquisition of the same shares at the same price. His tax return will reflect this gain and he will be entitled to claim entrepreneurs' relief in respect of the deemed disposal.

The interesting question, however, is to consider what value does one take for Steven's shares prior to the dilution. Is it the isolated minority value of a 10% holding or alternatively 10% of the value of the company as a whole (which would be the position if the company had been sold)? This decision could make a significant difference! One fears that it will be the former.

The Government appreciate that many taxpayers will not want, or indeed be able, to pay the 'dry' tax charge arising from this election and so they plan to allow individuals to make a claim to defer the accrual of such gains until the occasion of an actual disposal of the shares.

The consultative document continues:

> 'Where this claim is made, entitlement to entrepreneurs' relief on the deferred gain will be preserved so that (the relief) can be claimed under the then-current rules at the time the gain is treated as accruing. Where the individual has chosen to pay the dry tax charge at the time of the first election, subsequent losses will not be (permitted) to be set against the gain on the deemed disposal of the shares and so will not give rise to an effective repayment of tax.'

An exception would of course be if the capital loss arose in the tax year of the shareholder's death – see S62(2) TCGA 1992.

Illustration 2

If Steven in Illustration 1 does not wish to pay CGT on his 2023/24 gain of £100,000, he can claim for the accrual of the gain to be deferred. Such a claim must be made in his 2023/24 tax return or by some other legitimate means, but no later than 5 April 2028.

Illustration 3

In November 2029, Steven resigns from the company and sells his shares. By now, the shares are worth £11.80 each, i.e. his sale proceeds will be £472,000.

Steven's gain breaks down into two parts:

- The first part is his pre-dilution gain of £100,000. He is able to claim entrepreneurs' relief on this amount.

- The second part is the growth in value of his shares since that election. This works out as £11.80 – £3.50 = £8.30 x 40,000 = £332,000.

Steven's tax bill on his 2029/30 disposal will therefore be:

	£
£100,000 @ 10%	10,000
£332,000 @ 20%	66,400
	£76,400

The Government have confirmed that this new procedure will not be extended to disposals by trustees. Nor will the elective facility apply to associated disposals.

Contributed by Robert Jamieson

Offshore trusts – anti-avoidance measures (Lecture P1090 – 33.30 minutes)

Income and gains of the trustees of an offshore trust are, broadly speaking, taxable in the following four ways:

1. S86 TCGA 1992 treats gains accruing to the trustees of a settlor-interested offshore trust as being taxable on a UK-resident settlor who is domiciled or (from 6 April 2017) deemed domiciled in the UK.

2. If S86 TCGA 1992 does not apply, S87 TCGA 1992 attributes trust gains to beneficiaries to the extent that they receive one or more capital payments which can be matched with the gains.

3. Ss619 – 648 ITTOIA 2005 treat income arising to the trustees of a settlor-interested offshore trust as arising to the settlor (irrespective of whether he actually enjoys the income). Capital sums such as loans, which are paid to settlors in excess of the trustees' undistributed income, are also treated as income arising to the settlor. Where the settlor is subject to the remittance basis, any foreign source income is taxed in the year in which it is remitted.

4. Ss714 – 751 ITA 2007 apply where a person transfers assets as a result of which income becomes payable to a person abroad, e.g. the trustees of an offshore trust. This legislation deems income to arise to the transferor where that person is resident in the UK and:

   - has power to enjoy the income which belongs to the trustees; or
   - receives a capital sum from the person abroad; or
   - receives a benefit which is provided out of the transferred assets.

   The rules prevent double taxation under both the transfer of assets abroad provisions and, for example, Ss619 – 648 ITTOIA 2005. Where the remittance basis is in point for the transferor, any foreign source income is taxed in the year in which it is remitted.

Income and gains which fall into any of the provisions referred to in (1) above may not be immediately liable to UK tax where the relevant person is not resident in the UK or alternatively is a UK-resident non-UK domiciliary who is a remittance basis user. The measures in S35 and Sch 10 FA 2018, which are described below and which have effect from 6 April 2018, seek to counteract the ability to wash out such income or gains by routing payments via:

- non-UK residents; or
- UK-resident remittance basis users.

TCGA 1992 changes

Para 1(1) Sch 10 FA 2018 inserts 12 new sections (Ss87D – 87P) into TCGA 1992. The following points should be noted.

S87D TCGA 1992 disapplies the attribution and matching rules contained in Ss87 and 87A TCGA 1992 where a capital payment is made to a person who is not resident in the UK.

S87E TCGA 1992 overrides S87D TCGA 1992 to the extent that a capital payment is made to a temporary non-UK resident. In this case, the payment is treated as having been received by the beneficiary in the period of his return to the UK.

S87F TCGA 1992 modifies SS87D TCGA 1992 where:

- capital payments are received in the tax year when the offshore trust comes to an end;
- payments are made to two or more beneficiaries; and
- at least one of the recipients is a UK-resident beneficiary and at least one is not.

S87G TCGA 1992 applies if the beneficiary in receipt of the payment from the trustees is a close member of the settlor's family and the settlor is resident in the UK. Where this is the case, the capital payment rules are applied as if the payment were received by the settlor (rather than by the close family member). Where tax becomes chargeable on the settlor, the settlor can recover this sum from the beneficiary who received the capital payment. A 'close member of the settlor's family' is defined by S87H TCGA 1992 as:

- the settlor's spouse (or civil partner); or
- a minor child of the settlor, spouse or civil partner.

  Two people living together as if they were spouses (or civil partners) will be treated as spouses (or civil partners). S87H TCGA 1992 makes it clear that these rules cease to be relevant in the event of the settlor's death.

S87I TCGA 1992 provides that Ss87J and 87K TCGA 1992 apply where:

- the trustees of an offshore trust make a capital payment ('the original payment') to a person ('the original recipient');
- there is an arrangement or intention for that payment (or anything which derives from, or represents, it) to be passed on within three years ('the onward payment') to a UK resident ('the subsequent recipient'); and
- in at least one of the tax years from the year of the original payment to the year of the onward payment the original recipient (or, where S87G TCGA 1992 applies, the settlor) is either a non-UK resident or a remittance basis user.

  Where there is a series of payments via non-UK residents, the intermediate steps are ignored.

S87J TCGA 1992 is brought into play by S87I TCGA 1992. In the Tax Faculty's words, the section 'lays the groundwork for S87K TCGA 1992 by splitting the original . . . payment received by the original recipient into three slices'. The three slices are described as the:

- taxed amount (T);
- untaxed amount (U); and
- rest of the original payment (R).

In broad terms, T is the amount which is matched with the trust's stockpiled gains under S87 TCGA 1992 and taxed. U is the amount matched but which is untaxed due to being retained offshore on the remittance basis. R represents the balance of the capital payment once the above two amounts (T and U) have been calculated.

S87K TCGA 1992 is the operative section that attributes to the subsequent recipient an appropriate part of both the trust gains and the capital payment. How much is attributed to the subsequent recipient depends on the mix of T, U and R. S87K TCGA 1992 also introduces another component (G) which is the amount of the onward payment. The legislation in Ss87I – 87K TCGA 1992 is extremely complicated and S87K contains a number of formulae. A simple example is set out in below in the hope of making the position somewhat clearer.

Example

Assume that the trustees of an offshore trust make a capital payment to Alan of £200,000. Alan is a remittance basis user. This capital payment is matched with trust gains of £130,000, leaving £70,000 unmatched. Alan does not remit any part of his receipt. A few months later, Alan gifts £150,000 to Boris who is resident in the UK. The original payment is divided up as follows:

T = £0;

U = £130,000; and

R = £70,000.

When Alan makes his gift to Boris, G = £150,000. Applying the formulae in S87K(2) and (3) TCGA 1992, the legislation attributes to Boris:

£70,000 as a capital payment (this is R); and

£80,000 as trust gains (this is G – R).

Alan is left with gains of £50,000 which will be taxed if he makes a remittance to the UK.

S87L TCGA 1992 sets out the cases where the settlor is liable for tax on the onward payment, notwithstanding the fact that he is not the actual recipient.

The purpose of S87M TCGA 1992 is explained by the Tax Faculty as follows:

> ‘(This section) is designed to deal with scenarios whereby the recipient of the onward . . . payment is not the settlor, has (trust) gains or capital payments attributed under S87K TCGA 1992 and is a remittance basis user. In this case, parts of S87K TCGA 1992 are turned off and the capital payment is plugged back into S87I TCGA 1992. This is presumably to deal with chains of onward payments by UK-resident remittance basis users (as the chains dealt with by S87I(2) TCGA 1992 are only those chains involving non-UK residents).’

S87N TCGA 1992 applies if a capital payment is made to a beneficiary who was resident in the UK at the time when the payment was received, but the beneficiary then becomes non-UK resident before some, or all, of the payment is matched. The provision confirms that Ss87 and 87A TCGA 1992 are to be applied without taking into account the unmatched portion of the payment.

S87P modifies the application of S87N TCGA 1992 where a capital payment is made to a temporary non-UK resident beneficiary who returns to the UK. It confirms that Ss87 and 87A TCGA 1992 operate as if the payment was received during the beneficiary’s period of return.

Para 1(12) – (15) Sch 10 FA 2018 sets out the detailed commencement rules for all these new sections.

ITTOIA 2005 and ITA 2007 changes

For income tax purposes, there are similar adjustments to the:

- settlements anti-avoidance regime in Ss619 – 648 ITTOIA 2005; and
- transfer of assets abroad rules in Ss714 – 751 ITA 2007.

The key elements of the new legislation are Ss643A – 643N ITTOIA 2005 and Ss733B – 733E ITA 2007. The Government’s intention behind these income tax changes is to align the treatment of foreign source income with the rules that apply for CGT.

Contributed by Robert Jamieson

Residential property for SDLT

The CIOT has published the notes of a meeting it attended with HMRC and the Stamp Taxes Practitioners Group in June, summarising HMRC's view on aspects of the definition of 'residential property' for SDLT under FA 2003 s 116. Issues discussed included:

- gardens and grounds;
- when the construction/adaptation process starts;
- meaning of 'marketed for';
- relevance of legally enforceable restrictions;

- relevance of non-domestic rates/council tax;
- businesses/trades carried on at home;
- holiday lettings and relevance of planning permissions/conditions;
- derelict buildings;
- the 'six or more' rule; and
- the distinction between serviced apartments and hotels, and between assisted living units and care homes, and student accommodation.

https://www.tax.org.uk/policy-technical/technical-news/sdlt-residential-definitions-finance-act-2003-section-116-meaning-

Administration

Follower Notice and corrective action

Joseph Hutchinson took part in a tax avoidance scheme known as 'working wheels', claiming a repayment of just over £250,000. HMRC did not repay the balance but opened an enquiry into his return which resulted in Joseph Hutchinson receiving a:

- An accelerated payment notice (APN) which he paid;
- A follower notice and corrective action form requiring him to take 'corrective action' and withdraw his claim that he gave to his advisers.

HMRC issued a penalty of about 25% of the denied tax advantage (£64,162).

The taxpayer appealed saying that he had left the form to his advisers to deal with and he thought he had taken corrective action by paying the APN.

Decision

The First Tier Tribunal confirmed that Joseph Hutchinson was required to both pay the APN and submit the corrective form. To comply, he had to accept that he had been wrong to claim the tax relief and give it up. The two regimes were distinct and compliance with one did not amount to compliance with the other.

The fact that he received both notices at the same time was not 'inherently confusing' so was also not a reason. Additionally, the stress and depression that he had suffered due to personal matters was no excuse as it was clear that he had been able to continue working throughout.

However, the Tribunal judge revised the penalty to £46,205 as Mr Hutchinson had not put HMRC to the expense of an appeal, he had not defended the scheme and his failure to file the corrective action form did not 'appear to create much work for HMRC'.

The taxpayer's appeal was allowed in part.

Joseph Hutchinson v HMRC (TC06520)

Notice to file not issued by Officer of the Board

Summary – HMRC had not issued a valid 'notice to file' under section 8(1)(a) TMA 1970, the taxpayer had not failed to deliver a return under section 8(1) TMA 1970 and so no penalties were due.

Nigel Rogers has been self-employed since November 1988 and completed self-assessment returns on line for 2007/08 to 2014/15 inclusive. HMRC computer records suggest that a "notice to file" for 2015/16 was issued to Mr Rogers on 6 April 2016 at his home address.

Mr Rogers filed an electronic return for 2015/16 was received by HMRC on 23 October 2017.

- As the return was not received by the filing date, HMRC issued a notice of penalty assessment on or around 7 February 2017 for the late filing penalty of £100.

- As the return had still not been received 3 months after the penalty date, HMRC issued a notice of daily penalty assessment for the daily penalty of £900.

- As the return had still not been received 6 months after the penalty date, HMRC issued a notice of penalty assessment for the 6 month penalty of £300.

Mr Rogers appealed the penalty notices.

Decision

The First Tier Tribunal considered whether, a valid notice to file a return had been issued to Mr Rogers by an officer of the Board. If no valid notice to file had been lawfully given then there could be no failure to make or deliver a return under s8(1)(a) TMA 1970 as is required by Schedule 55. If no valid notice to file had been lawfully given, then any return submitted Mr Rogers was a voluntary return.

The Tribunal said that they would expect any notice to be signed by a named officer. The officer giving the notice needs to be identified in the notice because the return must be made and delivered to that officer.

In this case, HMRC provided:

- an extract from their computer records entitled "Return Summary" which purports to indicate that a notice to file for the tax year 2015/2016 was issued on 6 April 2016.

- an extract from HMRC's computer records indicating that a notice to file was sent to the appellant at his address as Eastlin, Summerhill Road, Wrexham; and

- a generic copy of a notice to file comprising a letter (pro forma) dated 6 April 2016 but with no addressee or signature (or indeed signature block).

There was nothing in the Statement of Case suggesting that the notice to file was given by an officer of the Board. It simply stated that a notice to file was issued. Similarly, there was nothing in the computer printouts that indicated whether an officer, and if so which officer, gave the notice to file to Mr Rogers.

The Tribunal concluded that they were being asked to speculate that an officer of the Board had issued the notice. They held that no valid 'notice to file' had been issued and so the penalties were invalidly assessed.

Nigel Rogers v HMRC (TC06542)

Auto Enrolment Update (Lecture B1088 – 15.26 minutes)

Since October 2012 all employers are required to automatically enrol employees, known as "eligible jobholders" into, and contribute towards, a qualifying pension scheme.

Initially The Pensions Regulator (TPR) contacted employers between three to twelve months before their “staging” date (the date auto enrolment applies) in order to help them prepare for the changes. From 1st October 2017 businesses taking on staff for the first time will have automatic enrolment duties from the day the employee starts work.

Who will it affect and what do they need to do?

Auto enrolment applies to all employers with one or more workers, defined as an employee or someone who has a contract to perform work or services personally, that is not undertake as part of their own business. Under auto enrolment employers will need to:

- Provide a qualifying pension scheme for “workers”;
- Automatically enrol eligible jobholders into the scheme;
- Tell all eligible jobholders they have been automatically enrolled and they have the right to opt if they want to do so;
- Pay employer contributions them into the scheme;
- Register with The Pensions Regulator and provide details of the qualifying scheme and number of employees auto enrolled.

Who can be excluded?

Self employed individuals working under a contract for services are not normally workers.

Office holders such as non-executive directors, company secretaries, trustees and board members of statutory bodies are not normally workers. They usually have no contract or service agreement, do not receive a salary but may be paid expenses or a fee to cover their services. Where the person who appears to be an office holder also has a contract of service for part of their duties they will be a worker for those duties.

One person limited companies – The Pensions Regulator Guidance 1 “Employer duties and defining the workforce” says that if an individual is a director of a company and the company has no other employees, that individual is not a worker by virtue of any office that they hold or contract of employment under which they work. The company is therefore not subject to the employer duties in relation to that individual. However, if the company takes on a second worker, and both the director and the new employee work under a contract of employment, then both will be workers for the purposes of the employer duties and the company will have responsibilities in respect of both of them. There is further guidance on the TPR website.

Employers must assess their workforce

Employers must assess all their workforce to ascertain their responsibilities for each type of worker. Employees who are working their notice out, are under notice of dismissal or have given notice of retirement can be excluded from the assessment. However employees on sick leave, long term sick leave, maternity, adoption, paternity or shared parental leave must be assessed.

There are two main categories of worker – jobholder and entitled worker. A jobholder may then be "eligible" or "non-eligible". An employer's duties apply to eligible jobholders, non-eligible jobholders and entitled workers and the duties for each are different.

A worker is a jobholder if they:

- have a contract of employment or have a contract to perform work or services personally;
- are aged between 16 and 74;
- work or ordinarily work in the UK (not Jersey, Guernsey, Isle of Man);
- have qualifying earnings.

Zero hours, term time, fixed term, temporary workers, carers and nannies must be included when assessing the workforce. Individuals seconded from another employer will usually remain a worker of that employer. Agency workers will be employees of either the agent or principal depending which is paying the worker.

The earnings trigger for auto enrolment for 2018/19 is £10,000 which equates to £192 a week, £384 every 2 weeks, £768 every 4 weeks and £833 a month. Earnings means gross salary, wages, commission, overtime, bonuses, SSP, SMP, SPP, SHPP and SAP. It excludes any payments from third parties such as PHI.

Obligations for different categories of worker

Eligible jobholder: This is an employee aged 22 up to state pension age with earning over £10,000. This worker must be automatically enrolled and both they and their employer must make pension contributions.

Non eligible job holder: This is an employee:

- Aged 16 to 21 or between state pension age and 74 with earnings over £10,000, OR
- Aged between 16 and 74 with earnings of £6,032 per annum to £10,000

This individual does not have to be automatically enrolled but has the right to ask to be enrolled in an automatic enrolment scheme. Employer must provide them with information on their right to "opt in" within 6 weeks of date they became a non-eligible jobholder, i.e. the employer's staging date or if after staging their first day of employment. If the person chooses to opt in they must give employer an "opting in notice". The employer must then enrol them into the automatic enrolment scheme following the same process as auto enrolment. The employer must contribute to the scheme.

Entitled worker

This is an employee aged 16 to 74 with earnings of £6,032 or less (£116 a week or £503 per month).

These workers have a right to join a pension scheme.

The scheme the employer chooses can be different to the one used for automatic enrolment. The employer must provide information to these workers about their right to join a pension scheme within 6 weeks of date they became an entitled worker, i.e. the employer's staging date or if after staging their first day of employment. The employer must provide one if they ask but only after the staging date. If the person chooses to join a pension scheme they must give the employer a "joining notice". The employer must then arrange membership of a scheme for them. The employer will have to deduct contributions from the person and pay these over, however the employer does not need to contribute to the scheme unless the scheme requires.

Employers must choose a pension scheme

Employers with an automatic enrolment duty must choose a pension scheme – it can be an occupational or a personal pension scheme. They may use an existing scheme, if suitable, or set up a new one. Employers who already have a pension scheme can confirm that it is suitable for automatic enrolment by a process called "certification".

Among the scheme providers are:

- The National Employment Savings Trust (NEST). This is a pension scheme which has a public obligation, i.e. it must accept all employers who apply. It has been established by the government to ensure that all employers can access pension savings and comply with their automatic enrolment duties. There are no charges currently;

- The Peoples Pension which is run by B & CE a not for profit organisation. £500 plus VAT set up charge;

- Smart Pension – there are no charges;

- Now Pension – set up is free but there is a £432 plus VAT ongoing fee.

When the pension scheme is in place the employer must provide key personal information to the scheme provider about the staff being auto enrolled. In addition the employer must advise the employees about auto enrolment and their right to opt out of the scheme after they have been enrolled. If the scheme is a personal pension scheme the employer must ensure that the scheme provider has sent the scheme's terms and conditions to the employees being auto enrolled.

Declaration of compliance

Every employer with at least one member of staff must complete their Declaration of Compliance with TPR within 5 months of their staging date and provide details of how many employees have been automatically enrolled. If there is only one member of staff who needs to go into a scheme they must be enrolled into the scheme before they can ask to leave.

Opt-out notices

Workers who have been automatically enrolled have the right to opt out of the employer's pension scheme. They also have the right to opt back in again at a later date but not within the same 12 month period. If the employee decides to opt out they must complete an "opt out notice" which they obtain directly from the pension scheme and pass to their employer.

They have one month from auto enrolment, to opt out and if they do so any deductions from their salary will be refunded. Employers must keep the originals or copies of all opt out notices for four years – either in paper format or electronically.

At any date in the future the worker can chose to cease membership of the scheme although they may not be entitled to a cash refund of contributions after the end of the one month opt out period.

Employers must make contributions

The minimum level of contributions that must be paid into the pension scheme have been set by government. These increase between now and April 2019 and from that date the minimum total contribution will be 8% of the workers qualifying earnings, falling between a lower and upper limit. Any earnings below or above these figures are not subject to contributions. Of the 8% the employer must pay at least 3%, but can pay more, and the employee will pay the rest, receiving tax relief on their contributions.

	Contributions	
	E'er minimum	Total minimum
Employer staging date to 5/4/18	1%	2%
6/4/18 to 5/4/19	2%	5%
From 6/4/19 onwards	3%	8%

For 2018/19 contributions are based on the earnings falling between the lower limit of £6,032 and the upper limit of £46,350. These limits are known as banded earnings. An employer can choose to pay contributions based on “unbanded” earnings so all salary is liable to pension contributions.

Where the employer pays more than the minimum employer’s contribution the employee may reduce their contribution as long as the total minimum contribution figure is met. Similarly if both decide to pay a higher contribution they can and the employer can also pay contributions based on earnings above the qualifying earnings cap if they choose.

Postponement

Postponement is the flexibility for an employer that allows them to choose to postpone automatic enrolment for a period of their choice of up to three months. Postponement does not change the staging date. The employer can postpone auto enrolment from the staging date, an employee’s first day of employment or the date an employee first becomes eligible to auto enrolment.

The postponement is a waiting period. It gives the employer the flexibility to align the administration of the employer duties to their existing business and payroll processes. If a new starter takes up employment after the payroll has closed for the week or month and they are an eligible jobholder they should be enrolled in that PRP. The work this would involve could be avoided by postponing them until the next pay period.

On the last day of the postponement period (the deferral date) the employer needs to check whether employees are still eligible for auto enrolment. If so that is their assessment date, it is not backdated, and they must be auto enrolled into the pension scheme immediately. Where some employees are not eligible at this point then the next time eligibility is triggers a new postponement period can begin.

The employer must issue the worker or workers with a postponement notice within 6 weeks from the date of postponement. This advises the worker that automatic enrolment has been postponed, the deferral date and that on the deferral date they will be automatically enrolled.

Re-enrolment – necessary steps

An employer MUST automatically re-enrolled certain employees into an automatic enrolment pension scheme every three years. There will be a number of employers undertaking this exercise over the coming months by assess those workers to see if they must be re-enrolled. The third anniversary will be three years from the staging date and employers can choose the re-enrolment date. There is a six month window which starts 3 months before the third anniversary and ends 3 months after staging date.

The employer must assess which staff need to be included in re-enrolment. These employees are those who have:

- Asked to leave, i.e. opted out of, the scheme;
- Left, ceased active membership after the opt out period;
- Stayed in pension scheme but chosen to reduce the level of contributions below the minimum level.

The following employees do not need to be assessed if on the re-enrolment date they:

- Are already in the scheme;
- Are 21 or under;
- Are at SPA or over;
- Has not yet had an automatic enrolment date.

Having assessed the staff the employer must re-enrol anyone who left the pension scheme more than 12 months before re-enrolment date and meet the criteria for age and earnings. The timescale is within 6 weeks of re-enrolment date. If there are no staff to re-enrol then the employer should complete the re-declaration of compliance. The employer cannot use postponement at re-enrolment.

Employers will notify TPR of this date when completing the re-declaration of compliance. The re-declaration of compliance must be filed with TPR advising how duties have been met with 5 months of the third anniversary of the staging date.

Contributed by Alexandra Durrant

Deadlines

1 August 2018

- CT due for periods ended 31 October 2017 if not liable to pay by instalments.
- Late 2016-17 SA tax returns subject to £300 penalty or 5% of tax due.

2 August 2018

- Filing date for form P46(Car) for quarter ended 5 July 2018.

5 August 2018

- Quarterly report by employment intermediaries for period 6 April to 5 July 2018.

7 August 2018

- Due date for VAT return/ payment for q/e 30 June 2018 (electronic payment).

14 August 2018

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

19 August 2018

- Pay PAYE/CIS for month ended 5 August 2018 if by cheque;
- File monthly CIS return.

21 August 2018

- Online monthly EC sales list;
- Intrastat — supplementary declarations for July 2018.

22 August 2018

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

31 August 2018

- File private limited companies accounts with 30 November 2017 year end;
- File public limited companies accounts with 28 February 2018 year end;
- CTSA returns for accounting periods ended 31 August 2017;
- Annual adjustment for VAT partial exemption claims, May year end;
- Submit PSA figures to HMRC to enable final income tax and National Insurance liabilities to be advised for 19 October 2018 deadline.

News

Finance Bill 2019: Draft legislation

The government consulted on a number of tax policies announced at Autumn Budget 2017 and other events and has now published responses to some of these consultations alongside draft legislation to be included in Finance Bill 2018/19. The technical consultation on draft legislation will be open for eight weeks, closing on 31 August 2018.

Four items of legislation have immediate or retrospective effect.

1. Changes to the income tax treatment of emergency vehicles

The government has extended the scope of the current income tax exemption for emergency vehicles to cover all commuting journeys and to make related provisions. This will be treated as having taken effect on 6 April 2017.

2. Workplace charging for all-electric and plug-in hybrid vehicles

As announced at Autumn Budget 2017, the draft legislation introduces an exemption to remove any tax liability for charging electric cars or plug-in hybrids at or near a workplace will be treated as having taken effect on 6 April 2018.

3.Amendments to Corporate Interest Restriction rules

Draft legislation clarifies the application of the Corporate Interest Restriction legislation in a number of specific circumstances and ensures that the rules work as intended. Certain wholly-relieving elements of the changes being made, such as to the amendment of the Corporate Interest Restriction rules to Real Estate Investment Trusts (REITs) to prevent REITS suffering a double restriction in certain cases, will be deemed to always have had effect. This change will ensure the Corporate Interest Restriction rules apply as originally intended.

4. Corporation tax relief for carried-forward losses

The government has published draft legislation for Exchequer protection purposes to put beyond doubt the amount of relief that may be claimed, and also ensure the regime applies to insurers within the Basic Life Assurance and General Annuity Business as intended. The legislation will take effect from 6 July 2018 to prevent companies from claiming excessive relief.

Other legislation incudes:

- As announced at Autumn Budget 2017, legislation in Finance Bill 2019 will reduce the time limit purchasers have to file a SDLT return and pay the tax due from 30 days to 14 days. The new time limit will apply to transactions with an effective date on or after 1 March 2019.

- A new shared occupancy rule for taxpayers wishing to use rent-a-room relief. From 6 April 2019 the test will require the taxpayer to be living in the residence and physically present for all or part of the let period.

- The government has published draft legislation for a new late payment penalty system and proposals to align interest rules across taxes. This is in addition to previously announced reforms to late filing penalties.
- Amounts reimbursed to employees within tax free allowances are free of tax and NIC, and from 6 April 2019 employers will not be required to check receipts provided by employees, but they must check that the employee has undertaken the qualifying business journey.
- From 6 April 2019, legislation will correct two anomalies in the optional remuneration arrangements rules. The changes will ensure that when taxable cars or vans are provided through optional remuneration arrangements, the value of any connected costs, such as insurance, is included in calculating the value of the amount foregone to arrive at the reportable amount; and adjust the value of any capital contribution towards a taxable car when the car is made available for only part of the tax year.
- From 6 April 2019 individuals will be able to make two elections allowing them to obtain entrepreneurs' relief where their shareholding is diluted below the 5% qualifying threshold. The first election will treat the individual's shares as having been disposed of and immediately reacquired at market value prior to dilution, giving rise to a chargeable gain at that point. The second election will allow the gain to be deferred until an actual disposal takes place. This gain will be treated according to the rules in force at the time of the actual disposal.
- Non-resident individuals, close companies and trusts, who are not registered for self assessment, corporation tax or ATED, currently have to pay their non-resident CGT within 30 days of completion for disposals of residential property. From 6 April 2019 these rules are to be extended to cover all gains made from UK real property, commercial and residential.
- From 6 April 2020, non-UK resident companies that carry on a UK property business, or have other UK property income, will be brought within the scope of corporation tax, rather than income tax. Transitional provisions will apply in relation to capital allowances, grandfathering of existing income tax losses to set against future corporation tax profits, and restriction of relief for past capital expenditure on contaminated or derelict land. Provision is also made for just and reasonable adjustments to be made for fair value movements arising on derivative contracts.
- Legislation in Finance Bill 2019 will allow non-corporate entities, such as partnerships or individuals, to join VAT groups. The non-corporate entity must control all of the members of the VAT group and be UK VAT registered. The change is being made in response to judgments of the ECJ.
- A small number of technical tax changes have been announced that need to be made to ensure legislation works as intended, including:
    - Clarifying the effect of the Optional Remuneration Arrangements legislation in respect of taxable cars and vans to correct two anomalies.
    - Modernising the exemption relating to premiums and contributions paid by employers for death in service and retirement benefits.

Other consultations

For other consultations, including those relating to withholding tax on royalties, hidden economy conditionality, the intangible fixed assets regime and tax abuse and insolvency, the government is continuing to consider the responses and will respond in due course.

www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2018-07-06/HCWS834

Law Society and the OTS review of IHT

The Law Society has requested that whatever changes are implemented, they urge the OTS to retain a spouse exemption and to consider extending this to unmarried cohabitees.

In addition, their recommendations for simplification includes:

- Streamlining the process for the completion of IHT forms using online automation and form building technology available on HMRC's website;
- Introducing a graduated tax rate or a return to the inflationary increase in the amount of the Nil Rate Band;
- Increasing the annual exemption amount for lifetime giving in line with inflation (e.g. £10,000), providing the chance to remove small or insignificant amounts from the scope of monitoring, which in itself would be a simplification;
- Repealing the Residence Nil Rate Band and replacing it with an increase in the standard Nil Rate Band;
- Removing current inconsistencies across the IHT regime i.e. in respect of Business Property Relief not being available on furnished holiday lets;
- Extending the bereaved minor trust regime to age 25, extending it to any child inheriting under a Will and repealing 18-25 trusts.

www.lawsociety.org.uk/policy-campaigns/consultation-responses/law-society-response-inheritance-tax-review-call-for-evidence/

EU tax convergence

In a joint paper published on 19th June, the Meseberg Declaration, is a wide-ranging statement of a vision for Franco-German cooperation in economic, social and fiscal matters, as well as foreign policy, security and defence. The two countries intend that their bilateral cooperation will be enforced in a new 'Elysée Treaty' by the end of 2018.

They have said that they have agreed a common position on the Commission proposal for a directive establishing a Common Corporate Tax Base (CCTB). They plan to promote it jointly in order to support and accelerate the European project to harmonise the corporate tax base in Europe. The proposal would apply to all corporate entities, regardless of size.

The declaration also includes the:

- commitment 'to reach an EU agreement on a fair digital taxation by the end of 2018';
- allocation of tax revenues to a Eurozone budget starting in 2021.

https://www.bundesregierung.de/Content/EN/Pressemitteilungen/BPA/2018/2018-06-19-meseberg-declaration.html

International tax enforcement group formed

The UK has joined forces with Canada, the Netherlands, the United States and Australia to launch the Joint Chiefs of Global Tax Enforcement (J5) – a new alliance dedicated to tackling international tax crime and money laundering.

The group will build on existing international cooperation by sharing intelligence and expertise, and will work together on joint operations to crack down on those who make a living out of enabling tax crime.

At their first meeting, the J5 brought together leading experts in tax and other financial crimes from each of the 5 member countries. Together they developed tactical plans and identified opportunities to pursue cyber criminals and enablers of international tax crime.

The new alliance will help HMRC build on work that has secured more than £2.8 billion from offshore tax evaders since 2010. That money has been used to fund our vital public services like the NHS.

This J5 has formed in response to a call to action from the OECD for countries to do more to tackle the enablers of tax crime. All 5 countries face similar threats – organised crime groups and wealthy offshore tax evaders who are well resourced and have access to professional enablers to hide income and assets using the global financial system.

By having a small number of partners, it will allow the group to be more agile and flexible to develop new approaches and carry out joint operations. Any results and benefits will be shared with wider international partners to develop a global understanding of offshore crime.

Membership of the J5 includes the heads of tax crime and senior officials from The Australian Criminal Intelligence Commission (ACIC) and Australian Taxation Office (ATO), the Canada Revenue Agency (CRA), the Dutch Fiscal Information and Investigation Service (FIOD), HMRC, and Internal Revenue Service Criminal Investigation (IRS-CI).

www.gov.uk/government/news/tax-chiefs-unite-to-tackle-international-tax-crime

HMRC annual report and accounts 2017/18

HMRC’s latest annual report and accounts show total revenues collected in 2017/18 of £605.8bn, an increase of £30.9bn (5.4%) over 2016/17:

- income tax (31%) /NICs (21%) up by 6.8% due to higher employment and wages;
- VAT (21%) up by 3.4% - from oil, gas and mining, leisure and business sectors;
- corporation tax (9%) increased by 4.3% due to rising company profits;
- hydrocarbon oils (5%) decreased by 0.4%;
- stamp taxes (3%) increased by 7.8% due to a continued rise in house prices;
- CGT (1.3%) decreased by 7.1% due to the reduction in rates; and
- tobacco (1.5%) remained static;
- alcohol (2%) increased by 1.8% due to increases in duty rate; and
- insurance premium tax (1%) increased by 37.8% due to a rise in the standard rate.

The remaining 4.2% of total revenue was split between 13 other taxes, duties and levies, the three largest shares belonging to IHT, APD and customs duties.

The extra yield from compliance interventions amounted to £30.3bn (£28.9bn in 2016/17). This overall figure comprises several elements, including certain estimates:

- £10.3bn of cash expected;
- £9.7bn of revenue loss prevented;
- £6.1bn of future revenue benefit (estimated effect of compliance interventions spread over future years);
- £3.4bn of product and process yield (estimated impact of legislative changes to close tax loopholes, etc); and
- £0.8bn of revenue from accelerated payment notices.

The National Audit Office has welcomed the 5.4% increase in tax revenues collected during 2017/18, but is concerned by a continued rise in error and fraud affecting tax credits and child benefit. Following HMRC’s reprioritisation of its transformation plans, the NAO says it is still not clear how effective this will be for the delivery of benefits, or in terms of value for money.

www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2017-to-2018

www.nao.org.uk/press-release/her-majestys-revenue-customs-annual-accounts-2017-18/

Business Taxation

Loan to an LLP - unauthorised payment?

Summary – The LLP was dormant when the loan was made and so could not be attributed to its partners as an unauthorised payment.

Bayonet Ventures Pension Scheme was established on 2 November 2009 as a Small Self-Administered Scheme.

Bayonet Ventures Pension Scheme filed its pension scheme tax return for 2009/10 which included details of a £66,000 loan.

HMRC opened an enquiry into the pension scheme tax return claiming that it had made an unauthorised payment under s164 FA 2004 by making the £66,000 loan to Bayonet Ventures LLP. They argued that, under s863 ITTOIA 2005, a loan to a limited liability partnership should be treated as a loan to the partner.

The taxpayers appealed.

Decision

The First Tier Tribunal concluded that the loan had been made from the pension scheme to Bayonet Ventures LLP. The Tribunal held that s863 ITTOIA 2005 only applied if Bayonet Ventures LLP was carrying on 'a trade, profession or business with a view to profit'. The partnership was dormant until 2012 and so the loan could not be treated as made to the partners of the partnership.

The tribunal concluded there was no unauthorised payment and the appeal was allowed.

Bayonet Ventures LLP; R K Howard (TC06493)

Interest on foreign loan UK sourced

Summary - the Court of Appeal found that interest paid by a UK company under a foreign loan facility was UK sourced.

Ardmore Construction Ltd is a UK resident company that carries on the trade of general builders and civil engineering. The company is owned and managed by two brothers.

The company carries on its business entirely in the UK and derives its income solely from activities within the UK. All of its assets are situated in the UK, except for four 'A' redeemable shares in certain companies incorporated in the British Virgin Islands and controlled by Gibraltar family trusts established by the two brothers.

The company had subscribed for shares in two companies incorporated in the British Virgin Islands and owned by trusts established by the brothers. £1.35m, the amount subscribed by way of part payment of share premium by Ardmore to the British Virgin Islands companies, was lent by those companies to the trusts and by the trusts to Ardmore Construction Ltd.

The issue was whether the loan interest paid of just over £1 million was paid from a UK source so that Ardmore Construction Ltd should have deducted tax from it under S957 ITA 2007

Decision

The Court of Appeal observed that there is no universal test for applying the principle; and that case law (National Bank (1970) 46 TC 472) has established that a 'multifactorial' assessment is required. The source could either be Gibraltar or the UK:

Gibraltar: the place where the loan was made; the place of the trusts' bank accounts; the governing law and exclusive jurisdiction clauses; the place of residence of the creditors; and the absence of security in the UK.

The UK: the physical source of the funds for paying the interest; the location of the assets on which any judgment given in Gibraltar would be enforced; the business of the Ardmore and Ardmore's bank accounts and thus the place from which interest was paid; and the absence of any security over foreign property.

The court said that what mattered was the source of the interest, not the source of the loan. The links to Gibraltar had less substance than the links to the UK, in particular, because no activity was carried out in Gibraltar.

Ardmore Construction Ltd v HMRC [2018] EWCA 1438

Loan waiver scheme

Summary – The companies decided the directors should receive a bonus and delivered the bonus by reducing the indebtedness of the company. There was no release of loan by the close companies for the purposes of s415 ITTOIA 2005.

This case hearing covered four sets of appeals involving close companies and directors' overdrawn loan accounts. Each of the appeals related to a remuneration planning scheme promoted by Tenon Limited (now Premier Strategies Limited) which was known as the "loan waiver scheme".

The documentation underlying the arrangements followed a very similar format. A board minute explained the company's wish to release sums owing by the director by way of a bonus for the director's services to the company. A deed was accordingly executed setting out the sums released. The company paid NICs but not employment income tax on the released amounts and deducted the sums released from its taxable profits.

In brief:

- the appellants argued the amounts released were taxable in the hands of the directors under s415 ITTOIA 2005 at the dividend ordinary rate;

- HMRC contend the amounts are taxable as employment income under s62 ITEPA 2003, as a reward for the directors' services. The loan waiver was simply the mechanism for the delivery of a performance based bonus by way of set-off.

Decision

The First Tier Tribunal concluded that the board minutes highlighted the intention was to reward the director(s) "with sufficient net funds to enable them to repay" their Director's loan accounts. The purpose of the discussions with Tenon was reported as being to provide those net funds (i.e. the net funds) to repay the loans at the lowest cost to the company. Authority was given to affect the release of the loan accounts of the director(s) "in satisfaction of their bonuses" for the relevant year.

The Tribunal found that, on the facts of each of the appeals, the transaction that took place between the company and the director <u>amounted to a repayment of the relevant loan</u>. The companies <u>did not release the loans</u> for the purposes of the s415 ITTOIA charge.

The appellants conceded that, if the s415 charge did not apply, then the sums were taxable under s62 ITEPA. Although the company was not contractually obliged to credit the account, when it did so, this amounted to a payment of remuneration that was subject not only to NICs as is accepted, but to tax under s62 ITEPA too.

The Tribunal's decision did not address the question of liability to PAYE but they stated that if agreement could not be reached on that issue or on the quantum of the relevant determinations and assessments under appeal then the parties could revert to the tribunal for further directions.

Esprit Logistics Management Limited, Mr Graham Dixon, OCUK Limited, Michon Limited, Ripple Developments Limited, Mr David Wolfenden v HMRC (TC06517)

Dividend waivers – yes they do still work! (Lecture B1086 – 11.07 minutes)

Introduction

When a company declares a dividend on a class of shares, the proceeds must be distributed to the shareholders in proportion to the number of shares held in that class at the date the dividend is announced.

This may not be desirable from a tax perceptive as it could create a higher or additional rate liability at 32.5% or 38.1% for a shareholder who probably has no pressing need for the cash in the first place.

The solution is therefore a dividend waiver whereby one or more shareholders give up their right to the dividend thereby enabling more of the profits of the company to be distributed to either:

- Family shareholders with lower marginal tax rates and/or unused dividend nil bands; or
- Employee shareholders in place of remuneration which would otherwise be taxable (and NICable) as earnings.

The tax advantages are therefore clear to see. However to avoid challenge from HMRC, certain procedures must be followed when considering a dividend waiver.

Deed of Waiver

As in all successful tax planning arrangements, the paperwork must be in order.

Dividends can only be waived by a Deed of Waiver. The Deed of Waiver must be formally executed and signed by all shareholders who are exercising their rights to give up their dividend entitlement. The Deed is then retained by the company.

In the good old days, it would have been sufficient for the FD or the company accountant to organise this with some simple basic wording along the lines that:

> "…I, Fred Bloggs of 7 Acacia Avenue being the registered holder of 1,000 £1 Ordinary shares in Bloggs Trading Ltd hereby waive all rights to the final dividend of £100 per share declared by Bloggs Trading Ltd on 16 August 19XX in respect of the accounting period ended 31 March 19XX…." (or words to that effect).

The Deed would be witnessed by someone in the office, popped on file and Bob, as they say, is your uncle.

But things are different in our new modern world and stuff we would have gotten away with in times gone by are no longer allowed. The preparation of a Deed of Waiver is a "reserved legal activity" under the Legal Services Act which means that only those who are members of the Bar or the Law Society (or who work for an employer who is authorised as such) are entitled to draw up such Deeds. So, in short, we now need to pay a fee to a solicitor who will pull-up a standard template from his server – no doubt with wording not dissimilar to that above – and charge us accordingly. [A careful read of the firm's PII policy might reveal that the business isn't covered for having a stab at the legal stuff, so all this is probably for the best.]

Without wishing to be a doom-monger, preparing a Deed of Waiver (or similar legal document) for a client without being properly authorised is a criminal offence with a prison sentence of up to two years and/or a fine. There are defences along the lines that the person did not know and could not reasonably have been expected to know that an offence was being committed. However this may now be a difficult argument to sustain giving that you are currently reading an article that warns you of the dangers of doing this, so enough said.

Create some commerciality

A dividend waiver should be used for genuine commercial reasons and, as we know, the desire to avoid or mitigate tax does not tick this box.

Paying out less of the distributable profits by way of dividend enables the company to retain funds to use for a specific or earmarked purpose. Therefore, if a shareholder decides to assist the company in this regard, his motives – and the specific purpose for which funds are being retained – should be recorded.

In Donovan & McLaren v HMRC (2014) the director / shareholders engaged in a series of dividend waivers so that their spouses could utilise their personal allowances and basic rate bands (instead of the dividend being taxed on director / shareholders at higher rates).

The First Tier Tribunal rejected Mr Donovan & Mr McLaren's contention that they had waived their rights to the dividend in order to maintain cash reserves in the company for the purpose of funding the purchase of a freehold property. The First Tier Tribunal said that this could have been more easily achieved by voting a smaller dividend. The First Tier Tribunal held that there was no commercial reason for the dividend waiver, the waiver would not have taken place on an arm's length basis and the arrangement was entered wholly for the purpose of reducing the tax liability of the taxpayers' families. As such the waivers fell within the settlements rules making them ineffective for income tax (see more on the settlements rules below).

As an aside, the First Tier Tribunal also concluded that discovery assessments could be made in this case to collect the tax as none of the tax returns disclosed the fact that dividend waivers were in place. This suggests that shareholders who have executed dividend waivers and want protection against discovery assessments ought to include relevant information relating to the dividend waiver in the appropriate white space box.

Watch your timing

The Deed of Waiver must be in place before the right to receive a dividend arises. For interim dividends, this is the day before the dividend is paid.

For final dividends, this is the day before entitlement to the dividend arises (normally at the AGM) because at that point the shareholder has a legally enforceable right to the declared dividend.

In short, once the dividend is "unreservedly placed at the shareholder's disposal" – for example by credit to a loan account - there is no going back.

Don't create a "settlement"

HMRC has been using the settlements legislation in ITTOIA 2005 to attack income shifting in family businesses for decades. I first came across it in the early 90's (when the attack was under S.660A ICTA). So whilst the statutory authority has relocated to a different Tax Act, the technical argument is nothing new.

The argument is as follows:

- A planning scheme to divert income to a family member is a bounteous arrangement which falls within the statutory definition of a "settlement";

- Where a settlement is made by an individual and the persons benefitting from the settlement are his spouse and/or minor children, the income of the settlement is taxed on the settlor; therefore

- Income which is diverted to a spouse by means other than the outright gift of an asset would effectively bounce-back and remain taxable on the settlor.

HMRC apply the same idea to dividend waivers where one spouse waives their rights to a dividend thereby enabling the company to pay a higher dividend to their spouse. The waiver does not constitute the gift of an asset (it represents a right to income), so there is no protection under S.626 (or under the Artic Systems logic).

However, HMRC will only attack dividend waivers under the settlements rules where the arrangement is “bounteous”. Not all dividend waivers are bounteous. For example, if A and B are 50% shareholders and A waives his right to a dividend, it doesn’t follow that B receives an increased amount. B’s dividend is the same. There is the argument that the company now has more cash in the bank making it worth more thereby increasing the value of B’s 50% share, but the IHT legislation deals with this in S.15 IHTA 1984 by saying that no transfer of value takes place.

The “bounty” test here is whether, on occasions where a dividend waiver has taken place, there would be sufficient retained profit to pay the dividends on the shares which are subject to the waiver. If there isn’t, there is bounty and this brings the settlement rules into play.

Even then there is only a charge on the shareholder waiving his rights where the beneficiary of the bounteous arrangement is his spouse or minor child (as S.624 and S.629 ITTOIA 2005 only work to attribute income of settlements for the benefit of spouses and minor children back to the settlor). Dividend waivers made in favour of other family members - for example adult children - would be tax effective (although where dividend waivers are used as part of a wider arrangement to replace employment income, an attack under employment-related securities legislation or disguised remuneration rules might be forthcoming).

In Buck v HMRC (2009) Mr Buck owned 9,999 of the 10,000 issued shares in his company. His wife owned one share. Mr Buck waived his right to a dividend and the company duly declared a dividend of £35,000 per share, all of which was paid to his wife in respect of her single share. The company had sufficient distributable reserves to make the dividend payments.

This arrangement was found to be bounteous by the Special Commissions because the company would have needed about £350 million of retained profits to pay a £35,000 per-share dividend had Mr Buck’s waiver not been in place. [The actual distributable profits were around £46,000.] This arrangement would clearly have not been entered into between Mr Buck and an unconnected third party. The dividend waiver is therefore a bounteous arrangement to increase the dividend paid to Mrs Buck and is a settlement of income by Mr Buck to his spouse. The dividend paid to Mrs Buck (i.e., the £35,000) was therefore taxable on Mr Buck under S.624 ITTOIA.

The requirement to retain sufficient profit to cover the waived dividend is both an in-year and a cumulative requirement. This means that before entering into a dividend waiver, we should look back at cumulative retained profits over more than just the current financial period to see if there is enough money in the pot to have paid the dividend had no waivers been made. If not, the arrangement is bounteous and if the person benefiting from the arrangement is a spouse (or minor child) of the shareholder waiving the dividend, the benefit is bounced-back and taxed on the deemed settlor. This is illustrated below.

Illustration

A husband (H) and wife (W) each own 50 shares out of the issued share capital of 100 £1 shares. Retained reserves are minimal.

Year to 31 March 2017

- Profit £85,000.
- H waives his right to the final dividend of £800 per share.
- W receives a dividend of 50 x £800 = £40,000.
- Retained profits are £(85,000 – 40,000) = £45,000.
- This would be enough to cover the dividend of £40,000 which would have been payable to H had he not waived his right.
- The arrangement is not therefore bounteous as W has not received an increased dividend because of the actions of H.
- The settlements legislation does not apply and W is taxed on a dividend of £50,000.

Year to 31 March 2018:

- Profit £90,000 plus opening reserves of £45,000 = £135,000.
- H waives his right to the final dividend of £1,000 per share.
- W receives a dividend of 50 x £1,000 = £50,000.
- Retained profits are £(135,000 – 50,000) = £85,000.
- Is this now enough to cover the dividends which would have been payable to H had he not waived his right?
- These would be £(40,000 + 50,000) = £90,000. Therefore, no.
- There is therefore bounty here as W has received £5,000 more than she would otherwise have been able to had H not waived his rights.
- The settlements legislation therefore applies and £5,000 of the £50,000 dividend is taxed on H.

But waivers DO work!

Don't let all this lead you to the conclusion that waivers are not effective in tax planning.

If the waiver is commercially justifiable, properly and legally documented, put in place in advance of the dividends being declared and not excessive when measured against retained profits, then HMRC should not have a problem.

Repetitive waivers should be avoided where possible. Therefore if this is a tax planning arrangement that the client wishes to optimise and repeat, having different classes of shares in place for different shareholders is probably a more effective solution. We will cover this in another session.

Contributed by Steve Sanders

Tax planning using 'alphabet shares' (Lecture B1087 – 15.07 minutes)

Introduction

Companies are traditionally formed with a nominal number of ordinary shares. These typically give the shareholder rights to dividends, the right to vote at Board meetings and the right to a share of the assets on a winding-up.

Dividends are paid equitably in proportion to the shares held. This means that shareholders with the same number of ordinary shares are entitled to the same dividend. This might not be ideal in a family situation where one shareholder is a higher-rate taxpayer and the other is not as the payment of a dividend could trigger an income tax charge at 32.5% or 38.1%. This can be dealt with to a certain extent by a dividend waiver, but as explained in a separate lecture, waivers can bring the settlement rules into play and the over-use of dividend waivers is not recommended. In addition, a formal Deed of Waiver needs to be executed every time a shareholder wishes to give up their right to a dividend (which can be laborious and costs money).

A more effective long-term solution is to use so-called 'alphabet shares'.

What are 'alphabet shares'?

Alphabet shares are different types of share classes that are denominated by a letter - for example, "A" Ordinary shares, "B" Ordinary Shares", "C" Ordinary Shares" etc. The main purpose behind alphabet shares is to enable the company to pay dividends to shareholders of differing amounts and at different times (which isn't possible with standard, generic ordinary shares of the same class). Typically alphabet shares will give the company flexibility to vary the amounts of dividends paid to husband and wife shareholders. Using alphabet shares to create an income stream for a university-bound 18 year-old is also not unheard-of.

There is no need for a shareholder to waive any dividend rights because a dividend declared on a 'B' share would have no bearing on the holder of an 'A' share or a 'C' share. Paperwork and costs are duly reduced.

The rights attaching to these shares are normally found in the company's Articles of Association. However, the rights can also be specified by a separate contract such as a Shareholders' Agreement.

Not all alphabet shares have to carry the same rights, therefore different rights or restrictions can be attributed to alphabet shares as required. It is therefore very important that the rights attaching to alphabet shares are clearly established and that all shareholders are aware of what rights their alphabet shares carry.

If a company wishes to pay dividends on one class of shares to the exclusion of another, or if dividends are to be paid on both classes but in different amounts, a clause or article to this effect must be in evidence. Standard model articles are unlikely to be fit-for-purpose in these situations so proper advice should therefore be sought to ensure that the I's are dotted and the T's are crossed before a dividend strategy is put into effect. Secretarial agencies can prepare the paperwork for as little as £200 to ensure the formalities are in place. This will include appropriate articles and necessary board resolutions to confirm that dividends can be independently declared on each class of ordinary share.

The Settlements Rules

Before alphabet shares, the weapon of choice was often non-voting preference shares which carried a right to a dividend but (as the title suggests) little else. However this route is no longer effective following Young v Pearce and Young v Scrutton (1996).

In these cases (heard together) the diversion of income via newly issued preference shares to the lower-tax paying spouses of the existing shareholder / directors was held to be a gift of a right to income. As the arrangement was bounteous and in favour of a spouse, under the settlements code (in what is now S.624 ITTOIA 2005), the income of the settlement – in this case the dividends paid to the wives – was taxed on the settlors (the husbands). The "get-out" provision of S.626 did not apply as there was no outright gift of an asset to a spouse. The gift was of a right to income as the preference shares carried only dividend rights.

HMRC can use the same mantra to challenge alphabet shares if the shares are merely a conduit through which to pay a dividend to a spouse (or minor child), the shares do not carry any capital / voting rights and the alphabet shares would not have been issued to a third-party on an arms' length basis. Therefore, advice when using alphabet shares is to ensure that the shares issued to a spouse are not restricted in terms of voting power or capital returns on a winding-up. The spouse's shares should therefore carry the same rights as the ordinary shares held by the other spouse.

As an aside here, one should keep in mind that entrepreneurs' relief (ER) will only be available on a disposal of the shares where the individual holds at least 5% of the ordinary share capital (tested by reference to the nominal value of the shares in issue) and is able to freely exercise at least 5% of the voting rights. Shares carrying dividend rights only would not be eligible for ER.

To avoid these settlements rules, other issues should also be borne in mind when using alphabet shares:

1) Make sure the company has sufficient distributable reserves.

HMRC can deem the issue of alphabet shares to be a bounteous arrangement in favour of a spouse where a dividend on the spouse's "B" shares could not have been met from reserves without fellow shareholders receiving a zero or negligible dividend.

For example, assume Mrs. H owns 80 ordinary 'A' shares in H Ltd. Mr. H owns 20 ordinary 'B' shares. The shares carry the same rights and rank equally. In 2018, the company made a profit of £25,000. A dividend of £20,000 is voted on the 'B' shares while no dividend is voted on the 'A' shares.

By not voting dividends on the 'A' shares (which rank equally with the 'B' shares), this is a bounteous arrangement as the dividend paid on the 'B' shares could only be paid if no dividend (or a very low one) was declared in respect of the 'A' shares. Part of the dividend paid to Mr. H is attributed to Mrs. H under S.624 ITTOIA 2005 because the decision only to vote dividends on certain shares was a bounteous arrangement.

[Example taken from HMRC Trusts, Settlements and Estates Manual at TSEM4225.]

2) Demonstrate that the spouse plays an active part in the business.

This adds a degree of commerciality to the arrangement that is helpful when trying to defend an assertion that the arrangement is bounteous.

Employment issues

The low-salary / dividend top-up strategy is well known. It utilises personal allowances, basic rate bands, dividend allowances and NIC thresholds at a very low effective rate of tax. It is also perfectly acceptable tax planning if it is done correctly.

Where alphabet shares are used to pay dividends to employees, it is important to ensure that those employees receive wages at or above the national minimum wage. The salary must not therefore be so low as to contravene NMW rules. For a full-time employee working (say) 35 hours a week, this means that paying a salary at or below the level of the personal allowance or the primary Class 1 earnings threshold might not be sufficient. [NMW does not apply to directors unless the director has an employment or service contract.]

A major consideration with issuing shares of any description to an employee or director is compliance with the rules on employment-related securities (ERS). Assuming that the shares are not issued as part of a tax-advantaged scheme – highly unlikely with alphabet shares - the employee will have a taxable benefit equal to the value of the shares issued. Any amounts paid for the shares reduce the taxable benefit.

In cases where the shares carry no rights other than the 'hope' of a dividend, this value will be low reflecting the difficulty in being able to sell the shares to a third party. But even in cases where the shares have no value so no taxable benefit arises, the majority of share issues must be reported using HMRC's online portal (the electronic form 42) by the following 6 July. This enables HMRC to raise any questions which they feel need raising.

However, the issue of shares (or the allotment of further shares) by a newly incorporated company is not a reportable event. The founders of a company can set it up with any type of share capital they choose. Once a founder has subscribed for his shares, any dividends paid on those shares are taxed as dividends because the source of the income is the share ownership. This fact is not altered if the subscriber subsequently becomes a director or employee.

So, establishing the family company with equal-right alphabet shares for different shareholders is good practice.

There is similarly nothing wrong with a husband and wife forming a company under which H has ordinary 'A' 'B' 'C' and 'D' shares and W has ordinary 'E' 'F' 'G' and 'H' shares etc, as this then allows a tax free (and form 42 free) gift of those shares to their children down the line. The transfer by an individual of shares "in the normal course of domestic, family or personal relationships of the person transferring the shares" is not reportable and does not trigger any taxable benefit by virtue of the get-out in S.421B. There needs to be demonstrated that there is no element of remuneration in the award or grant - i.e., the transfer is by the familial relationship rather than the shares being offered as an employment reward. So, setting up an alphabet structure then transferring those shares to family members should bring with it no employment issues whatsoever. Assuming the company is trading, any gains issues (and any possible value-shifting issues) can be taken care of with a gift relief claim (using form HS 295).

The ERS legislation in ITEPA 2003

Alphabet shares have been used by employers to pay targeted dividends to employees to reduce income tax and avoid PAYE and NIC. The dividend is paid in lieu of wages or bonuses. Umbrella companies have been using this strategy for a while.

This is typically achieved by creating a separate class of shares for each employee which only carry a right to a dividend. The taxable benefit on the share issue is negligible (these shares having no re-sell value). The settlement legislation is not in play because even though this is a bounteous arrangement, the beneficiary is not the spouse of minor child of the person doing the arranging. IR35 issues are avoided as the shareholders do not have a 5% interest in the corporate umbrella.

But – naturally – HMRC do not like it and can use ERS legislation in ITEPA 2003 to argue that the dividend income – being de-facto employment income – should be taxed under PAYE and subjected to NIC.

There are two angles of possible attack, both under Part 7 of ITEPA 2003 (“Employment Income: Income and exemptions relating to securities”).

The first is S.446K ITEPA 2003 under which employment income charges can arise where value is realised by artificial increases to the value of securities. HMRC use the example of a company using special classes of shares to pay all or most of employees’ wages as dividends. Each employee will have their own class of shares so different dividends can be paid to each. The shares have no rights other than that the employer can award dividends at his discretion.

Each dividend is acting as if it were a cash bonus specific to the employee. Each time the dividend is voted, the value of the share will rise and each time the dividend is paid, the value will fall again. The accumulated rises for the year will be artificial increases in value of the shares. As this is not for a commercial purpose, the increase in value – being the amount of the dividend - is treated as employment income. The fall-back in value is ignored. HMRC have nick-named this “Alphabet Soup”. [See HMRC ERSM60030.]

The defences against this attack are that:

1. Shares issued to family are protected by the “domestic and family” exemption is S.421B and this rules out any charges under the ERS code; and

2. If the alphabet shares have full capital and voting rights, there is no such artificial increase in value every time a dividend is declared.

There is also the second argument that where different classes of shares are issued to employees, any benefits received in relation to those shares are caught under S.447 ITEPA as “post-acquisition benefits from employment-related securities”.

This legislation applies where the shareholder has received shares after becoming an employee. HMRC’s argument is that the employee's shares are 'employment-related' and that the dividend is therefore a post-acquisition benefit.

This argument is more difficult for HMRC to get across the line and their guidance at ERSM90060 suggests that HMRC is more likely to try and apply S.447 to "contrived" arrangements by composite companies paying dividends to its contracted workers in place of income subject to PAYE and NICs. Alphabet share strategies used by umbrella companies to avoid PAYE and NIC on distributions to their contractors might therefore be vulnerable.

Conclusion

As with dividend waivers, the use of alphabet shares to pay dividends in a tax-efficient manner is acceptable and valid planning if it is done with care and some fore-thought.

Avoid the settlements rules by either retaining full rights for alphabet shares issued to spouses or make sure that there are sufficient distributable reserves to meet a dividend on shares in the other classes.

And avoid any "smoking guns" linking dividend payments to employees with rewards for services as HMRC can use ERS legislation to recategorise what should be dividend income as employment income.

Contributed by Steve Sanders

Hard-to-value intangibles and transactional profit splits

On 21 June 2018, the OECD released two reports.

Report 1: Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles (BEPS Action 8)

This guidance is aimed at reaching a common understanding and practice among tax administrations on how to apply adjustments resulting from the application of this approach.

It should improve consistency and reduce the risk of economic double taxation by providing the principles that should underlie the application of the Hard-to-Value Intangibles approach.

The guidance also includes a number of examples have been included to clarify the application of the Hard-to-Value Intangibles approach in different scenarios and addresses the interaction between the Hard-to-Value Intangibles approach and the access to the mutual agreement procedure under the applicable tax treaty.

Report 2: Revised Guidance on the Application of the Transactional Profit Split Method (BEPS Action 10)

This guidance has been formally incorporated into the Transfer Pricing Guidelines, replacing the previous text on the transactional profit split method in Chapter II.

The revised guidance retains the basic premise that the profit split method should be applied where it is found to be the most appropriate method to the case at hand, but it significantly expands the guidance available to help determine when that may be the case.

The report also contains more guidance on how to apply the method, as well as numerous examples.

www.oecd.org/tax/oecd-releases-new-guidance-on-the-application-of-the-approach-to-hard-to-value-intangibles-and-the-transactional-profit-split-method-under-beps-actions-8-10.htm

UK reservations and notifications under BEPS Multilateral Instrument

On 29 June 2018 the UK deposited its instrument of ratification and final list of reservations and notifications under the Multilateral Instrument (MLI).

The MLI will apply from 1 October 2018 and will begin to have effect in the UK for UK tax treaties from:

- 1 January 2019 for taxes withheld at source;
- 1 April 2019 for corporation tax; and
- 6 April 2019 for income tax and capital gains tax.

The date which individual UK tax treaties are modified by the MLI depends on the date our treaty partners deposit their own instruments of ratification, acceptance or approval.

Details of the date individual treaties are modified by the MLI, and of the modifications themselves, will be published on the relevant country tax treaties page.

The text of the MLI and explanatory statement to the MLI are available on the OECD website.

www.gov.uk/government/publications/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-base-erosion-and-profit-shifting

VAT

VAT Notice 700/22

Making Tax Digital (MTD) for VAT requires VAT registered businesses with taxable turnover above the VAT registration threshold to keep records in digital form and file their VAT Returns using software which must be capable of keeping and maintaining the records specified in the regulations, preparing their VAT Returns using the information maintained in those digital records and communicating with HMRC digitally via our Application Programming Interface (API) platform.

HMRC has published VAT notice 700/22: Making Tax Digital for VAT. This is a new HMRC notice, providing information on who has to comply with the MTD rules from 1 April 2019 and what is meant by digital record-keeping.

Taxpayers will not have to follow the MTD rules where HMRC is satisfied that:

- the business is run entirely by practicing members of a religious society whose beliefs are incompatible with the requirements of the regulations;
- it is not reasonably practicable for a taxpayer to use digital tools to keep their business records or submit returns, for reasons of age, disability, remoteness of location or for any other reason;
- a taxpayer is subject to an insolvency procedure.

Digital record keeping

All VAT registered businesses must keep and preserve certain records and accounts. Under MTD, some of these records (paragraph 3.3) must be kept digitally within functional compatible software (paragraph 3.2). Records that are not specified in this notice, or that are not required to complete your VAT Return, do not need to be kept in functional compatible software.

Some software will record all VAT records and accounts information. However, there are some records that by law must be kept and preserved in their original form either for VAT purposes or other tax purposes. For example taxpayers must still keep a C79 (import VAT certificate) in its original form.

Digital links

From 1 April 2020, there must be a ‘digital link’ for any transfer or exchange of data between software applications used as ‘functional compatible software’, without the need for any manual intervention. Section 7 of the Notice sets out examples that are intended to illustrate the extent to which a digital link is required between programs within a set of software programs used by a business or its agent. They show where information transfer must be digital and where it need not be, taking into account the variety of digital record keeping and reporting options that businesses will have. These scenarios are not intended to be exhaustive or prescriptive; they merely illustrate the more common ones.

www.gov.uk/government/publications/vat-notice-70022-making-tax-digital-for-vat

R&C Brief 4/2018 - Extended time limit for public sector refunds

With effect from 1 July 2018, refund claims by public bodies in respect of VAT costs associated with their statutory obligations are extended from three to four years.

This will align public sector refunds with normal VAT time limits.

The time limit for HMRC to seek adjustments relating to claims is also extended from three to four years.

Transitional rules between 30 June 2018 and 30 June 2019 will prevent adjustments for accounting periods ending earlier than 30 May 2015.

By 31 July 2019, the four year time limit will have come fully into effect, which means a claim for adjustment made on that date would go back to the period ending 30 June 2015.

R&C Brief 5/2018: VAT liability of goods supplied on approval

In the case of Littlewoods Organisation plc (VTD 14977), the Tribunal held that goods were supplied on approval where there is no contract of sale unless and until the recipient concerned adopted or was deemed to have adopted the goods. This is different from a supply of goods with a subsequent right to return them. The Tribunal found in that case that Littlewoods did not supply goods on approval.

Whether or not goods are supplied on approval will depend on the facts in each case. Relevant indicators can be found in the updated guidance at VRS9150: Mail order traders: Time of supply under retail schemes.

Businesses have three months from 18 June 2018 to ensure they are accounting for VAT correctly on these supplies. HMRC will not require correction of past returns for time-of-supply discrepancies highlighted by this guidance.

Delivery charges

In a single supply of delivered goods, the delivery is ancillary to the supply of the goods. Therefore the liability of the delivery charge follows that of the goods being supplied. Where goods are supplied on approval, the delivery service is not ancillary. As delivery happens before the customer or the mail order retailer know whether there will be a supply of goods, delivery is an aim in itself. If the goods are sent on approval, the purpose of the delivery service is to facilitate the customer inspecting the goods to decide whether or not they wish to purchase them. The supply of the delivery service is therefore not dependent upon the supply of the goods. Consequently the delivery of goods supplied on approval terms is always a separate supply that is taxable at the standard rate.

www.gov.uk/government/publications/revenue-and-customs-brief-5-2018-vat-liability-on-goods-supplied-on-approval

Golf club affiliation fees

Summary – The Upper Tribunal found that affiliation fees paid to golf governing bodies by golf clubs were exempt under Schedule 9 Group 10 Item 3 VATA 1994.

The appellants owned golf clubs that were profit-making organisations. They paid annual affiliation fees to a number of regional and national governing bodies. Affiliation fees were charged to the members but the clubs had to pay the fees irrespective of whether the members paid the club. Around two thirds of members paid but one third did not, mainly on the ground that they considered that they did not derive any benefit from the fees.

The issue was whether the affiliation fees were standard-rated or exempt by reference to Schedule 9 Group 10 Item 3 VATA 1994 and more specifically whether exemption applied to supplies to profit-making bodies and whether supplies relating to standardised handicaps were essential to sport.

Although only about one-third of the golfers in England belong to clubs, the First Tier Tribunal found that members are attracted to clubs where better players play, and those players typically want to have a handicap and to participate in competitions. If a club failed to pay affiliation fees, the club’s members would lose their handicaps. If that happened, some members would leave the club. Accordingly, it was the Taxpayers’ own evidence that it would be “commercial suicide” for a club not to affiliate with the county unions/associations and England Golf.

Decision

The Upper Tribunal found, by reference to Canterbury Hockey Club v HMRC, that it was clear why the distinction between profit and non-profit making was not important. When considering the exemption, the nature of the ostensible recipient of the service is immaterial and that what matters is whether the true beneficiaries of the service are persons taking part in sport. On this reasoning, it is immaterial whether the recipient is profit-making or not. Additionally, it would run counter to the principle of fiscal neutrality for the availability of the exemption to depend on whether the club was a profit-making organisation or not.

Finally the Tribunal concluded that It would be impossible to participate in golf of the same value without CONGU handicaps and so supplies relating to standardised handicaps were essential to sport.

The appeal was dismissed.

Abbotsley Ltd and Others v HMRC [2018] UKUT 0191 (TCC)

Supply of telecoms services

Summary –VAT was payable on the supply of telecoms packages, including mobile phone usage abroad, when the recurring monthly charge was paid but subject to an adjustment after the event to the extent that telecoms services had been used outside the EU in a ‘Feel at home’ destination.

Business to consumer ('B2C') telecommunications services are not subject to UK VAT if they are 'effectively used and enjoyed' outside the UK.

On 27 August 2013, Hutchison 3G UK limited changed the terms it gave to its ‘pay monthly’ customers. After that date, use of their device in certain specified locations abroad no longer incurred roaming charges. Instead, usage of the device abroad counted towards the customers’ set allowances for phone calls, texts and data downloads.

This meant that prior to H3G's change of charging method, roaming charges imposed on the use of a mobile phone abroad were not subject to UK VAT but what happened under the new terms?

Argument 1: The payment of the monthly charge did not trigger a tax point because all the relevant charging information was not known at the time of payment. This was far more than a timing difference: A customer might have a contract which entitled them to 200 minutes of calls per month but only use 98 of them in a particular billing period, with only 96 of those 98 being used within the EU. H3G’s position was that no VAT at all was due on the monthly fee paid for these 200 minutes until after the end of the billing period and then VAT should only be paid on the actual airtime which had been ‘used’ within the EU (96 minutes), and no VAT paid on either the airtime within the allowances which had not been ‘used’ nor on the airtime used outside the EU (104 minutes). By contrast, HMRC thought VAT was due on the full monthly fee at the time of payment, with a later repayment to reflect the 2 minutes actually used outside the EU.

Argument 2: Monthly contracts were electronic face value vouchers and VAT was only due to the extent the voucher was exchanged for network services in the UK.

Decision

The First Tier Tribunal found that H3G was making two separate supplies: the supply of a handset; and the supply of telecoms services. The monthly charge should therefore be apportioned. This meant that the part of the monthly charge relating to H3G's claim should be excluded.

In relation to the tax point, the First Tier Tribunal noted that the relevant uncertainties in the CJEU's decisions in MacDonald Resorts (Case C-270/09) and Bupa (Case C-419/02) were fundamental and did not relate to the place of supply being unknown. There was therefore no authority for the proposition that uncertainty relating to the place of supply would prevent the trigger of a tax point. The time of supply was therefore the time of payment of the monthly charge.

Finally, the First Tier Tribunal found that the contract did not qualify as a voucher. A voucher entitles its holder to obtain a right to services at a future point but cannot, itself, be a supply of that right. The monthly fee effectively entitled the customer to set amount of calls, texts and data downloads within a set period. The only uncertainty was whether and to what extent the customer would use the rights he had purchased. There was therefore no voucher that represented the right to receive services; there was a supply of telecoms services.

Hutchison 3G UK limited v HMRC (TC06519)

Minimum standard VAT rate

The minimum standard VAT rate prevents excessive divergence in rates in member states, eliminating the risk of distortions of competition through lower VAT rates that would have an impact on cross-border trade.

Since VAT rules for the EU single market were first applied in 1993 we have had 15% minimum standard rate but on a provisional basis. This was last extended in May 2016 for two years, expiring on 31 December 2017.

On 22 June 2018, the Economic and Financial Council adopted a directive making the 15% minimum standard rate a permanent feature of a new VAT system.

Proposals aimed at replacing the current 'transitional' VAT arrangements with a definitive VAT system and reforming VAT rates are meanwhile under discussion.

www.consilium.europa.eu/en/press/press-releases/2018/06/22/vat-minimum-standard-rate-set-permanently-at-15/

Property not used as a dwelling in previous 10 years

Summary – No 135 was used as a dwelling during the period of ten years immediately preceding 23 June 2017 making it an exempt supply.

This appeal is against a decision dated 4 May 2017 reducing the input tax claimed by Fireguard Developments Ltd from £23,496 to £9,378.47 on its 12/16 VAT return.

These inputs related to the renovation of two residential properties, 133 and 135 Hart Street, Southport. Fireguard Developments Ltd's entitlement to claim the input tax depends upon whether or not the subsequent sales of the properties were exempt supplies or zero-rated supplies.

By the time of the appeal, HMRC accepted that the sale of No 133 was zero-rated but continued to maintain that No 135 was exempt.

Under Item 1(b), Group 5, Schedule 8 VATA 1994 zero rating will apply where the first grant is by a person "converting a non-residential building or a non-residential part of a building into a building designed as a dwelling or number of dwellings or a building intended for use solely for a relevant residential purpose, of a major interest in, or in any part of, the building, dwelling or its site."

Note 7, Group 5, Schedule 8 VATA 1994 provides that:

> "For the purposes of item 1(b), and for the purposes of these Notes so far as having effect for the purposes of item 1(b), a building or a part of a building is "non-residential" if –
>
> > (b) it is designed, or adapted for such use but –
> >
> > > (i) it was constructed more than 10 years before the grant of the major interest; and
> > >
> > > (ii) no part of it has, in the period of 10 years immediately preceding the grant, been used as a dwelling or for a relevant residential purpose."

Decision

In reaching its decision, the First tier Tribunal took the following into account:

1. PAYE Records showed that someone was using this address implying that somebody was resident at No 135 until 27 November 2008.

2. A letter from the Council confirmed that based on its records, No 135 was empty from 28 November 2008. While payments to the Council could have been made in error, there was no evidence to suggest that that was the case here.

3. The fact that both the PAYE Record and the Council Letter refer to November 2008 made this conclusion all the more compelling.

4. While the statutory declaration from he property's previous owner was admissible evidence, the Tribunal did not accept that their evidence overrode the PAYE Record or the Council Letter. They gave it limited weight because the owner was not present to amplify it or be cross- examined upon it.

The First Tier Tribunal found that as a matter of fact No 135 was used as a dwelling during the period of ten years immediately preceding 23 June 2017; indeed it was occupied until November 2008.

While No133 was zero rated, No 135 was held to be exempt.

Fireguard Developments Ltd v HMRC (TC06514)

Letting of property to a subsidiary

Summary - The CJEU found that the letting of property to a subsidiary constitutes an economic activity for the holding company.

Marle Participations is the holding company of the Marle group, which manufactures orthopaedic implants. It lets a building to one of its subsidiaries.

Marle Participations had conducted a restructuring operation, which had included the buying and selling of shares. It deducted the VAT charged on various expenses connected with that operation. The French tax authorities refused the deduction on the ground that the expenditure related to capital transactions that fell outside the scope of VAT.

Following Larentia + Minerva (Case C-108/14), it was accepted that if a holding company is involved in the management of its subsidiary, VAT incurred in relation to the acquisition of shareholdings is deductible. The issue was therefore whether the letting of a building by a holding company to its subsidiary constitutes involvement in the management of that subsidiary.

Decision

The CJEU observed that there was no exhaustive list of activities which would constitute 'involvement in the management of a subsidiary' and that the expression covers all transactions constituting an economic activity. The court therefore concluded that in circumstances where the property letting is taxable and made on a continuing basis, and where there is a direct link between the supply and the consideration received, the letting of property to a subsidiary is an economic activity. This means that input tax incurred in relation to the acquisition of shares in that subsidiary is deductible.

Marle Participations SARL v Ministre de l'Économie et des Finances (Case C-320/17)

Adapted from case summary in Tax Journal (13 July 2018)

Faulty direct debit instruction

Summary – The company had no reason to believe that their direct debit instruction had not been successful so the late payment of VAT due for the 08/16 VAT return was not liable to any surcharge penalty, with the knock effect that only a 2% penalty was applied to the 09/16 return.

Godolphin Management Company Limited operates a business of the breeding and racing of thoroughbred racehorses acting in association with Zampino Limited, which is the ultimate owner of the racehorses through various trusts. Godolphin Management Company Limited has been registered for VAT since 1994 and submits VAT returns on a monthly basis.

Since around 1994 Godolphin Management Company Limited ‘s VAT returns were always nil returns as its accountable output tax was always offset by its input tax as its purchases/sales from/onto third parties were always (exactly matched by sales/purchases from/onto the Zampino trusts.

In April 2016, following an inspection, HMRC decided that this approach was incorrect. In their view any intra-community acquisitions that Godolphin Management Company Limited made on behalf of Zampino Limited should be recorded in Godolphin Management Company Limited ‘s VAT return and it should account for output VAT on the onward supply of goods to Zampino Limited. The result of this was that Godolphin Management Company Limited had an additional VAT liability on all intra-community acquisitions that it could not offset, leaving it with a net VAT liability each month.

Following negotiation with HMRC, it was decided that the new treatment would start as regards the return due in respect of the 06/16 period. The due date for electronic submission of the VAT return and payment of VAT due for the 06/16 period was 7 August 2016. The return was submitted on 8 August and the VAT due was paid on 15 August 2016. It was accepted that this put the company within the default surcharge regime.

On 7th September, to ensure that payment was always made on time, the company attempted to set up a direct debit for the payment of VAT going forward, in time for the next return. When the 08/16 VAT return was submitted on 7 October 2016 the company was confident that the relevant sum of VAT due would be taken automatically in line with the DDI. They believed that they had been successful. It was not until 14th October 2016, when the company received a notice of default surcharge issued by HMRC for the 08/16 period for £8,041.48 (calculated at 2% of the VAT due) that they realised that the DD instruction had failed.

The due date for the electronic submission of the VAT return and payment of the VAT due for the 09/16 period was 7 November 2016. The return for that period was submitted on that date. Again payment was made late on 8 November 2016. On 11 November 2016 HMRC issued a default surcharge notice for the period 09/16 for £217,435.79. The reason for this high surcharge was because of an exceptional monthly return.

Godolphin Management Company Limited believed that the sole reason for the late payment of the VAT for the 08/16 period was the failure of HMRC's systems and their failure to notify them of any problems.

Decision

The First Tier Tribunal said that it was clear that the conditions for imposing the default surcharges were met. There was no dispute that the VAT due for the 08/16 and 09/16 periods was paid late and that the company received the surcharge liability notices issued by HMRC.

The Tribunal accepted the evidence that a DDI was filled in and submitted to HMRC online on 7 September 2016, a month before the due date for payment of VAT due for the 08/16 period. They could not see that the company had any reason to question that the direct debit had been successfully set up having filled in the form with the relevant details according to the instructions given, in particular, as there appeared to be no problem with the online submission. Accordingly no surcharge was due for the period 08/16 which had the knock on effect that there was no default in that period so that the surcharge for the period 09/16 should to be calculated at the rate of 2% of the late paid VAT rather than at the 5% rate.

Godolphin Management Company Limited did not argue that the surcharge for 09/16 return was not validly imposed or that the company had a reasonable excuse for the late payment of VAT for that period. The company's only argument was that the surcharge was disproportionate which the Tribunal decided was not the case. The Tribunal concluded that the surcharge imposed in the period 09/16 was not disproportionate, noting that the company had been in default for a substantial period of time. The on-going notices and surcharges should have alerted them to the fact that on-going penalties would be charged.

The Tribunal noted comments in Total Technology that a "spike in profits" is not of itself sufficient to comprise circumstances where a penalty may be regarded as disproportionate.

They also noted that the company had argued that the penalty was disproportionate as looking at the position of the company and Zampino Limited overall there is no VAT due to HMRC. However, the Tribunal could not see that that was a relevant factor. The VAT was due from the Godolphin Management Company Limited. The two companies were not in a group for VAT purposes.

Godolphin Management Company Limited v HMRC (TC06515)

VAT used to pay other bills

Summary – cited cash flow problems as the reason for its late payments.

KD Productions Ltd provided sets for theatre shows and supplied technical crews for concerts and events.

It was VAT registered and operated the cash accounting scheme. Under the cash accounting scheme, the taxpayer accounts for output tax on a VAT return when customers pay their bills.

In this case, KD Productions Ltd paid VAT late for most returns between April 2016 and July 2017, incurring a series of default surcharges, claiming that cash flow problems was a reasonable excuse for paying VAT late.

The reality was that the company had a profitability problem, exacerbated by a bad debt resulting from a customer going into liquidation.

As Neil Warren said:

> 'The reality was that the company had to use the VAT element of its income to help to pay other bills rather than HMRC. It had no contingency plans such as an overdraft or other back-up finance to manage its cash flow if customers paid late.”

Decision

On the final default, which had been only one day late, the director cited a bad debt and a late-paying customer as an excuse but the tribunal rejected that argument. The judge said the company had known a customer might be a late payer so it should have made a contingency plan.

The First Tier Tribunal decided that KD Productions Ltd did not have a reasonable excuse for the late payments.

The taxpayer's appeal was dismissed.

KD Productions Ltd v HMRC (TC06488)

Adapted from Taxation case summary (12 July 2018)

Recovery of input tax on taxable supplies wrongly treated as exempt

Summary – Zipvit Ltd was not entitled to an input tax credit in respect of supplies which had had been treated as exempt by the supplier but had subsequently been found to be taxable.

Zipvit Ltd supplied vitamins and minerals by mail order using Royal Mail to send its orders and to distribute advertisements. Both Royal Mail and HMRC believed that the supplies made by Royal Mail were exempt and no VAT invoices were issued for these supplies.

In April 2009, the CJEU ruled, in R (oao TNT Post UK Limited) v HMRC (Case C-357/07), that the postal exemption did not apply to individually negotiated supplies so the services supplied by Royal Mail to Zipvit Ltd were taxable.

The invoices which Royal Mail had provided to Zipvit purported to be VAT invoices, in the sense that they contained all the information which Royal Mail considered was required by the terms of reg 14, and they specified the individual supplies as either zero rated or exempt, as Royal Mail then considered them to be.

Decision

The Court of Appeal considered that Royal Mail had a contractual right to recover an amount equivalent to the VAT, which should have been charged, but had taken no steps to enforce that right. A reference to the CJEU may be required in order to establish whether Zipvit Ltd was entitled to claim a deduction for the VAT element of the original purchase price, on the footing that it should now be treated as VAT inclusive.

However, the court said that VAT invoices were needed as evidence that the supplier has duly paid or accounted for the tax to HMRC. In the absence of a VAT invoice, such a deduction could not be justified.

The invoices had not contained details of the VAT charge which should have been added to the contract price given that the supplies were standard rated. The real issue, was whether Zipvit could claim a deduction for VAT by treating the original price as VAT-inclusive, without producing evidence that the tax in question had been duly paid by the supplier. The invoices showed that no tax was paid because the supplies were considered to be exempt. No evidence was provided that any VAT had been paid by Royal Mail to HMRC.

Zipvit Ltd v HMRC [2018] EWCA Civ 1515 (29 June)

Points-based late submission penalties

HMRC published a technical note on 6 July alongside draft legislation for Finance Bill 2019, concerning the new points-based penalty regime for late submission of returns, to be introduced initially for VAT from 1 April 2020. The new regime is designed to be applicable to as many taxes with regular filing obligations as possible to provide a clear, transparent and consistent approach for taxpayers and HMRC.

Scope of new regime

This new regime will only apply to returns (including Making Tax Digital regular updates) with a regular filing frequency, for example monthly, quarterly or annually. It will not apply to occasional returns (for example a return required for a one-off transaction), which will continue to be covered by current penalty regime for the relevant return.

Overview of how the new late submission penalties work

A taxpayer will automatically receive a point every time they fail to make a return on time. HMRC will notify them of this point. At a certain threshold of points, a financial penalty will be charged and notified (value to be confirmed in due course). The government expects to introduce the new regime with the following thresholds, although it will have the power to change them through secondary legislation:

Submission frequency	Penalty threshold
Annual	2 points
Quarterly (including Making Tax Digital)	4 points
Monthly	5 points

Expiry of points

Points will have a 2-year lifetime, from the month after the month in which the failure occurred, after which they expire. Points will not expire when a taxpayer is at the penalty threshold in order to ensure they must achieve a period of good compliance to reset their points.

Expiry of points for good compliance

Any points accrued will be reset to zero after a period of good compliance (that is, filing returns on time), and the additional criterion that they have submitted all the returns which were due within the preceding 24 months. This will be regardless of whether or not these returns were initially late. Both criteria must be met at the same time to reset points.

If a taxpayer is at the penalty threshold, has achieved the period of good compliance but has not provided outstanding returns, they will continue to be charged penalties for further failures to file on time.

The government expects to introduce the new regime with following periods of good compliance, although it will have the power to change them (and the period for which outstanding returns are required) through secondary legislation:

Submission frequency	Period of good compliance
Annual	2 submissions
Quarterly (including Making Tax Digital)	4 submissions
Monthly	6 submissions

Time limits

There will be time limits for HMRC to notify a taxpayer of a point, after which the point cannot be incurred. The government expects to introduce the regime with the following time limits, calculated from the month after the month in which the failure occurred:

Submission frequency	Time limit for notifying a point
Annual	12 months
Quarterly (including Making Tax Digital)	3 months
Monthly	1 month

There will also be a time limit for HMRC to assess a financial penalty. The government expects to introduce the regime with a time limit of 2 years after the last failure that led to the penalty.

Where HMRC may not apply a point or penalty

HMRC may use its discretionary powers in the law not to award a point or charge a penalty in relation to an individual customer or group of customers where there is a reasonable excuse.

www.gov.uk/government/publications/technical-note-on-

Group VAT repayment claim

Summary – Any VAT repaid as a result of a repayment claim must be made to the VAT group representative member

In 1990, Taylor Clark transferred its bingo business to a wholly owned subsidiary, Carlton. Taylor Clark was the representative member of the VAT group between 1973 and 2009, and Carlton was a member from 1990 until it was sold in 1998.

In 2007, Carlton submitted four claims for repayment of VAT that Taylor Clark had overpaid in the period 1973 to 1998. The claims used the Taylor Clark group registration number but it had not authorised them.

In 2008, as a result of the decision in Fleming t/a Bodycraft v CRC [2008] STC 324, FA 2008, s 121 extended the time limit to 31 March 2009 for claims for output tax overpaid before December 2006.

In January 2009 Carlton submitted a revised claim that HMRC processed but made the repayment to Taylor Clark. It rejected Carlton's other claims. In 2010, Taylor Clark requested repayment of the other claims but HMRC refused on the ground it was too late to make them.

The matter proceeded to the First-tier Tribunal, which agreed with HMRC. The Upper Tribunal and Court of Session found in favour of the taxpayer. HMRC appealed.

Decision

Lord Hodge gave the lead judgment in the Supreme Court. He disagreed with the Court of Session that a claim by a member of a VAT group should be construed as made on behalf of the representative member. VATA 1994, s 43 did 'not make the group a taxable person but treats the group's supplies and liabilities as those of the representative member for the time being'. It was clear from s 80 that a claim should be made by the person who accounted for VAT — in the case of a group, this had to be the representative member.

The judge said the First-tier Tribunal had been correct to find the claims had been made by Carlton — and not on behalf of Taylor Clark. The claims had been submitted after Carlton left the group, by which time it was making claims relating to its own business activities; the use by Carlton of the group's VAT registration number was necessary to identify the original source of the purportedly overpaid VAT but did not disclose which of the companies was entitled to the repayment; and the claims covered the years before it joined the group. Further, Carlton had no authority to act on Taylor Clark's behalf.

HMRC's appeal was allowed.

HMRC v Taylor Clark Leisure Plc (Scotland) [2018] UKSC 35

Adapted from case summary (Taxation 19 July 2018)

Imports and acquisitions of goods (Lecture B1089 – 20.12 minutes)

Imports

Goods imported from outside the EU are subject to import duty and VAT by HMRC when they arrive in the UK. Generally the customer must pay these before Customs will release the goods, but it is possible to apply for Duty Deferment.

If the business signs a direct debit mandate for HMRC and gets a bank guarantee for the import duty (not the VAT) HMRC will release the goods without immediate payment. It will send the business a statement of all goods imported each month and the duty and VAT payable. This amount will then be collected by direct debit.

The import VAT can be reclaimed in the same way as VAT charged by a supplier but the duty is not recoverable.

Goods with a value of less than £15 are zero-rated on import, unless they come from the Channel Islands.

Acquisitions

A supplier of goods from another EU country will zero-rate the supply if the UK customer gives them its VAT registration number to quote on the invoice.

HMRC will not charge VAT when the goods arrive.

Instead the UK customer will account for the acquisition in its own VAT return by including output VAT at 20% of the value of the goods in Box 2 and reclaiming this as input VAT as appropriate in Box 4.

Exception to input VAT recovery in Box 4

If a UK business sources goods from one EU member state and delivers direct to a third EU state, and uses its UK VAT number to ensure zero-rating by supplier, it cannot recover the acquisition VAT in box 4 unless acquisition VAT has been accounted for in EU state where goods arrived.

Triangulation

A simplification procedure can be used for a chain of intra-EC supplies of goods where three parties are involved.

Instead of goods passing through the chain they are delivered from the first party to the last party in the chain.

Example

A UK client takes an order from an Italian customer and sources the goods from a Polish supplier (the UK client is an 'intermediate supplier').

The Polish company sends the goods directly to Italian company and invoices the UK company for the goods.

The UK company invoices Italian company for the goods

Without triangulation, the Polish supplier will zero-rate the supply if the UK client gives it its VAT registration number.

The UK client is then treated as acquiring the goods in Italy and selling them locally to an Italian customer. This requires the client to register in Italy, file Italian VAT returns, etc.

If the transaction qualifies for triangulation simplification, the Polish supplier will still zero-rate the supply to the UK client, but this time the Italian customer will account for the goods as an acquisition from the UK client. It will already be VAT-registered in Italy so this is not a problem for it.

This saves the UK client from registering in Italy and its invoice to the customer will be zero-rated using the customer's VAT registration number and stating that the invoice is using the simplification procedure.

Some destination countries' tax authorities (including the UK) require the intermediate supplier (your client) to inform them they will be using the simplification procedure and also to inform the customer in writing (with a copy sent to the tax authority). You may need to take local advice about specific countries' requirements.

Contributed by Malcolm Greenbaum

Exports and dispatches of goods (Lecture B1090 – 23.03 minutes)

Place of supply of goods

The place of supply is where the goods are located at time of supply (when dispatched to the customer or made available if customer collects). Assets that cannot be dispatched (such as buildings) are supplied where they are located.

Goods supplied in the UK are taxable supplies – they might qualify for zero-rating (see later).

Goods supplied outside the UK are outside the scope of VAT and are generally not reportable on a UK VAT return. There may be a need to register for VAT in the country where goods are supplied from, though.

Common practical problem

A UK supplier has a UK customer who orders goods to be delivered to them in the UK. The supplier sources the goods from a supplier in Hong Kong and they are sent directly from the supplier to the customer.

Where does the supply of goods take place?

A good rule of thumb to use is to look at whether the supplier or the customer is responsible for the importation of the goods to the UK. If it is the customer (i.e. the customer's name is on the import documentation) the supplier has made a supply in Hong Kong which is outside the scope of UK VAT.

If the UK supplier's name is on the import documentation, it has imported the goods and will be liable for any duty and import VAT payable. It will then make domestic UK supply to its customer, charging 20% VAT as the goods are sent to the customer until they are in the UK.

Exports of goods

Exports are where the goods are delivered to a country outside the EU. They are taxable supplies (because they are in the UK at the time of supply), but are zero-rated if certain conditions are met (covered later). If they fail any of the conditions, the goods are treated as supplied within the UK and the appropriate rate of VAT will have to be applied.

Dispatches of goods

Dispatches are where the goods are delivered to another EU member state. Again they are taxable supplies because they are in the UK when they begin their delivery process.

Dispatches are generally only zero-rated when the supplier obtains the customer's VAT registration number and quotes it on the sales invoice. If this is not done (either because the customer is not VAT registered or the supplier fails to obtain the VRN) it is treated as a domestic supply within the UK and the appropriate rate of VAT must be applied.

The one exception to needing the customer's VAT registration number is for the supply of new means of transport (e.g. new cars). In this case, dispatches are always zero-rated and the customer has to pay VAT in the country in which the car is delivered (in the UK, this VAT must be paid before the car can be registered here).

Conditions for exports and dispatches to be zero-rated

Apart from the customer’s VRN mentioned above for dispatches, there are several other conditions that must be met for both exports and dispatches to be zero-rated.

The goods must be removed from the UK within three months of the time of supply (which is the earlier of dispatch or cash received). This is extended to six months for goods involved in processing or incorporation into other products prior to removal.

The supplier must obtain either official evidence (i.e. customs generated) or commercial (from a courier or freight forwarder, for example) evidence of removal within the same time limits.

For dispatches, it is important to verify the customer’s VAT number. This can be checked by logging onto: http://ec.europa.eu/taxation_customs/vies/vieshome.do

Normally this has full details of who holds the VRN but not always. If not, then contact HMRC to verify by telephone.

Failure to verify can expose the supplier to total tax losses if customer is involved in VAT fraud or if customer fails to account for acquisition VAT in their country.

Indirect exports and dispatches

This is where the customer picks up goods in UK and then dispatches or exports them.

HMRC is concerned that this gives scope for the customer to tell the supplier they are removing them from the UK but they could actually enter free circulation in the UK (in which case UK VAT should have been accounted for).

It is still possible to zero-rate the goods but in this case the supplier must have both official and commercial evidence that the customer actually transported the goods to the intended country within the time limits prescribed.

As the customer contracted with a courier/transport company, the supplier will need to obtain written evidence from that company.

It may be worth asking the customer to pay a 20% refundable deposit on top of the invoice value in case they do not provide the necessary information in time to cover the VAT that will become payable.

Distance selling rules

Because of the way the above rules operate, if a UK supplier sent goods to unregistered customers in (say) France, it would charge UK VAT at the appropriate rate. This money would go to HMRC and be available to the UK Government and the French government would receive nothing.

To protect EU countries in this situation, once a supplier has made supplies of goods to unregistered customers in another EU country above a set threshold in that country (normally either €30,000 or €100,000 at the country’s option) during a calendar year, the supplier must register in that country.

From that point, the supplier will have to charge the appropriate rate of VAT for the destination country, file VAT returns in that country and pay the VAT over to the tax authority.

They must also contact the VAT authority in other EU member state at least thirty days before making the first supply to be covered by the option, and register by the date of this supply.

This might be beneficial where, for example, the domestic rate of VAT in the customer's country is below the rate in the UK (because the customers are unregistered, they cannot recover any VAT charged).

Goods lost, destroyed or stolen

If this happens in the UK before the goods have been dispatched there has been no supply so there is nothing to report.

If it happens in the UK after leaving the supplier, while being transported to a customer in another EU member state, VAT is payable at the normal rate unless the supplier holds evidence of the loss (such as an insurance claim or police report). This is to ensure that the goods are not just reported as lost, destroyed or stolen, but then actually enter free circulation in the UK.

If it happened while the goods are being transported to the customer but are now outside the UK, the supplier can continue to zero-rate the supply (if they hold proof of removal from UK and quote the customer's VAT number on the invoice). There may be a VAT liability in member state of where the loss occurs, so this would need to be checked as different countries may have different rules in this situation.

Contributed by Malcolm Greenbaum