Tolley®CPD

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Personal tax

Temporary car benefit reductions

HM Treasury has published the outcomes of its consultation, launched at Budget 2018, on the impact of the 'worldwide harmonised light-vehicles test procedure' (WLTP) on vehicle taxes that are linked to CO_2 emissions. In the UK, this affects vehicle excise duty and company car taxation. On average, WLTP testing will result in higher CO2 values, although these increases will be greatest for cars with smaller engines and lower emissions. While the government's view is that vehicle tax rates should more closely reflect the environmental impacts of driving, its approach seeks to balance climate change commitments with consumer protection during the transition.

This testing procedure has been required for new car registrations since September 2018, but the government confirmed at Autumn Budget 2017 that it would begin basing taxation of cars registered from April 2020 on WLTP figures.

The document sets out the government's key decisions as follows:

- for cars first registered from 6 April 2020, most company car appropriate percentages will be reduced by 2% in 2020/21 before returning to planned rates over the following two years, with an increase of 1% in 2021/22 and 1% in 2022/23;

- to accelerate the shift to zero emission cars, all such models will pay no company car tax in 2020/21, 1% in 2021/22 before returning to the planned 2% rate in 2022/23.

Legislation for the changes will be introduced in Finance Bill 2020.

The WLTP impact on vans is being considered separately, as WLTP testing for heavier vans does not become mandatory for new registrations until September 2019.

www.gov.uk/government/publications/review-of-wltp-and-vehicle-taxes

Director's use of home as an office – part 1 (Lecture P1147 – 10.07 minutes)

During the school-run outside the school gates the other day, I found myself in conversation with my wife's friend's friend. And, as regularly happens when I am forced to tell relative strangers what I do for a living, she said "Oh, can I ask you a quick question?" following which we enter the world of hopefully brief but inevitably free tax advice!

Cutting a long-story short, she quit her job to start a family and is going back to work in a few months. But rather than trying to find an accommodating and flexible local employer who will allow her to fit her hours around the school-run, she will set-up as a freelance "whatever-it-is-she-does" and work from home. She will form a company and will be the sole shareholder / director. She will need a home-office, so she is hoping to build a small extension on the side of her house that she will use as her workspace. The other alternative is the 'cabin-in-the-garden' type of office, but the house extension is preferred as this will add more value.

She had a couple of questions which 'she was sure were simple and I would know the answer to':

1. Can she claim the building costs back from her company?

2. Once things are up and running, can the company pay her for "use of home"?

I've been around long enough to know that there isn't a simple answer here (and this was certainly not something I wanted to get into without the promise of cash changing hands which I sensed wasn't on the agenda). So I basically said, "yes" and "yes" and suggested she talk to her accountant about how she should go about doing this. Free consultation over. You're welcome, don't mention it.

But just to prove that there is much more to these questions than meets the eye, I've expanded on the 'yes, yes' approach with some proper answers.

Part 1 of these notes will deal with the tax issues concerning the construction of a home office at the director's home and whether these costs should be borne by the director or the company.

Part 2 of these notes will discuss the ways in which a company can reimburse a director for the costs of working from home and the tax effects of such payments.

Can a director reclaim the building costs of a home-office from the company?

When I said, 'yes', to this question, what I should really have said is, er.…"no". Not really. Not unless she wants to pay tax.

The costs of building of extension will be capital expenditure on the director's only or main residence. The CGT base cost of the house will be increased by the VAT-inclusive costs of the works, this being genuine enhancement expenditure.

Principal private residence (PPR) relief is affected where part of a home is used "exclusively" for business. If this is the case, no part of a subsequent gain on the disposal of this part of the house would qualify for PPR relief (not even the final 18 months), as this bit of the house has never been occupied as a residence. Apportionment of proceeds and costs on sale would then be required (itself subject to HMRC agreement).

The sensible advice here would be to either:

(a) Use the extension for 'family living' for a short period – for example, as a kids' play room, TV room etc – before bringing it into use as a home-office. This accesses PPR relief for the initial non-business period plus the final 18 months (reducing to 9 months from April 2020). It might also mean that any gain arising on the office element would be eligible for entrepreneurs' relief under the associated disposals rules, this being a disposal of an asset used in the business of the taxpayer's personal trading company which is sold as part of the taxpayer's withdrawal from that business; or

(b) Do not use the extension "exclusively" as an office and instead have some consistent mixed-use of the space (for example by having a TV and sofa in there or coupling the office with occasional use as a mini-gym by the surreptitious housing of a treadmill in the corner). This would leave any PPR claims unaffected. Entrepreneurs' relief would not then come into the picture as PPR relief will deal with the gain. B) in most cases is the sensible way to go.

Any attempt by the director to seek reimbursement of the building costs from the company will give rise to a taxable benefit equal to the VAT-inclusive cost to the company of providing that benefit. This cost should be reported on form P11D. Even if the company is VAT registered, it will not be allowed to recover any input VAT on the building costs, this being expenditure incurred for the private benefit of a director.

As the company would be settling an employee's personal liability, the amount reimbursed would be liable for Class 1 NICs (both primary and secondary) and should accordingly be put through the payroll for NIC only. As any amounts reimbursed by the company will be taxable as remuneration in the hands of the director, these costs will be corporation tax deductible for the company.

The office will then need to be equipped with the usual paraphernalia such as furniture (desk, office chair, cabinets, shelving etc) and equipment (laptop and printer). It makes sense for these costs to be suffered by the company (either directly or by reimbursement to the director).

A taxable benefit only arises where a company purchases an asset and subsequently makes that asset available to a director for private use. In this case there will be a strong argument that the plant and machinery acquired for the office is for business use only and any private use by the director is incidental and can be ignored. No income tax or NIC charge should therefore arise.

If the costs of the TV and treadmill are borne by the company, that is a different story and a taxable benefit will arise being 20% per annum of the cost of the assets. The benefits are reportable on form P11D and will be subject to Class 1A employer's NIC. A further benefit could arise if and when the assets are transferred to the employee. Advice is not to do this as it's more trouble than it's worth.

The company will be able to claim capital allowances (in most cases at 100% within the annual investment allowance) on the cost of the furniture and equipment so provided.

The company can reclaim VAT on the purchase of assets used to make taxable supplies, so it will be able to recover its input VAT on any furniture and equipment used by the director in the home office. [Assuming of course that the business is VAT-registered. If it isn't, it may be able to recover this later as pre-registration input tax.]

The garden-office alternative….

The (probably cheaper and less disruptive) alternative is for the company to construct its own office on the site. This could be achieved by building an office in the garden – typically by parachuting-in some sort of log-cabin or similar structure - which is then kitted out as an office and used for that purpose.

Planning permission is not usually needed. However, business rates may need to be paid (so a phone call to the Council is recommended). Business rates are not usually payable by home-based businesses if only a small part of the home is used for the business, although this is worth checking with the local Council in case of separate home-office.

The company could pay for, and retain ownership of, the structure. Assuming the director is not receiving any personal benefit from the garden-office - i.e., the director can demonstrate that any private use of the workspace is incidental and insignificant - there are no benefit-in-kind and NIC issues. However, if the workspace is used for a non-business purpose, a value will need to be place on this and that benefit value reported on the P11D (with a Class 1A NIC charge added on for good measure).

Although the building would be a “new commercial structure” rather than a residential dwelling, the new Structures & Buildings Allowances (SBA) is not available as the HMRC Technical Notes on the new SBA tell us that “no relief will be provided for work spaces within domestic settings, such as home-offices”.

However, any expenditure qualifying as plant and machinery within the construction costs would be eligible for capital allowances. This would include things such as insulation, wiring and plumbing. In most cases relief would be available at 100% giving an effective immediate write-off against profits.

The company (if VAT registered) would be able to recover the VAT both on the structure and on business set-up costs (plant and machinery etc).

One issue to bear in mind with this arrangement is that, on an eventual sale of the property, part of the proceeds should be allocated to the garden-office and this element will need to be paid to the company. This will potentially give the company a chargeable gain on the disposal on which no relief is available. This should not be a major concern because the gain is unlikely to be substantial as log-cabins tend not to appreciate in the same way as bricks and mortar.

From the homeowner’s point of view, there is also the possible argument that the 20 square metres or so of garden and grounds on which the log-cabin has been standing has not been “used for the enjoyment of the residence” giving a possible restriction in PPR relief. However given that cabins tend not to take up a significant amount of space, this is likely to prove immaterial in most cases. A particularly officious HMRC Officer may however make this point.

Legal fees on sale could be higher as the conveyancer may point out that there are two vendors here selling two separate assets, so two sale contracts may need to be drawn up leading to two sets of fees. This paper-mess can be easily tidied-up by the homeowner simply buying the log-cabin from the company for its market value before the house is sold.

Contributed by Steve Sanders

Director's use of home as an office – part 2 (Lecture P1148 – 11.01 minutes)

Can the company pay for the director's "use of home"?

This is a definite 'yes'. If the company is wholly or partly run from the home and the director performs a substantial amount of duties from that home, it is only fair that the director receives reasonable recompense for the additional costs incurred in performing those duties. It's just a question of how we go about doing this.

To this end there are two ways:

1. The director can charge rent to the company for effectively letting-out the part of her house which is then used by the company as its business premises; or

2. The director can simply recharge the company for costs she has incurred in performed those duties.

Considering each in turn.

Renting-out part of the property to the company

If rent is charged, the director will then have a property letting business, the profits from which must be declared via the Land and Property section of their SA return. The profits are chargeable to income tax but (unlike most forms of income from an employer company) are not liable to NICs.

If the property is jointly owned (meaning that any newly built extension to act as an office will also be jointly-owned land), each landlord will record their share of the rental profit on their separate personal returns.

Care must be taken here not to push this particular envelope too far because the rents charged to the company should not exceed a normal commercial rent payable to an unconnected third-party tenant. [There is a strong argument that excessive rents are 'disguised remuneration' and should be taxed as employment income via PAYE, but even if this can be defended, the excess will be a distribution.]

It should also be remembered that a company director has obligations under the Companies Act to ensure that he does not allow the company to enter into detrimental contracts or agreements (which a licence agreement with a landlord at excessive rents would be). Some research is therefore recommended as to what is a typical monthly rent for a serviced office in the local area.

The rental payments are tax-deductible for the company provided they are wholly and exclusively incurred for the purposes of its business. As long as genuine business activities are taking place and the rents charged are reasonable and justifiable, this is rarely a problem.

It is advisable for the director to draw up a licence agreement with the company to formalise the arrangement and give evidential back-up for the deductibility of the rental payments in the company. Typical licence agreements are for short periods (say 12 months, renewable annually) and formalise things such as the level and frequency of rental payments and terms of notice. If the house is jointly owned, the licence agreement should be in joint names.

This agreement would typically give the company the non-exclusive right to occupy part of the property during working hours. This agreement should be properly recorded (ideally by means of a Board Minute). The mortgage-lender should also be consulted before the licence agreement commences (just in case the terms of the mortgage are infringed).

The rent will cover the running costs of the home-office. These costs will then be deductible expenses for the director / landlord. Note that there is no possibility of the rents falling under the rent-a-room scheme because the letting is not residential.

Arriving at the amount of deductible expenses requires a 'just and reasonable' apportionment of total household expenses such as light and heat, cleaning, insurance, council tax, water rates and any repairs / re-decoration costs. Apportionment can be based on the number of rooms or on square footage as long as the result is fair. Only normal living spaces are considered, so we can exclude hallways and landings. Kitchens and bathrooms can also be ignored as these are not considered workspaces.

If the workspace will be occasionally used for a non-business purpose (which is sensible given that exclusive use will impact on PPR relief), then further apportionment is required. The apportionment method should be disclosed to HMRC (for example, via a white space disclosure) and is subject to their agreement.

For example, assume that the running costs of the house are £6,000 per year. The house has 8 living spaces, one of which is use as an office. The office itself is used 90% of the time for business (with occasional private usage). A reasonable apportionment would be:

£6,000 x 1/8 x 90% = £675 as a deduction from rents.

Telephone calls can be considered separately and can also be apportioned if the business is sharing the home land-line. However it is often more sensible for the company to contract in its own name for a separate phone line (and possibly for separate business broadband) in which case the company can reclaim the full costs (and the associated input VAT).

It is worth mentioning here that the £1,000 "property allowance" is not available where rental income includes payments from an employer, or from a close company in which the individual is a shareholder. This particular simplification tool is not therefore an option, so we have to do this the long way.

Where a loan is taken out for the purpose of the property business (a "dwelling-related loan"), the interest is deductible from rental income. Since 2017/18, the interest deduction is restricted with any disallowed interest being relieved as a 20% tax reducer in the taxpayer's income tax computation. In 2018/19, only 50% of the interest paid is deductible against rental profits. The deduction reduces to 25% in 2019/20 and is zero from 2020/21 (with all interest then being relieved as a tax reducer at basic rate only).

Claims for home-office costs typically include a reasonable proportion of the mortgage interest on the property (which is fair enough given that the taxpayer has borrowed money to acquire a property, part of which is being used for business). The question is, do the interest restrictions apply?

There was a school of thought which said that because the purpose of the mortgage was to provide the director with a home (and any subsequent business use of part of that home is incidental), the loan was not "borrowed for the purposes of the business" and is not dwelling-related meaning that the interest restrictions do not apply.

HMRC’s view is (not surprisingly) the opposite. The part of the property being used for business is part of a dwelling and that part is used “for the purpose of generating income” (as required by ITTOIA 2005, S.272B). This makes the loan “dwelling-related” and brings it within the interest restriction rules.

Where a loan is taken out specifically to construct an office (as is the case for my ‘non-client’), the interest on that specific loan should be deductible against rents without apportionment. Bearing in mind our previous advice that the director should not use the new room “exclusively” for business due to PPR restrictions, it is not advisable to claim a full deduction for such interest. The part of the interest attributable to business use will then be subject to the interest restriction rules in S.272A as outlined above.

Conversely, where there is an existing mortgage on the house, but a home-office has been separately constructed and funded by cash (such that no loan relates to that “business” part), it may be difficult to justify an interest deduction at all.

For example, assume an extension to the house was constructed at a cost of £50,000 and funded by a loan of the same amount. Interest is paid on the loan at a fixed annual rate of 4%. The extension is licenced to the company and used as an office. Business use of the space is 90%.

The interest paid on the loan in 2019/20 is £50,000 x 4% = £2,000. 90% of this relates to the property business being £1,800. The deduction against rental profits in 2019/20 is £1,800 x 25% = £450. The disallowed interest (£1,350) is then relieved as a 20% tax reducer in the taxpayer’s income tax computation giving a tax reduction of £270.

In terms of physically receiving the money, the director would typically fill in an expense form and submit that claim to the company for approval and payment. Alternatively the director could be set up as a supplier on the company’s system and approved expenses entered as purchase invoices and paid accordingly. For businesses with a payroll, a third option is to pay the costs via the payroll (with no tax or NIC). Expenses can either be paid physically or offset against a director’s loan account.

Recharge expenses to the company

As an alternative to drawing up a licence agreement and charging rents, the director could simply make an expense claim to the company to cover any costs she is personally incurring while working from home.

Any employee (including directors of one-man companies) can reclaim ‘homeworking expenses’ from an employer company without triggering a taxable benefit provided that the employee/director performs some or all of his duties from home.

The simplest method is to make a claim based on HMRC's approved homeworking allowance of £4 per week (or £18 a month). This guideline rate can be reclaimed from the company without keeping detailed expense records (which is perhaps the main attraction).

HMRC expect that £4 per week is normally sufficient in most cases, particularly where the additional costs are only for heating and lighting the work area. However, a higher amount can be claimed provided it does no more than reimburse the average additional costs that the director will incur while working at home. This higher amount must be agreed in advance with HMRC (who might also allow this to be increased annually with inflation). This is usually achieved by carrying-out a sampling exercise to demonstrate that £4 per week is insufficient to cover the additional homeworking costs.

Amounts paid to the director within HMRC agreed rates are exempt income and are tax and NIC free and tax-deductible for the company.

The £4 a week allowance excludes business telephone calls which can be separately reclaimed based on actual costs incurred.

Alternatively, an employee/director can make an expense claim based on the actual additional costs (i.e., the "marginal" costs) of working from home. This claim will typically include a reasonable proportion of light and heat, home telephone calls, broadband costs, insurance and cleaning. Expenses should be supported by receipts.

No claim can be made for 'fixed' costs such as mortgage interest (or rent paid to a superior landlord), insurance premiums (unless there is a separate policy under which business items are insured), general repairs, council tax or water rates as these expenses would have paid anyway irrespective of whether any employment duties were carried on in the home.

As my non-client said, just a quick question...

Contributed by Steve Sanders

Locum urologist – mixed decision **(Lecture P1146 – 14.25 minutes)**

Summary – Under a hypothetical contract, a locum urologist was found to be employed by one hospital but self employed at another.

George Mantides is a locum urologist. He is the sole director and owner of the shares in George Mantides Ltd. Between March and August 2013 George Mantides Ltd made Mr Mantides' services available to the Royal Berkshire Hospital, and between September and October 2013 George Mantides Ltd made those services available to Medway Maritime Hospital.

Royal Berkshire Hospital and Medway Maritime Hospital paid George Mantides Ltd for those services. At both Royal Berkshire Hospital and Medway Maritime Hospital Mr Mantides's work consisted of conducting outpatient clinics, procedures and minor operations. At Royal Berkshire Hospital he also undertook a small amount of on-call duty.

HMRC raised assessments for PAYE and Class 1 NIC for £30,000 on George Mantides Ltd on the basis that the payments were caught by the IR35 legislation.

George Mantides Ltd appealed arguing that any hypothetical contracts between the entities would not have been ones of employment.

Decision

The First Tier Tribunal considered the arrangements with both hospitals, concluding that one did fall foul of the IR35 rules while the other did not.

At the Royal Berkshire Hospital:

- Mr Mantides had to provide his personal service with no provision for a substitute;
- He was subject to some control by the hospital. However, his work was not closely supervised: he was not told how to deal with outpatients or how to operate. Overall the level of control did not point strongly towards employment;
- There was sufficient mutuality of obligation to indicate employment. There was an obligation to work and obligation to pay for the work done. The Tribunal found it likely that the hospital would have been under a duty to use reasonable endeavours to provide the 10 half-day sessions per week contracted during the contract period;
- Using the hospital's equipment pointed weakly towards employment;
- He bore the risk that his contract could terminate early and of having to find new work but these are risks borne equally by a salaried employee;
- It was likely that the contract would terminable with at least a week's notice which was not an indication of self-employment;
- The lack of any employee benefits points away from employment.

Taking all these factors together and standing back the First Tier Tribunal concluded that had Mr Mantides' services been provided under a contract with the hospital, he would have been an employee (both on the income tax and the NI tests).

The circumstances of Mr Mantides's work for Medway Maritime Hospital differs in three material respects from those of his work for Royal Berkshire Hospital:

1. Under the notional contract with Medway Maritime Hospital he had a right to send a substitute if that substitute was approved by the agency, making it a possibility;
2. The notional contract with Medway Maritime Hospital could be terminated with just one day's notice. One day's notice is almost illusory and does not point to employment;
3. The notional contract with Medway Maritime Hospital would have contained no obligation on Medway Maritime Hospital to try to provide either 37.5 hours or 10 half day sessions in a week. There would not have been even a qualified obligation to provide work. That points away from employment.

In other respects, the circumstances of the Medway Maritime Hospital engagement would be the same as the Royal Berkshire engagement. However, standing back and looking at the factors together with the three noted above, the First Tier Tribunal found that the balance lies on the side of self-employment (both as regards the income tax and the NI tests).

George Mantides Ltd v HMRC (TC07202)

Radio broadcaster – successful IR35 appeal (Lecture P1146 – 14.25 minutes)

Summary – Successful scriptwriter has convinced the courts that his work as a radio presenter for the same company over an 18-year period does not fall foul of IR35.

Paul Hawksbee is a successful scriptwriter as well as being known for presenting the radio show which arises in this appeal. After a variety of other roles in television and sport, in 2000 he and his colleague, Andy Jacobs, began to write and perform a light-hearted cricket show for Talksport. At the end of 2000 they were asked by Talksport to present a three-hour sports-based show each day from Monday to Friday. This was the Hawksbee & Jacobs Show, which has now been running for 18 years.

The extent of his paid work outside this show has varied considerably over the years, but has been considerable. For example, he wrote for all 161 episodes of "Harry Hill's TV Burp" between 2002 and 2012. For the three years subject of this appeal, the income from Talksport comprised on average approximately 90% of his total income. Prior to this period his non-Talksport income was a higher percentage of his total income. For instance, for the two tax years preceding the period under appeal the Talksport income comprised approximately 70%.

From 2001 onwards, the pair performed their show pursuant to a series of two-year contracts. On the advice of his accountant, Paul Hawksbee set up Kickabout Productions Limited in January 2001 to provide his services on a range of projects. The contracts for his services on the show were provided through Kickabout Productions Limited.

HMRC determined that for the two contracts and periods under appeal the IR35 legislation applied to those services, on the basis that the hypothetical contract between Paul Hawksbee and Talksport would have been a contract of employment.

Paul Hawksbee appealed.

Decision

In line with other IR35 cases, the First Tier Tribunal considered the areas of mutuality of obligation, control and other factors contained within the two contracts.

The minimum of mutuality of obligation existed because Paul Hawksbee had to provide the services personally, and Talksport had to pay for them. He was obliged to work for at least 222 days a year. However, Talksport was not obliged to provide that work, even though in practice both parties expected that he would perform the minimum number of shows each year barring unforeseen circumstances.

Under both hypothetical contracts, Talksport controlled the where and when, but that was considered to be of relatively little significance compared to control of the how and what.

In relation to how Paul Hawksbee performed his services, Talksport had no effective control of a live broadcast, but the Tribunal placed little weight on this. In advance of each broadcast, editorial and artistic control of the content and format lay almost entirely with Paul Hawksbee.

However, the ultimate right of control in advance of a broadcast if the parties had been unable to agree on a material issue would have rested with Talksport. In relation to control over what services Paul Hawksbee could be required to provide, under both hypothetical contracts this was limited to the show and some ancillary obligations to promote the brand. Talksport could not, for instance, require Paul Hawksbee to act as a researcher or scriptwriter, to read the sports results, or to perform any role in relation to any other Talksport show.

Other factors considered by the Tribunal included the following:

- The degree of economic dependency and length of time over which the contracts had been renewed were material indicators of an employment relationship;
- Under the contracts Paul Hawksbee was restricted in his freedom to act as a radio presenter elsewhere but there was no restriction applying to the ways in which he habitually earned income outside the show as a television script writer;
- Neither hypothetical contract contained any right for another person to be substituted for Paul Hawksbee. Given the Tribunal's finding that Talksport were contracting for the unique expertise and work product of Paul Hawksbee, this was to be expected;
- Neither hypothetical contract contained any rights in respect of holiday, sick pay, pensions or paternity leave - clearly pointing away from employment;
- Neither hypothetical contract contained provisions relating to medicals, training, appraisals or formal disciplinary or grievance procedures - clearly pointing away from employment;
- Talksport paid a fee per show, regardless of how long it took him to research and prepare for each show. His ability to continue to do other work and to generate and progress opportunities depended on how effectively he managed his time outside the three hours per weekday when the show was on air;
- Although Paul Hawksbee was strongly associated by listeners with the show, the factors identified above do not support the view that he was part and parcel of the Talksport organisation;

Looking at the picture as a whole, the Tribunal narrowly concluded that the relationship was a contract for services. The Tribunal added that, if contrary to their conclusions, the analysis of the relationship under the hypothetical contracts was properly described as "doubtful" (per MacKenna J) or "borderline" (per Dragonfly) then the clear statements in the hypothetical contracts by the parties as to their intentions, namely to create a contractor relationship and not one of employment, supported their conclusion that the relationship was not one of employment. The appeal was allowed.

Kickabout Productions Limited v HMRC (TC07230)

Spotlight 47 **(Lecture P1149 – 13.21 minutes)**

HMRC published Spotlight 47 on 4 February 2019. This document provides information about schemes which 'try to avoid an income tax charge on distributions when winding up a company'.

More recently, the CIOT and the Tax Faculty have met with HMRC to discuss Spotlight 47 with a view to having a better understanding of HMRC's official position on the relevant legislation which can be found in S396B ITTOIA 2005 (as inserted by S35 FA 2016). This contains a targeted anti-avoidance rule (TAAR) which treats distributions made on or after 6 April 2016 to an individual in respect of share capital on the winding up of a UK-resident company as income (as opposed to capital), but only where the four conditions specified in S396B(2) – (5) ITTOIA 2005 are met.

The CIOT have previously commented that the FA 2016 legislation is very widely drafted and, as a result, there has been considerable uncertainty over when, or if, it can apply. Unfortunately, the guidance which HMRC produced in July 2017 (and updated 12 months later) is far too brief and lacks practical case studies – as evidence of this, see Paras CTM36300 – CTM36350 of the Company Taxation Manual.

The purpose of the TAAR is to prevent income tax avoidance when someone winds up a company and it was introduced principally to tackle what is known as 'phoenixism'. This term describes the situation where a company goes into liquidation and a new company is then set up to replace the old one, with the purpose of carrying on the same, or virtually the same, trade or business as before. The shareholder receives the value of his company in a capital form, while the trade or business continues, albeit now in the new company. Typically, there is no commercial rationale behind these arrangements.

Spotlight 47 goes on to explain that HMRC have become aware of phoenixism schemes which claim that the TAAR does not apply because the parties involved have made 'an artificial modification of the arrangements aimed at defeating the intention of the legislation (by selling the company to a third party rather than winding it up)'. HMRC assert that these schemes are within the scope and purpose of the FA 2016 legislation and that therefore the TAAR does apply to them. They have also confirmed that they will consider using the GAAR regime, if necessary.

During the meeting referred to above, HMRC said that they had seen a change in taxpayer behaviour since the introduction of the TAAR and that this is what had prompted them to issue Spotlight 47. Clearance applications, which are not of course relevant for S396B ITTOIA 2005, seemingly showed increasing numbers of instances where individuals were selling off companies rather than liquidating them, in an apparent attempt to sidestep the rigours of the TAAR.

Looking at two extremes:

1. If an individual wanted to stop running his business, sold the company which operated that business to an independent third party as a going concern and had no intention of working in that area again, it is pretty clear that the TAAR would not be in point.

2. However, if the businessman simply wanted to liquidate that business and start afresh doing something similar, it is likely that HMRC would apply the TAAR. Attempting to avoid this outcome by disposing of the company's assets and liabilities, effectively turning it into a money-box company, and then selling this to a third party who immediately winds it up and uses the proceeds to pay the vendor would almost certainly lead to HMRC invoking the TAAR. Even if a tribunal subsequently ruled that the TAAR did not apply in these circumstances, HMRC have stated that they would not hesitate to use the GAAR, given that the TAAR was being deliberately avoided. Although not specifically mentioned, it seems probable that HMRC would still have recourse to the TAAR if the money-box company was not liquidated by the buyer but kept instead as a dormant subsidiary.

Between the extremes of the above two examples, HMRC indicated that the result of any case would depend on its particular facts, but the CIOT understood that HMRC's position, in essence, was that selling shares in a company as an alternative to winding it up would not decrease their chances of invoking the TAAR.

The CIOT concluded their summary of the meeting with these words:

> 'HMRC acknowledged that the scope of anti-abuse rules can lead to uncertainties and that ultimately addressing them is a matter for the Courts. But they take the view that the chargeable gains treatment of disposals of shares is in general confined to straightforward sales and company liquidation distributions untrammelled by tax considerations. It follows that they will seek to apply anti-abuse rules in situations where the purpose of the legislation appears to be being circumvented and there is evidence that this is being achieved deliberately through what HMRC consider to be artificial means.'

Contributed by Robert Jamieson

Capital Taxes

Property sale **(Lecture P1146 – 14.25 minutes)**

Summary – The gain on the sale of a property should be recalculated using a reduced figure for sale proceeds, resulting in no gain become chargeable.

In November 2001 Jeremy Sage bought a property from which he then ran his business.

In December 2005 he sold a half share in the property to Mrs Peterson, his domestic partner.

In 2010, the couple separated and Jeremy Sage moved out of the property. On 30 April 2010 the property was sold for £300,000 to Lyndhurst Services Limited, a company in which Mrs Peterson had an interest. Jeremy Sage did not include details of this sale on his 2010/2011 tax return.

Following an enquiry by HMRC, a closure notice was issued for additional tax of £10,959.66 that was due as a result of the sale of his share of the property. Since then, HMRC allowed additional costs and expenses incurred in buying and selling the property and, as a result, the amount of CGT outstanding was reduced to £5528.16.

Jeremy Sage appealed arguing that the SDLT and VOA records were wrong and that he did not benefit from the sale of the property, save that his mortgage was discharged.

Decision

In the Tribunal's view, HMRC had rightly assumed that as Jeremy Sage was a 50% owner of the property, he would have received £150,000 (50% of the £300,000) That £150,000 was then used as the basis of the CGT assessment.

However, the First Tier Tribunal found as a fact that Jeremy Sage did not receive one half of the £300,000 as his share of the transaction. The only benefit that he received was that his liability under the mortgage of £116,170.48 (half of £232,340.96) was discharged or assumed by Lyndhurst Services Limited.

The Tribunal concluded that HMRC's assessment was too high and that there was sufficient positive evidence to say that the CGT computation should be corrected using the figure of £116,170.48 instead of the £150,000 used by HMRC.

In their view this meant that the assessable gain was reduced from £40,812 to £6,982.48 which is covered by the annual exemption and so no CGT was payable in respect of the sale of his share of the Property. But they deferred to HMRC to provide the definitive figure.

With no tax to pay, the late payment penalty would no longer apply.

Jeremy Sage v HMRC (TC07174)

Share defence (Lecture P1146 – 14.25 minutes)

Summary – Litigation costs were not incurred in defending the title of shares and so were not deductible in arriving at the gain arising on disposal.

Nigel Gray had acquired a minority shareholding in a BVI company in 2003.

In 2011, he had started legal proceedings against the majority shareholder under the relevant BVI provisions, and an out of court settlement was reached. As part of the settlement, he sold his shares to the majority shareholder receiving over $4.6 million.

He argued that the litigation costs were deductible in arriving at the gain arising from the sale as they fell within s38(1)(b) TCGA 1992.

HMRC contended that the litigation costs had not been incurred 'to establish, preserve or defend any title or rights' over the shares, as share ownership had never been challenged.

Decision

The First Tier Tribunal agreed with HMRC. Stating:

> 'The rights that the appellant describes are rights that might derive from a shareholding. They are not over a shareholding.'

Up until the sale, the rights and obligations conferred or imposed on Nigel Gray by the Articles of Association never changed.

They added that even if the costs had fallen under s38 TCGA 1992, they had not been incurred 'wholly and exclusively for that purpose'. Mr Gray had a number of reasons to start the litigation, including obtaining a declaration that the affairs of the company were managed in a manner prejudicial to him.

The litigation costs were not deductible for CGT purposes

The appeal was dismissed.

Nigel Gray v HMRC (TC07208)

CGT on settlement (Lecture P1146 – 14.25 minutes)

Summary - A cash payment was payable under a sale purchase agreement and so constituted an earn-out paid by the buyers to the sellers of the company, and was subject to CGT.

The taxpayers in this case were all UK tax resident owning the entire issued share capital of two UK companies that they sold. They included their share of the initial consideration from the sale in their self-assessment returns. This amount was not disputed.

However, under the share purchase agreement, should some outstanding litigation be settled, there was a potential earn-out element payable in the form of loan notes. In June 2013, the litigation was settled but rather than receiving loan notes, a deed of variation was executed so that the sellers received cash, rather than the loan notes.

The sellers argued that under the sale purchases agreement they were entitled to receive loans notes and not cash. The cash payments received were not derived from the sale of the shares under the SPA.

Decision

The First Tier Tribunal observed that the entitlement to the payment had been an asset, in its own right, and fell within the scope of s138A TCGA 1992 as an earn-out right. This asset was disposed of when the taxpayers received the payment in cash and so was subject to CGT.

In addition, the taxpayers argued that the closure notices issued by HMRC were invalid as they referred to the sale of a company in which two of the taxpayers did not own any shares. The Tribunal found that any reasonable taxpayer receiving the closure notices would have understood that the reference to the shares they did not own 'was simply a typographical error'.

D Briggs and others v HMRC (TC07166)

Adapted from Tax Journal (14 June 2019)

Inheritance Tax Review: Simplifying the design

The OTS makes 11 recommendations in this report. These are concentrated on three key areas of Inheritance Tax:

1. Lifetime gifts;
2. Interaction with Capital Gains Tax;
3. Businesses and Farms.

Many of the problems identified are connected, so solving one in isolation would simply create knock-on issues in other areas. That is why some of the recommendations consist of packages of changes that would need to be implemented together.

Lifetime gifts

1. The government should replace the annual gift exemption and the exemption for gifts in consideration of marriage or civil partnership with an overall personal gifts allowance, consider the level of this allowance and reconsider the level of the small gifts exemption, and reform the exemption for normal expenditure out of income or replace it with a higher personal gift allowance;
2. The government should reduce the seven-year period to five years, so that gifts to individuals made more than five years before death are exempt from inheritance tax, and abolish taper relief;
3. The government should remove the need to take account of gifts made outside of the seven-year period when calculating the inheritance tax due (under what is known as the '14-year rule');

4. The government should explore options for simplifying and clarifying the rules on liability for the payment of tax on lifetime gifts to individuals and the allocation of the nil rate band;

Interaction with Capital Gains Tax

5. Where a relief or exemption from Inheritance Tax applies, the government should consider removing the capital gains uplift and instead provide that the recipient is treated as acquiring the assets at the historic base cost of the person who has died;

Businesses and Farms

6. The government should consider whether it continues to be appropriate for the level of trading activity for business property relief (BPR) to be set at a lower level than that for gift holdover relief or entrepreneurs' relief, review the treatment of indirect non-controlling holdings in trading companies, and consider whether to align the Inheritance Tax treatment of furnished holiday lets with that of income tax and capital gains tax, where they are treated as trading providing that certain conditions are met;

7. The government should review the treatment of limited liability partnerships to ensure they are treated appropriately for the purposes of the BPR trading requirement;

8. HMRC should review their current approach around the eligibility of farmhouses for agricultural property relief in sensitive cases, such as where a farmer needs to leave the farmhouse for medical treatment or to go into care;

9. HMRC should be clear in their guidance as to when a valuation of a business or farm is required and, if it is required, whether this needs to be a formal valuation or an estimate;

10. The government should consider ensuring that death benefit payments from term life insurance are inheritance tax free on the death of the life assured without the need for them to be written in trust;

11. The government should review the pre-owned asset tax rules and their interaction with other inheritance tax anti-avoidance legislation to consider whether they function as intended and whether they are still necessary.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/814181/Final_Inheritance_Tax_2_report_-_web_copy.pdf

SDLT implications of property incorporations (Lecture P1150 – 14.07 minutes)

For Stamp Duty Land Tax (SDLT) purposes, a chargeable interest held by or on behalf of a partnership is treated as held by or on behalf of the partners and a land transaction entered into for the purposes of the partnership is treated as entered into by or on behalf of the partners. This is logical given that ordinary partnerships have no separate legal identity in England and Wales but it also applies in scenarios where they do have a separate legal identity. The provisions apply equally to LLPs and limited partnerships.

Anything that is required or authorised to be done by the purchaser is required or authorised to be done in relation to all of the responsible partners. The responsible partners are the persons who are partners at the effective date of the transaction and any person who becomes a partner after that date. The responsible partners can nominate a representative partner to act on their behalf and this person is deemed to be such until the nomination is formally revoked.

Liability for tax, interest and penalties within the SDLT legislation is joint and several on all of the partners, although there is a restriction on the liability of a person who becomes a partner after the effective date of the transaction.

There are specific rules applying to the following partnership transactions:

- The transfer of a chargeable interest to a partnership;
- The transfer of an interest in a partnership;
- The transfer of a chargeable interest from a partnership.

The transfer of a chargeable interest expressly includes:

- The grant or creation of a chargeable interest;
- The variation of a chargeable interest;
- The surrender, release or renunciation of a chargeable interest.

What these rules do is impose a special mechanism for calculating the chargeable consideration for SDLT purposes for any of the transactions outlined in the previous paragraph. The one is most pertinent at the moment is the transfer of a chargeable interest from a partnership. This is due to the current planning around incorporation of property businesses due to the interest restriction that applies to individual’s property businesses.

Normally the transfer of property from an individual to a company with which they are connected or where the transfer is in exchange for shares, the legislation states that the chargeable consideration cannot be less than the market value of the property transferred. Since most transactions will be in exchange for shares in order to benefit from incorporation relief, this legislation would apply. However, the partnership rules take priority so that if the partnership provisions impose a chargeable consideration of less than market value, then the SDLT charge is reduced. In some cases, it will be eliminated completely.

Transfer of chargeable interest from a partnership

The transfer of an interest in land from a partnership to a person who is or has been a partner – or to anyone connected with them – is chargeable to SDLT. This is an important point as many people refer to an exemption from SDLT on incorporation of property partnerships but this is simply not true. The legislation imposes the special method of calculating the chargeable consideration that, as noted above, may eliminate the charge altogether but this needs to be calculated.

The chargeable consideration is therefore taken to be equal to:

MV x (100 – SLP)%

SLP (which is an abbreviation of the sum of the lower proportions) is calculated using the following steps.

Step 1: First you need to identify the relevant owner or owners. A person is a relevant owner if immediately after the transaction he is entitled to a proportion of the chargeable interest and immediately before the transaction he was a partner or connected with a partner.

Step 2: For each relevant owner, you need to identify the corresponding partner or partners. A person is a corresponding partner to a relevant owner if immediately before the transaction he was a partner and he was either the relevant owner or was connected with the relevant owner.

Step 3: For each relevant owner, you then need to find the proportion of the chargeable interest to which he is entitled immediately after the transaction and this is apportioned between any one or more of the relevant owner's corresponding partners.

Step 4: The next stage is to find the lower proportion for each person who is a corresponding partner in relation to one or more relevant owner. The lower proportion is the lower of:

- The proportion of the chargeable interest attributable to the partner (i.e. the sum of all interests allocated to him under Step 3); or

- The partnership share attributable to the partner (see below to determine partnership share).

Step 5: The final stage is to add together the lower proportions of each person who is a corresponding partner in relation to one or more relevant owners. This is the SLP.

It must be remembered that the legislation determines the partnership shares by reference to income shares and not capital shares; so the same formula applies even where the land is held within the partnership by one or more partners in isolation to the others.

What is also important in the above analysis is the definition of connected parties. It is the definition that will be familiar to many as it is the one contained in s1122 CTA 2010 with one important exception. This is that partners are not connected with each other for the purposes of these provisions. To summarise, as far as the provisions are relevant for these partnership rules:

- A company is connected with another person (A) if:
    - A has control of the company; or
    - A together with persons connected with A have control of the company.

Note that any two or more persons acting together to secure or exercise control of the company are connected with one another.

- An individual (A) is connected with another individual (B) if:
    - A is B's spouse or civil partner;
    - A is a relative of B;
    - A is the spouse or civil partner of a relative of B;
    - A is the relative of B's spouse or civil partner;
    - A is the spouse or civil partner of a relative of B's spouse or civil partner.

      (Relative means ancestor, descendant or sibling)

Let's have a look at how the steps work by looking at an example. We have a partnership with a husband and wife who split the income 60:40 and are wanting to transfer the property to a company where the shareholding will be split in the same way. We will call the husband and wife Mr and Mrs X and the company Y Ltd. Y Ltd is connected to both Mr and Mrs X.

Step 1: First you need to identify the relevant owner or owners. This is Y Ltd.

Step 2: For each relevant owner, you need to identify the corresponding partner or partners. This is Mr and Mrs X.

Step 3: For each relevant owner, you then need to find the proportion of the chargeable interest to which he is entitled immediately after the transaction and this is apportioned between any one or more of the relevant owner's corresponding partners. Y Ltd is entitled to 100% of the property after the transaction. This can be split in any proportion between the corresponding partners so we will split it 60:40 between the couple.

Step 4: The next stage is to find the lower proportion for each person who is a corresponding partner in relation to one or more relevant owner.

The lower proportion is the lower of:

- The proportion of the chargeable interest attributable to the partner (i.e. the sum of all interests allocated to him under Step 3); or
- The partnership share attributable to the partner (see below to determine partnership share).

For each of Mr and Mrs X, this figure is the same so that the proportion allocated to Mr X is 60% and to Mrs X is 40%.

Step 5: The final stage is to add together the lower proportions of each person who is a corresponding partner in relation to one or more relevant owners. This is the SLP. In this it is 60 + 40 = 100. If we input this into the formula above we can see that the chargeable consideration is MV x 0%. So no SDLT is payable.

What about a partnership with 2 unconnected individuals who split the income 60:40 and are wanting to transfer the property to a company where the shareholding will be split in the same way? We will call the two individuals Mr F and Ms G. The company is Z Ltd.

Step 1: First you need to identify the relevant owner or owners. This is Z Ltd.

Step 2: For each relevant owner, you need to identify the corresponding partner or partners. In this case, only the 60% partner is connected with Z Ltd. So Mr F is the corresponding partner.

Step 3: For each relevant owner, you then need to find the proportion of the chargeable interest to which he is entitled immediately after the transaction and this is apportioned between any one or more of the relevant owner's corresponding partners. Z Ltd is entitled to 100% of the property after the transaction. This is allocated entirely to Mr F.

Step 4: The next stage is to find the lower proportion for each person who is a corresponding partner in relation to one or more relevant owner. The lower proportion is the lower of:

- The proportion of the chargeable interest attributable to the partner (i.e. the sum of all interests allocated to him under Step 3); or

- The partnership share attributable to the partner (see below to determine partnership share).

For Mr F, the partnership share is lower than the amount allocated under Step 3. So the lower proportion is 60.

Step 5: The final stage is to add together the lower proportions of each person who is a corresponding partner in relation to one or more relevant owners. This is the SLP. In this it is 60. If we input this into the formula above we can see that the chargeable consideration is MV x 40%. So SDLT would be payable on 40% of the value of the property.

The reality is that many of these types of partnerships are going to be family owned and so there will be no SDLT but there will be partnerships where this does not apply. Remember that unmarried couples are not connected.

Another interesting point arises in 50:50 situations between unconnected parties. Unless the company has a shareholder's agreement saying that neither party has a casting vote then HMRC might argue that they are not acting together to control the company such that neither is connected with the company and the SLP is 0.

It is also important to note that the partnership share attributable to each partner will depend on when and how the partnership acquired the chargeable interest now being transferred out. The partnership share will be nil unless the effective date of transfer of the relevant chargeable interest to the partnership was:

- before 20 October 2003; or

- on or after that date but the stamp duty or SDLT liability on the transfer was fully paid.

If either of the conditions above is met, then the partnership share attributable to the partner is determined as follows.

Step 1: Find the partner's actual partnership share on the relevant date which is:

- For cases under the first heading of the conditions, the later of 19 October 2003 and the date on which the individual became a partner;

- For cases under the second heading of the conditions, the later of the effective date of the transfer of the relevant chargeable interest to the partnership and the date on which the individual became a partner.

Step 2: To that partnership share are added any increases in the partner's partnership share which occurs between the day after the relevant date and immediately before the transfer of the chargeable interest from the partnership and which 'count' for this purpose. An increase counts for this purpose only where ad valorem Stamp Duty or SDLT has been paid on the transfer.

Step 3: Deduct from the increased partnership share any decreases in the partner's partnership share which occur between the day after the relevant date and immediately before the transfer of the chargeable interest from the partnership.

The answer is the partnership share attributable to the partner, but this cannot fall below zero. This can have a significant impact where partnership shares are variable.

Practical issues arising from these provisions

The biggest issue that we see with these provisions is the question of whether a partnership exists at all. If the parties involved have been returning income on their own tax return as joint income then HMRC are unlikely to accept a partnership exists unless there are factors pointing towards the existence of a partnership.

What about forming a partnership and then incorporating it? If you do this, you will have to wait at least 3 years to incorporate. This is because the calculation involving the SLT is also relevant when calculating the SDLT liability on formation of a partnership. So if you have, say, a husband and wife jointly owning property, who form a new partnership, the SLP will be 100 and no SDLT will be charged.

However, the rules relating to transfer into a partnership also contain some anti-avoidance provisions which state that if you withdraw capital from the partnership within 3 years of formation then you have to go back and recalculate the SDLT on formation to take account of the withdrawn capital. Transferring of property would fall into the category of withdrawal of capital.

There are other general anti-avoidance provisions too which look at transactions undertaken by more than one step where the SDLT would have been greater if it had been done as a single transaction (found at s75A FA2003). The individual steps do have to be pre-ordained to an extent but incorporating at three years and one day would definitely be vulnerable to attack under these provisions too.

Contributed by Ros Martin

Administration

Three reasonable excuses

What constitutes a reasonable excuse very much depends on the facts of each case. Here are three recent First Tier Tribunal cases where the taxpayers have been successful:

Case 1 - No knowledge of registering for self-assessment

Mr Solomon filed his 2016/17 tax return late and appealed against the penalties imposed by HMRC. He had been working overseas and had no knowledge of ever registering for self-assessment..

HMRC said he had registered for self-assessment in March 2017 using form SA1 and, although he was working abroad, he was still under an obligation to file a return.

The First Tier Tribunal said when the taxpayer worked as a temporary school teacher, the agency that had found him the job had 'probably' required him to set up a company to receive his pay. Indeed the company that had registered the taxpayer was 'one of thousands … established at the same registered office address'.

Further, the taxpayer had left the UK before he was registered for self-assessment. All interaction with HMRC was carried out by the agency. The Tribunal concluded that the agency had filed form SA1 without the taxpayer's knowledge.

However, the notice to file under TMA 1970 s 8 had been properly given to the taxpayer — he was a director, so it was legitimate for HMRC to require a return but did he have a reasonable excuse for not filing? Ordinarily, when someone goes abroad, they should arrange to have their post from HMRC to be monitored but only 'if they have reason to expect any'. In this case, the taxpayer was unaware he had been set up for self-assessment so he had no reason to arrange such monitoring. The Tribunal concluded that he had a reasonable excuse and cancelled the initial penalty.

The Tribunal stated that the reasonable excuse could not continue after the taxpayer contacted HMRC in April 2018 but HMRC had not given evidence that it had sent the taxpayer information specifying the date from which daily penalties were payable (FA 2009, Sch 55 para 4(1)(c)), so the Tribunal cancelled the daily penalties.

Finally, it cancelled the six-month penalty because it had been issued automatically before the return was received 'without an officer of HMRC considering to the best of their knowledge and belief what the penalty should be.'

R Solomon v HMRC (TC7133)

Case 2 – Partner was abroad receiving treatment for serious illness

In this case, the partnership had filed its 2012/13 return late on 23 September 2014 and not surprisingly, HMRC had issued late filing penalties.

On the same date, Ms Patel, calling herself the nominated partner, had also submitted form SA371 by way of appeal against the penalties on behalf of the partnership. Both partners signed the appeal.

On 21 October 2014, HMRC responded that the appeal was out of time, having been submitted later than the 30 day time limit following each penalty; and that in any event, any appeal had to be by the partner previously notified as the nominated partner, which was Ms Ibrahim.

On 9 December 2014, Ms Ibrahim re-lodged the partnership's appeal with HMRC. The grounds of appeal were that the partnership had not received a partnership return or notice to complete a return; and that at the time when the accounts should have been prepared, Ms Patel, who had undertaken responsibility for maintaining them, had to travel overseas for urgent medical treatment (for pre-cancerous cells). Again, the appeal was rejected as out of time and HMRC refused to carry out a review for that reason.

On 20 April 2015, the firm lodged an appeal with the First Tier Tribunal.

The Tribunal observed that HMRC's only argument had been that there was no reason why Ms Ibrahim could not have filed the partnership return. HMRC had therefore failed to address the fundamental point that Ms Ibrahim needed Ms Patel's approval of the accounts and the return before they could be filed. In addition, HMRC had not presented any argument as to why Ms Patel's illness and absence abroad should not amount to a reasonable excuse for the late filing of the partnership's return.

Ansham White Solicitors v HMRC (TC07194)

Case 3 - Unaware of an underpayment made by his employer

Since June 2011, Thomas Mahood had lived at various addresses, having left his previous address in Chesson Road, West Kensington, which he had shared with his brother since April 2010. He was registered as homeless with Westminster City Council.

He had not informed HMRC of his various changes of address as he did not consider there was any need to do so, as they were temporary addresses. His move from Chesson Road was due to a family dispute and this may have contributed to correspondence from HMRC, sent to Chesson Road, not being forwarded onto him.

Unknown to him, his last employer had deducted tax at source using the wrong PAYE code, which had generated an income tax underpayment. HMRC had become aware of the underpayment and, on 6 March 2014, had issued a notice to file an individual return. Mr Mahood had not filed the return by the due date and he had been issued penalties.

He eventually filed his tax return in December 2014 (six months late). He had not signed it and it had been returned to him. The return was finally received by HMRC, in good order, in January 2015 and, in April 2015, Mr Mahood appealed against the penalties.

The First Tier Tribunal found that having been unaware of the mistake by his employers in using the wrong PAYE code and the under deduction of tax, there was no pressing reason for Mr Mahood to notify HMRC of his new address, which would only have been a temporary 'care of ' address.

The Tribunal also noted that on becoming aware of the underpayment of tax, Mr Mahood had dealt with matters diligently and as quickly as he could.

Finally, the Tribunal observed that Mr Mahood had made a mistake in not signing his return but that 'equally there were delays on the part of HMRC in returning the document to him'.

Thomas Mahood v HMRC (TC07188)

Employment related securities – no reasonable excuse

Summary –Talkative Limited did not have a reasonable excuse for the late filing of returns for the tax year 2017/18.

Talkative Ltd registered two Employer Related Securities schemes on 29 January and 2 March 2018 respectively.

Guidance on how to operate ERS schemes is available on HMRC's website, headed 'Tell HMRC about your employment related securities (ERS) schemes'. The guidance states that employers need to register their ERS scheme via Government Gateway and must submit an ERS return for each registered ERS scheme every year, even if there is no reportable event.

An ERS return must be submitted even if:

- There have been no transactions;
- A late filing penalty is under appeal;
- The scheme has been registered in error, or there is a duplicate scheme;
- No reminder from HMRC was received.

The company's return for 2017/18 was due by no later than 6 July 2018 but the company's accountant did not file the ERS returns stating that no return was filed because notice to submit a return was not received.

HMRC imposed a fixed penalty of £100 in relation to each scheme when the returns were not submitted by the filing date. A penalty notice was sent to the appellant on 17 July 2018. The returns still having not been received three months after the filing date HMRC then imposed fixed penalty of £300 in relation to each scheme and a penalty notice was sent on 10 October 2018.

Talkative Ltd appealed these penalties arguing that that they were unaware that they were required to submit ERS returns for the tax year 2017/18. Accordingly, he had a reasonable excuse for the delay in filing a return.

Decision

Although the accountant indicated that he was unaware of the first penalty notice, the Tribunal concluded that it was likely that the company received the notice but neglected to pass it on to the accountant. This notice should have prompted action that would have avoided the second penalty notices.

The fact that neither the company nor its agent were aware of their duties in relation to ERS schemes, does not constitute a reasonable excuse. The onus is upon the company to ensure that they properly understand their obligations under the law.

The appeal was dismissed.

Talkative Ltd v HMRC (TC07172)

Deadlines

1 August 2019

- CT due for periods ended 31 October 2018 if not liable to pay by instalments.
- Late 2017/18 SA tax returns subject to £300 penalty or 5% of tax due.

2 August 2019

- Filing date for form P46(Car) for quarter ended 5 July 2019.

5 August 2019

- Quarterly report by employment intermediaries for period 6 April to 5 July 2019.

7 August 2019

- Due date for VAT return/ payment for q/e 30 June 2019 (electronic payment).

14 August 2019

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

19 August 2019

- Pay PAYE/CIS for month ended 5 August 2019 if by cheque;
- File monthly CIS return.

21 August 2019

- Online monthly EC sales list;
- Intrastat — supplementary declarations for July 2019.

22 August 2019

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

31 August 2019

- File private limited companies accounts with 30 November 2018 year end;
- File public limited companies accounts with 28 February 2019 year end;
- CTSA returns for accounting periods ended 31 August 2018;
- 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 2019 deadline.

News

Land for the many

A report entitled "Land for the Many" has been published, commissioned by the Labour Party, and looks at potential ways of changing the way land is used, owned and governed. Its proposals may well be considered as part of Labour's policy development process in advance of the next general election.

Interestingly, the report includes a number of tax-related suggestions including the following.

Council tax

To discourage the use of homes as financial assets, it is proposed that Council tax is replaced with a progressive property tax, payable by owners, not tenants. Properties should be valued annually and empty homes and second homes should be taxed at a higher rate. Additionally, the report recommends a surcharge for all properties owned by non-UK residents.

Stamp Duty Land Tax

Where homes are being bought to live in as a main residence, SDLT should be phased out since it unfairly penalises people who need to move house. SDLT would still be payable where properties are bought by non-doms, companies, and for all second homes and investment properties.

Capital gains tax

Taxing income derived from asset appreciation, which requires no work to obtain, at a lower rate than income derived from labour, which requires significant exertion on the part of the worker, is intuitively unfair. Capital gains tax payable relating to the disposal of second homes and investment properties should be increased so that rates charged are at least in line with income tax rates. The report believes that this will encourage people to seek more productive and socially beneficial ways to invest their money.

The report states that applying a capital gains tax to main residences would limit wealth inequality arising from the housing boom, but would be controversial and would make it difficult for some households to buy properties of equivalent value when moving house .

Inheritance tax

The report proposes that inheritance tax is abolished and replaced with a lifetime gifts tax levied on the recipient. This would apply to gifts received above a lifetime allowance of £125,00).

To allow families to maintain the integrity of agricultural land or business assets, while also preventing recipients from gaining large tax-free windfall gains, transfers of business and agricultural property would be tax-free until the asset is sold or the business becomes an investment entity.

Business rates

These should be replaced with a Land Value Tax, calculated on the basis of the rental value of local commercial land. Vacant and derelict land should be brought into this regime once residential planning permission had been granted.

Farmland and forestry

It is suggested that the taxation of farmland and forestry should be reviewed "with a view to preventing the use of farmland as a tax shelter for land speculators, while protecting genuine small farms."

In the event of a General Election, it will be important for property owners to monitor how the Labour party responds to these proposals and to consider their implications.

https://landforthemany.uk/wp-content/uploads/2019/06/land-for-the-many.pdf

FB 2020: Draft legislation and measures with immediate effect

The initial draft clauses for the 2020 Finance Act were published on 11 July 2019 and include more detail on previously announced proposals. Whilst the Government refers to it as draft legislation for Finance Bill 2019/20, in this commentary, for clarity, it is referred to as Draft Finance Bill 2020. The final contents of the Bill will be subject to confirmation at Budget 2019.

Off-payroll working rules from April 2020

As announced at Budget 2018, outside the public sector, this change will only apply to medium and large-sized organisations. The draft legislation makes clear when non-public sector organisations, including unincorporated organisations, will be considered to be small and therefore not within the scope of the reform.

The draft legislation also includes provisions to ensure that all parties in the labour supply chain are aware of the organisation's decision and the reasons for that decision, and will introduce a statutory, client-led status disagreement process to allow individuals and fee-payers to challenge the organisation's determinations.

Principal Private residence Relief changes

The government confirmed that the final period exemption will be reduced to nine months, with the 36 months still available to disabled persons or those in a care home. In addition, lettings relief will apply only when the owner of the property is in shared occupancy with a tenant. In addition, job related accommodation relief has been extended to serving members of the armed forces who receive an accommodation allowance;

Digital services tax (DST) – contributed by Joanne Houghton

A new digital services tax (DST) will be introduced from April 2020. This follows a consultation that commenced in November 2018 where the government response confirmed that it still supports an international solution that the OECD is working towards but noted that this global process will take time. The DST is therefore seen as an interim measure and will be disapplied when an appropriate international solution is in place.

The DST is a 2% tax on UK digital services revenues. Digital services revenues for a group are the total amount of revenues arising to members of the group which are in connection with any digital services activities, as defined below, and UK digital services revenues are those digital services revenues that are attributable to UK users.

DST will only apply if a group exceeds the annual thresholds which are:

- £500m digital services revenues, and
- £25m UK digital services revenues.

So effectively there will be an annual allowance on the first £25m of UK digital services revenues.

As the DST is a revenue-based tax it may be disproportionately high on businesses with low profit margins or losses so there will be an alternative charge provision or 'safe harbour' election that allows a calculation of DST based on operating margins and therefore provides relief for businesses with low profit margins or losses.

Digital service activities means providing:

- a social media platform which promotes interactions between users and allows content to be shared, for example social network sites, online dating websites and user review websites;
- an internet search engine; or
- an online marketplace which facilitates the sale by users of services, goods or other property

and includes any associated online advertising business. An associated online advertising business is a business operated on an online platform that facilitates the placing of online advertising, and derives significant benefit from its connection with the social media platform, search engine or online marketplace.

Activities are not defined in the draft legislation but the draft guidance issued at the same time gives HMRC's view that an activity will meet two conditions. Firstly it would be something done for commercial purposes i.e. services or functions provided for or on behalf of third parties. Secondly the activity would be a substantive business service and not simply incidental or ancillary to a broader function.

There is a specific exemption for online financial marketplaces if the qualifying conditions are met.

UK users means any person who it is reasonable to assume is normally in the UK, if they are an individual, or are established in the UK, if they are a business. There is no further detail in the legislation on how to establish whether a user is a UK user but the draft guidance states that businesses should use all the information available to them so that if the user has a UK address or UK payment details they are likely to be a UK user.

Revenues will be attributable to UK users in respect of online advertising where the advertising is intended to be viewed by UK users. For all other types of digital service activities revenues are attributable to UK users if they arise in connection with UK users which is a broad rule and would include subscription fees, payments to access content or a premium service.

In addition, all of the revenues that arise in connection with a transaction on an online marketplace are attributable to UK users if one of the parties to the transaction is a UK user, this could be either the consumer or the provider of the goods or services in question. If the online marketplace transaction involves UK land, the revenues that arise in connection with the transaction will be attributable to a UK user even if the owner of the land is not a UK user. This includes revenues in connection with the sale or rental of land and the provision of accommodation. Because of these provisions, double taxation may arise on revenues where another user is based in a country which has a similar tax to the DST so there is relief for certain cross-border transactions which reduces the UK digital services revenues by 50% when a claim for the relief is made.

The total DST liability will be calculated at the group level but the tax will be charged on the individual entities in the group that realise the revenues that contribute to this total. The group consists of all entities that are included in the consolidated accounts, provided these are prepared under an acceptable accounting standard. Revenues will consequently be counted towards the thresholds even if they are recognised in entities that do not have a UK taxable presence for corporation tax purposes.

A DST return must be delivered to HMRC for each accounting period before the end of one year from the end of the accounting period. A group can use a nominated company to file a return. DST will be payable for an accounting period on the day following the end of nine months from the end of the accounting period, this differs from the proposals under the consultation which were for payments to be made quarterly. For these purposes a group’s first accounting period begins on 1 April 2020 and ends with the first accounting reference date to occur after that date or, if earlier, with 31 March 2021. Subsequent accounting periods, for the purposes of DST, end with the first accounting reference date to occur after the end of the last period or one year, if that is earlier. The accounting reference date means the date to which the group’s accounts are made up.

There are no specific provisions concerning the deductibility of DST for corporation tax purposes and therefore the general rules on wholly and exclusively will apply.

The draft legislation includes provisions about DST returns, enquiries, assessments and appeals in Schedule 1. There are penalties for failing to file a return by the filing date.

There are anti-avoidance provisions for relevant avoidance arrangements.

Corporate capital loss restriction – contributed by Joanne Houghton

Budget 2018 announced that legislation will be introduced in Finance Bill 2020 to restrict the use of carried forward capital losses for accounting periods beginning on or after 1 April 2020, with transitional rules for periods straddling that date. The details relating to this new restriction are covered by Robert Jamieson in his article contained within the Business Tax section of these notes.

There are special provisions for companies that have a one-day accounting period where the company is only within the charge to corporation tax because of chargeable gains. This would include non–resident companies making a direct or indirect disposal of UK land, where they have no other source of income subject to UK corporation tax. Such companies will also be able to make claims for deductions allowances of up to £5 million each financial year. In cases where there are multiple one-day accounting periods (for example, where several chargeable disposals are made), the company is able to offset allowable losses against any chargeable gains accruing in the same financial year without the CCLR applying.

Specific rules are also introduced to enable companies to prioritise the use of certain restricted (connected party and streamed) carried forward allowable losses.

The CCLR will not apply in the following cases:

- the offset of Basic Life Assurance and General Annuity Businesses (BLAGAB) losses against BLAGAB gains;
- ring fenced allowable capital losses arising in certain UK extraction activities of oil and gas companies;
- to real estate investment trusts where the capital losses are attributable to property income distributions.

Anti-forestalling provisions also apply with retrospective effect from 29 October 2018 to prevent companies from implementing planning to maximise the use of capital losses prior to the restrictions coming into effect.

Accounting standards for leases: spreading rules– contributed by Joanne Houghton

The Finance Act 2019 changed the income and corporation tax rules which apply to a right-of use asset on the adoption of IFRS 16 by a lessee and included specific transitional spreading adjustments for tax purposes on the adoption of IFRS 16.

The Draft Finance Bill 2020 clarifies that these spreading rules apply in circumstances where the lessee first recognises the right-of-use asset in any period of account beginning on or after 1 January 2019, even if that period is not the first period of account beginning on or after 1 January 2019. Where a lessee has already adopted IFRS 16 before 1 January 2019, as early adoption was allowed, the Draft Finance Bill 2020 also confirms that the spreading rules apply as if IFRS 16 had been adopted in the first period of account after 1 January 2019.

Deferral of CT payments on EU group asset transfers – contributed by Joanne Houghton

Following the FTT case of Gallaher [Gallaher v HMRC [2019] UKFTT 207 (TC)], draft legislation has been published which permits a UK company to defer, over a period of up to five years, the payment of tax due on certain transfers of assets to a group member that is resident in an EEA state other than the UK.

Currently, certain transfers of assets from a UK resident company to a group company that is resident in an EEA state other than the UK trigger a corporation tax liability but transfers that are identical other than that they are made to a UK resident group transferee company are deemed to take place on a no gain/no loss basis (and so no tax charge arises).

The transactions in question are:

- a disposal to which TCGA 1992, ss 139, 171 would apply if the transferee were a UK resident company (transfer of capital assets for no gain/no loss);
- a transaction to which CTA 2009, s 340(3) would apply if the transferee were a UK resident company (transfers of loans on group transactions and transfers of loans on insurance business transfers for notional carrying value);
- a transaction to which CTA 2009, s 625(3) would apply if the transferee were a UK resident company (group member replacing another as party to derivative contract for notional carrying value);
- a transaction to which CTA 2009, s 775(1) would apply if the transferee were a UK resident company (tax neutral intra-group transfer of intangible fixed asset).

The draft legislation will introduce a new Schedule 3ZC into TMA 1970, which provides for a CT payment plan for such transactions. This CT payment plan will enable companies that are liable to corporation tax as a result of these transactions to defer payment of the tax over five years (in six equal instalments). Entering into such a payment plan will be voluntary and can be in respect of the entire corporation tax liability or a part of it. The UK company will need to apply to HMRC to enter into the plan before the end of the nine month following the end of the relevant accounting period and will need to supply details of the relevant transaction(s) and the amount of corporation tax being deferred. The deferred tax will be subject to interest on overdue tax (under TMA 1970, Part 9, ss 86–92) and will also be subject to penalties if instalment payments are not made on time.

HMRC will be permitted to require security if it considers that 'agreeing to accept payment of the deferred tax... would present a serious risk as to collection of the tax in the absence of provision regarding security in respect of its payment' and the plan will be void if the company does not fully and accurately disclose all material facts and considerations to HMRC. The payment plan can be brought to an end early if:

- the company becomes insolvent or enters administration;
- a liquidator is appointed in respect of the company;
- an event occurs under the law of a country or territory outside the United Kingdom which corresponds to an event in the two bullet points above;
- the company fails to pay any amount of the deferred tax for a period of 12 months after the date on which the amount becomes due;
- the company ceases to be within the charge to corporation tax;

The payment plan can also be partially ended early. This will be the case if the payment plan covers more than one qualifying transaction and the transferee company:

- ceases to be resident in an EEA state;
- is no longer a member of the same group as the transferor company; or
- sells or otherwise disposes of the item that was the subject of the qualifying transaction

or there is a part disposal of items that are the subject of a qualifying transaction. There are specific formulae to calculate the deferred tax that is attributable to a particular qualifying transaction where more than one occurs in an accounting period and the corporation tax due in those circumstances where the payment plan ends early due to the status of the transferee company but where there is a part disposal of a relevant item companies may use any method that gives a just and reasonable result to determine the amount of tax attributable to such a part disposal.

In Gallaher, the FTT found that the exclusion from TCGA 1992, s 171 of an intra-group disposal to a transferee which is outside the UK tax net but located within an EU member state was a disproportionate restriction on the freedom of establishment. The tax charge arising on such a disposal was therefore disapplied. The tribunal noted that the terms of Council Directive (EU) 2016/1164 (the Tax Avoidance Directive) are 'indicative that, so far as exit taxes are concerned, deferral by way of an option to pay by instalments is a proportionate restriction on the EU freedoms'. This change is therefore clearly designed to prevent the disapplication of these tax charges in the future on the basis of incompatibility with EU law, a point which is obliquely acknowledged in the stated policy objective for this change.

The legislation is drafted to come into force on 11 July 2019 and to have effect in relation to accounting periods ending on or after 10 October 2018.

Share loss relief for income tax and corporation tax

Share loss relief allows a capital loss on a disposal of unquoted shares in a trading company to be set against income for the purposes of income tax (for individuals) and corporation tax (for investment companies). As the loss relief is so valuable, the legislation is tightly drafted to ensure it only applies if certain conditions are met.

The European Commission formally challenged these conditions in July 2018. In order for the disposal to qualify for income tax/corporation tax relief, the unquoted trading company has to carry on its business wholly or mainly in the UK but this breaches the fundamental principle of free movement of capital. In January 2019, the European Commission issued a reasoned opinion with which the UK is required to comply with, otherwise proceedings against the UK can be brought before the Court of Justice of the European Union.

Therefore, ITA 2007, s 134 and CTA 2010, s 78 are to be amended by Finance Bill 2020 to repeal the condition relating to where the company must carry on its business. This applies to disposals that take place on or after 24 January 2019. Therefore, where the disposal takes place on or after that date, income tax/corporation tax relief can be claimed no matter the jurisdiction in which the business is based, so long as the other conditions are met.

However, since the current version of the legislation is not compliant with EU law, it is possible that taxpayers could make claims for share loss relief in relation to disposals of shares in unquoted non-UK trading companies where the disposal occurred before 24 January 2019.

Stamp taxes on shares consideration rules

Following consultation, the government is extending the market value rule to the transfer of unlisted shares to a connected company. The draft legislation removes an anomaly where a double-charge can arise on certain company re-organisations.

Technical tax changes

In addition, the government is publishing a small number of technical tax changes that need to be made to ensure legislation works as intended. These include measures relating to:

- Capital Gains Tax: Relief for loans to traders – extending the scope of the Capital Gains Tax relief in respect of loans to traders, so that it applies to loans made to traders located anywhere in the world and not just the United Kingdom.

- Share loss relief – extending the scope of the Income Tax and Corporation Tax share loss relief, so that it applies to shares in companies carrying on a business anywhere in the world, and not just the United Kingdom.

Legislation with immediate or retrospective effect

The government has published legislation for the following measures that will have immediate or retrospective effect:

- Deferred Corporation Tax payments on cross border transfers – this legislation will allow companies to defer payment of tax that arises on certain transactions with group companies in the European Economic Area. This is intended to provide certainty for UK business following a recent First-tier Tax Tribunal decision. The legislation will apply to corporation tax that becomes payable for accounting periods that end on or after 10 October 2018.

- Minor amendments to clarify the scope of legislation on changes to lease accounting standards introduced in Finance Act 2019.

https://www.gov.uk/government/collections/finance-bill-2019-20

Adapted from summary produced by in Tolley Guidance

Supplemented by contributions from Joanne Houghton

2017/18 tax gap

The tax gap is the difference between the amount of tax that should, in theory, be paid to HMRC, and what is actually paid. This could be due to taxpayers making simple errors in calculating the tax that they owe or as a result of legal interpretation, evasion, avoidance and criminal attacks on the tax system.

It provides a useful tool for understanding the relative size and nature of non-compliance and provides a basis for HMRC's strategy — thinking about the tax gap helps the department to understand how non-compliance occurs and how HMRC can address the causes and improve the overall health of the tax system

HMRC has published 'Measuring tax gaps 2019 edition' showing an estimated tax gap for 2017/18 of £35bn, representing 5.6% of total liabilities. This is slightly lower than the 5.6% for the previous year.

HMRC say that:

- There has been a long-term reduction in the overall tax gap, from 7.2% in 2005/06 to 5.6% in 2017-/8;
- Between 2015/16 and 2017/18, the overall percentage tax gap has remained relatively stable, showing a small increase of 0.3%;
- The tax gap for income tax, National Insurance Contributions and Capital Gains Tax is 3.9% in 2017/18 at £12.9 billion and represents the biggest share of the total tax gap by type of tax;
- There has been a long-term reduction for the VAT gap from 12.2% in 2005/06 to 9.1% in 2017/18.
- The duty-only excise tax gap has reduced from 8.4% in 2005/06 to 5.1% in 2017/18.
- The Corporation Tax gap has reduced from 12.5% in 2005-06 to 8.1% in 2017/18.
- The avoidance tax gap reduced from £4.9 billion in 2005/06 to £1.8 billion in 2017/18.

The breakdown by taxpayer group shows small businesses making up the largest share of the overall tax gap at £14bn, followed by large businesses with £7.7bn, mid-sized businesses with £4.3bn and individuals with £3.9bn.

In terms of taxpayer behaviour:

- Criminal activity accounts for £4.9bn of the total;
- The hidden economy and evasion account for £3bn and £5.3bn respectively;
- Avoidance is responsible for an estimated £1.8bn. More than half of avoidance is attributed to corporation tax (55%), while income tax, NICs and CGT make up 35%. VAT and other direct taxes account for the smallest share of avoidance (around 3%);
- Errors and mistakes account for £9.8bn (28%) of the overall tax gap.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/810818/Measuring_tax_gaps_2019_edition.pdf

US wealth tax

In an open letter, a group of US billionaires is asking the 2020 US presidential candidates to support a wealth tax on individuals with assets of $50m and above.

They give six key reasons for why America has a 'moral, ethical and economic responsibility' to tax wealth more:

1. To help tackle the climate crisis;
2. To promote economic growth and success;
3. To improve public health and extend life expectancies;
4. To promote fairness and social mobility;
5. To strengthen freedom and democracy by contributing to political, social, and economic stability; and
6. To fulfil a patriotic duty.

The main proposal is for a 2% tax on assets of $50m and above, with a further 1% on assets over $1bn. The letter claims this would generate nearly $3 trillion in revenue over ten years.

Adapted from Tax Journal (28th June 2019)

New Investment Funds Manual

This manual brings together older guidance contained in a number of other manuals (Corporation Tax Manual, Offshore Funds Manual, Savings and Investment Manual), and provides HMRC's direct tax guidance on the following types of investment fund:

- Authorised investment funds (authorised unit trusts and open-ended investment companies) authorised by the Financial Conduct Authority;
- Authorised contractual schemes authorised by the Financial Conduct Authority;
- Unauthorised unit trusts;
- Offshore funds;
- Investment trusts; and
- Real estate investment trusts.

It provides guidance on the tax position of investors in these funds, and on non-resident capital gains for collective investment vehicles.

www.gov.uk/hmrc-internal-manuals/investment-funds

Business Taxation

Non-resident corporate landlords (Lecture B1146 – 19.23 minutes)

As previously reported, from 6 April 2020 non-resident companies with income from UK property will no longer be liable to income tax but will instead be subject to corporation tax. It will be important that steps are put in place well in advance of April 2020, in order to ensure companies are not caught out by the transition to corporation tax. Some of the main action points to be considered are outlined below:

Non-resident companies must register for corporation tax (even for those companies that are already registered with HMRC under the non-resident landlord scheme). Existing agent authorisations will not carry over so agents must reregister for each non-resident company.

For 2019/20, two tax returns will be completed (one income tax and one corporation tax) as well as the need to file iXBRL tagged accounts. Budgeting for these changes will be important.

Where the annual net interest costs are expected to be £2m or more, either in the non-resident company or across the wider UK group, it will be important to assess any potential disallowance under the corporate interest restriction rules. Where a disallowance is expected, it might be necessary to consider how funding has been structured around the group and if certain loans should be capitalised.

Where the non-resident company (or the wider group) has or is expected to have more than £5m of losses carried forward in periods from April 2020, it will be necessary to consider the potential restrictions on the use of the losses. In addition, the group allowance allocation statement will need to consider the non-resident company as part of the wider group exercise.

Non- resident companies will become subject to the corporate anti-hybrid rules from 6 April 2020. As a result, it will be important that a review of the entities and financial instruments involving the non-resident company are carried out. If a tax mismatch arises (for example, where a financial instrument is treated as equity in one jurisdiction but as debt in another), tax relief may be restricted. See the Cross-border financing guidance note for further details

Adapted from summary produced by Tolley (8 July 2019)

Latest GAAR advisory panel opinion (Lecture B1146 – 19.23 minutes)

Summary – Entering into and carrying out the tax arrangements was not a reasonable course of action in relation to the relevant tax provisions.

A close company and its majority shareholder/director jointly acquired an offshore bond for £272,500, the director contributing £1,000 and the company contributing £271,500.

The director then entered into a gilts option with a third-party counterparty, under which the director was entitled to a premium of £250,000 with a 5% risk of having to make a £5m gilt settlement to the option purchaser on expiry.

The option expired without requiring payment in settlement and the director became entitled to the £250,000 premium.

The bond manager entered into a hedging mirror option.

The mirror option expired, paying the premium of £250,000, which reduced the value of the offshore bond to nil. The company's assets were correspondingly reduced by £271,500.

Opinion

The panel summed up the overall result of the arrangements in the following terms:

- the director paid out £1,000 for his share in the offshore bond and received £250,000 in the form of a premium under the option; and

- the company's assets reduced in value by £271,500, representing the price it paid for its share in the offshore bond which became worthless as a result of the arrangements.

The shareholders had not taken any material financial risk and the company had not been in a position to make a profit. The purpose of the arrangements was the extraction of value by the shareholders from the company, the most likely comparable commercial transaction being a dividend or other cash distribution of £250,000.

www.gov.uk/government/publications/gaar-advisory-panel-opinion-of-28-may-2019-extraction-of-value-using-a-second-hand-bond-gilt-options-additional-contributions-and-cooling-off-righ

The timing of claims for capital allowances **(Lecture B1146 – 19.23 minutes)**

In Dundas Heritable the UT found that the opening of enquiries into two returns had 'cured' the fact that the returns contained claims for capital allowances that would otherwise have been out of time.

Dundas operated public houses. The filing date for the company's tax return for the period to 31 March 2012 was 31 March 2013. The return was received by HMRC on 3 February 2015. The filing date for the company's tax return for the period to 31 March 2013 was 31 March 2014. The return was received by HMRC on 26 November 2015. Both returns contained claims for capital allowances. Both claims were therefore submitted more than 12 months after the relevant filing date and so after the date specified in FA 1998 Sch 18 para 82(1)(a). HMRC had opened enquiries into both returns and the company contended that the claims had been made on time; before the date specified in para 82(1)(b) (30 days after completion of the respective enquiries), and therefore during the time up to whichever was the last of the dates listed in para 82(1).

HMRC's argument was that there could not have been an enquiry if there had not been a return, and a claim for capital allowances had to be made in a return. FA 1998 Sch 18 para 82(1)(a) was the core provision (i.e. the first anniversary of the filing date for the company return) and the claims were outside that period.

Agreeing with Dundas, the UT found that: 'The words of para 82(1) are clear and unambiguous: a claim for capital allowances may be made at any time up to whichever is the last of the four dates specified in subparagraphs (a), (b), (c) and (d).' The tribunal also referred to Stock v Franck Jones [1978] 1 WLR 231 as authority for the proposition that: 'The existence of anomalies, if they exist, cannot limit the meaning to be attached to clear language in a statute.' The tribunal also observed that para 82(4) did contain a specific exception, which suggested that Parliament had not seen fit to provide for any other exception.

HMRC v Dundas Heritable Limited [2019] UKUT 208

Pre-entry CGT losses

In ANO (No. 1), the FTT found that a pre-ordained series of transactions, implemented to avoid the application of TCGA 1992 Sch 7A to pre-entry losses, achieved its purpose.

Sch 7A restricts the ability to use capital losses which have accrued to a company before it joins a group, but they do not restrict the use of a group's losses against the capital gains of a company which joins the group after those losses have accrued. ANO had implemented a series of transactions intended to offset the capital gains of companies in the O&H group against the losses of companies in the ANO group, without falling foul of Sch 7A.

Had the O&H group (the gains group) acquired the ANO group (the loss group) then Sch 7A would have applied to restrict the use of ANO's losses. But if the ANO group acquired the O&H group Sch 7A would not have applied to restrict the use of ANO group's losses. The transactions resulted in the insertion of a new holding company (SSG) above ANO before the acquisition of O&H. Sch 7A para 1(7) has the effect that if two conditions are satisfied the group headed by the new holding company (SSG) is the treated as the same group as the original group (the ANO group). In which case the use of losses would not be restricted as the loss group would have acquired the gains group. The appeal was about whether those conditions of Sch 7A para 1(7) had been satisfied.

The two conditions were broadly that the:

1. same shareholders owned both the ANO group and the SSG group immediately after the acquisition; and

2. principal company of the SSG group was not the principal company of any other group and immediately after becoming the head of the ANO group the assets of the company consisted almost entirely of the shares in the principal company of the ANO group.

ANO contended that its shareholders immediately before its acquisition by SSG were the same as SSG's shareholders immediately after the acquisition, and that immediately following the acquisition of ANO, SSG's only asset was the shares in ANO, so that Sch 7A para 1(7) disapplied Sch 7A para 1(6).

HMRC argued that immediately after does not mean the moment after the transaction but would be long enough to include the subsequent acquisition of the O&H group and therefore the assets held by SSG would not be entirely the ANO group shares.

Furthermore the steps were preordained and therefore SSG could be said to have the assets of O&H immediately after the acquisition of ANO.

Agreeing with ANO, the FTT considered that ‘immediately’ did mean ‘the very moment after’. It added that, given the absence of any tax avoidance test in Sch 7A and its detailed nature, it could not be construed as being suffused with the purpose of restricting the use of losses whenever there is a scheme designed to use them. It denied the use of losses in specific circumstances only. The tribunal added that the exemption granted by para 1(7) applies to situations where ‘there will generally be planned and virtually certain further transactions in the shareholders and/or the assets of the new holding company after its imposition’.

Finally, the FTT observed that Sch 7A operates at the level of the groups involved, rather than at the level of their shareholders. So, although losses were, in effect bought, they were bought (in the form of ANO) by the shareholders of O&H and not by O&H. The legislation has no effect at that level.

ANO (No. 1) Limited v HMRC [2019] UKFTT 406

Capital or revenue expenditure (Lecture B1147 – 9.40 minutes)

The recent cases of Turners (Soham) Ltd (“Turners”) provides a useful refresher of the distinction between capital and revenue expenditure for tax purposes.

Capital expenditure is expenditure that is intended to give an enduring benefit to the business. Normally, the purchase of a fixed asset would meet the definition of capital expenditure but there are specific tax rules that can treat it as revenue expenditure instead.

Development expenditure of a revenue nature is deductible, irrespective of whether it is charged to P&L as an expense or capitalised in the balance sheet

Rewiring (because electrical systems are fixtures integrated into a building) is more complicated. If the cost of works exceeds 50% of cost of replacing the whole system (judged over a rolling 12-month period), it is treated as capital expenditure. The expenditure is therefore included in the special rate pool if no AIA is available.

Some capital items do (or did) qualify for immediate deduction such as the replacement of trade tools. But what are (and are not) trade tools?

The Turners case involved discussion of many aspects of the capital versus revenue debate.

Turners was a road haulage company that in the years 2008-2011 purchased replacement trailer units, tractors and tank units totalling £33 million. In their accounts they capitalised the acquisitions and put a depreciation charge to profit and loss in each period. In their tax computation for 2008 they initially claimed capital allowances but then in 2011 they amended their tax computation for 2008 by disclaiming the capital allowances and claimed a full deduction for the cost against their trading profits. They also made an overpayment claim under FA 1998, Sch 18 para 51. A similar amendment was made to 2009 tax computation and no claims for capital allowances were made in subsequent years.

The company argued that the deduction claimed for the year to 2008 was based on ICTA s74(1)(d) ICTA 1988 which stated that:

> 'Subject to the provisions of the Corporation Tax Acts, in computing the amount of profit to be charged under Case I or II of schedule D no sum shall be deducted in respect of ...
>
> (d) any sum expended for repairs of premises occupied, or for the supply, repairs or alterations of any implements, utensils or articles employed for the purposes of the trade or profession beyond the sum actually expended for those purposes;'

The basis for the argument was that by denying a deduction for amounts beyond those actually expended, the section implicitly permits deduction for expenditure up to that point and that this would include capital expenditure.

The FTT noted that if a deduction is to be claimed for an item the first step is to see if it is deducted in the accounts of the trade; if it has been, the second step is to see if its deduction is prohibited and the third step, if the first two do not result in a deduction, is to see if there is any express provision under which deduction is required.

They concluded that, as there was no deduction in the accounts and that the deduction would be prohibited as capital, there should be no deductible amount for the replacement items. Section 74 was prohibitive to restrict a deduction for amounts expensed but did not therefore allow provision for capital amounts up to the limit.

For the subsequent years, the company claimed relief under CTA 2009, s 68 which allowed a deduction for the expenses incurred on the replacement of trade tools which would otherwise not be allowable because they were capital in nature. The discussion centred around the meaning of 'expenses incurred' and the FTT took the view that this should mean the there was a debit in the accounts of the company under GAAP. As this was not the case here there could be no deduction. They also noted that tractor and trailer units would not fall to be treated as tools as used in common language.

Lastly the FTT rejected the claim for overpayment made by the company because HMRC are not liable to give effect to such a claim where the liability was calculated in accordance with generally prevailing practice at the time. As there was a generally agreed practice of claiming capital allowances on such replacement items HMRC were not liable to meet the company's claims for an overpayment of tax.

It should be noted that s68 CTA 2009 was repealed in relation to expenditure incurred on or after 1 April 2016 for corporation tax purposes. Relief is now available for most items under the existing capital allowances regime or the relief for residential landlords for replacement of furnishings, appliances and kitchenware, which took effect from the same date.

There is a common application of the principle that capitalised costs of a revenue nature cannot be deductible as revenue expenditure unless or until they are charged as expenses in the profit and loss account.

Many companies and businesses capitalise the cost of an office refurbishment. This might consist of little more than redecoration in some cases but might be expensive.

If a refurbishment that is revenue in nature is capitalised, no immediate deduction will be available. However, when the company or business depreciates this expenditure it will be allowable as a revenue expense in each period.

Care must be taken not to disallow this depreciation, perhaps by referring to it in the profit and loss account as "deferred refurbishment costs".

Contributed by Malcolm Greenbaum

EU group relief and final losses

Two recent cases in Sweden looked at the deductibility of losses from foreign subsidiaries and whether the losses were considered to be final within the meaning of the Marks & Spencer case (Marks and Spencer plc v HMRC C-446/03 [2006]).

In the Marks and Spencer case the CJEU concluded that losses of a EU subsidiary can be deducted in the parent company's state only if firstly the EU subsidiary has exhausted all loss set-off possibilities for the current and previous years. Secondly, there is also no possibility the losses will be used in future periods by the subsidiary or by a third party, for example where the subsidiary is sold to that third party.

The Swedish cases (Holmen and Memira Holding) had parent companies that were looking to deduct the losses from their non-resident subsidiaries in Spain (Holmen) and Germany (Memira Holding). In Germany the group intended to merge the German company with its Swedish parent in a cross border merger – if this took place the losses could not be used as the losses in the German company could not be transferred. In the Spanish company's case the Swedish company wanted to liquidate the Swedish company and under Spanish law the losses could not be transferred or carried back.

In both cases the CJEU ruled that, regardless of the limitation on the use of losses in the states where the subsidiary is resident, the losses cannot be regarded as final (and therefore available for group relief under the Marks and Spencer principles) unless the parent company demonstrates that it is impossible for it to deduct those losses 'economically' by transferring them to a third party, e.g. by sale of the subsidiary. However, it is still unclear as to how this 'impossibility' this can be demonstrated in practice.

The CJEU ruling in the Marks and Spencer case also stated that the subsidiary had to be directly held by the parent company. This prevents the double use of losses and stops groups choosing to use the losses in countries with higher tax rates.

However, an additional point was made by the CJEU in Holmen which was that the parent company's state could not make the use of final losses conditional on the parent company holding the subsidiary directly if all the intermediate companies between the parent and the loss-making subsidiary are in the same EU state. If there is an intermediate subsidiary in another EU state then the parent company's state is not required to allow the use of the final losses.

Skatteverket v Holmen AB C-608/17

Skatteverket v Memira Holding AB C-607/17

Corporate capital loss restriction (Lecture B1148 – 14.58 minutes)

The Government's plan

In his most recent Budget, the Chancellor announced the Government's intention to reform the rules for the relief of corporate capital losses with effect from 1 April 2020. The rationale behind this measure is to, in HMRC's words, 'extend the corporate income loss restriction (CILR) introduced in April 2017 to include carried-forward capital losses and help create a more modern loss relief regime in the UK'. The basic principle is that companies making capital gains will only be able to use carried-forward capital losses to offset up to 50% of those gains.

However, in order to ensure that the new restriction only impacts on those companies with substantial gains, the plan is to widen the deductions allowance of £5,000,000, which was originally provided just for the CILR, to cover capital losses as well. As a result, the vast majority of companies should be unaffected financially by this restriction. Note that there will not be a separate £5,000,000 allowance – it will encompass both trading and capital losses that are carried forward.

The present regime

At present, capital losses that accrue to a company in an accounting period are set against capital gains arising in the same period. Where gains exceed losses in an accounting period, the company has chargeable gains that are subject to corporation tax. Where losses exceed gains (or where there are no gains), the UK tax system has hitherto allowed the unrelieved losses to be carried forward indefinitely and set against gains arising in future years as and when they are made.

Another relevant provision is that companies within a 75% group for capital gains purposes can elect to transfer gains or losses which arise or accrue in an accounting period to another member of that 75% group (S171A TCGA 1992).

Reform

Enabling companies to claim relief for capital losses carried forward from previous accounting periods is an important feature of the corporate capital gains system, ensuring that the tax paid by a company is reflective of its net capital gains position over the long term.

However, the Government believe that the existing corporate capital loss rules are not consistent with the CILR measures for other corporate losses. Consequently, they argue that there is a case for alignment. In particular, the CILR legislation in F(No2)A 2017 benefits capital gains of a company by allowing carried-forward losses – and trading losses, in particular – to be set against capital gains.

HMRC go on to say:

'The absence of any restriction on the amount of capital gains that can be relieved by carried-forward capital losses can also have undesirable outcomes for the Exchequer, as businesses making substantial capital gains over many years may not pay any corporation tax due to losses incurred from historic disposals.'

The Government now propose a major reform of corporate capital losses in order to address this so that:

(i) the amount of capital gains that can be relieved by carried-forward capital losses will be limited to 50% from 1 April 2020; and

(ii) the allowance of £5,000,000 per group . . . introduced for CILR will also cover capital gains that can be offset with carried-forward capital losses.

Once introduced, these reforms will bring the treatment of capital losses closer to other corporate losses.'

It is understood that 'significant' amounts of carried-forward corporate capital losses predate some of the recent changes to the capital gains regime for companies such as the establishment of the SSE and the intangible fixed asset rules. The Government consider that limiting the capital gains that can be relieved with carried-forward capital losses will help to address this situation in a way which is consistent with the CILR.

Of course, where a company's capital losses are restricted, it will still be possible to carry forward any unutilised capital losses and set these against capital gains arising in later accounting periods.

In the event of the restriction being in point and where an election has been made to transfer capital gains between two members of a 75% group in order to access carried-forward capital losses in the transferee company, the 50% restriction will be applied to the capital gains transferred under that election.

Note that the Government intend to ensure that in-year capital losses are always able to be set off in full against a company's capital gains. In other words, the 50% restriction will never be implemented in this situation. However, if there are also carried-forward capital losses, the new rule can be applied to the company's net capital gains.

The steps to be taken

Where the carried-forward losses relate to a singleton company, the position is reasonably straightforward. The main decision that will need to be made is how the deductions allowance of £5,000,000 should be split between the company's capital losses and – usually – the company's trading losses. However, for groups of companies, the calculation becomes more complicated. The steps set out in (m) below show how this might be done.

There are five steps to the process:

1. Allocate the £5,000,000 group deductions allowance – the group is free to decide how much of this allowance should be allocated to the capital loss restriction (where there is more than one type of loss carry-forward);

2. Perform the CILR computation – the group will calculate the amount of the loss restriction required for each company under the CILR rules and the quantum of the deductions allowance used here will of course be limited to the amount not allocated to the capital loss restriction;

3. Allocate the deductions allowance to the net capital gains. Each company will calculate the net gains of the year after taking into account all in-year reliefs and the effect of any election under S171A TCGA 1992. In-year reliefs already dealt with in the CILR computations are ignored. The company must also disregard any gains to the extent that they are used as part of the CILR computations in (ii) above. The total of gains which can be relieved in full by carried-forward losses is the amount of the deductions allowance allocated to the company;

4. Calculate the maximum amount of carried-forward losses which can be set against gains – 50% of any gains which are left over after (iii) above plus gains equivalent to the allocated deductions allowance may be relieved by carried-forward losses (this assumes that sufficient losses are available);

5. Allocate carried-forward losses against capital gains. The company can choose which type of carried-forward losses are set against the amount of gains calculated in (iv) above. Once this has been done, the company's profits chargeable to corporation tax can be computed in the normal way.

Anti-avoidance

As would be expected nowadays, the legislation will include an anti-forestalling measure and other anti-avoidance rules to ensure that, in HMRC's words, 'this reform is robust against avoidance or abuse'. For example, bed and breakfasting an asset before 1 April 2020 could have the effect of crystallising a large capital gain, which is then fully sheltered by carried-forward capital losses, with the reacquired asset having a higher base cost. This is the sort of transaction that would be caught.

Contributed by Robert Jamieson

VAT

Memory cards connected to fraud (Lecture B1146 – 19.23 minutes)

Summary – The purchase of SD memory cards did not fall foul of the MTIC fraud rules and so input tax was recoverable.

Beigebell Limited was registered for VAT from 22 July 2010. The company normally supplied promotional merchandise, such as stickers, bags, T shirts, note books and mouse mats to companies such as McLaren, Triumph Motorcycles, Channel 4 and The Ritz.

The VAT period 10/15 showed an outputs figure for the quarter that was more than double any other quarter in the previous three years and the inputs figure was likewise significantly higher than that in previous quarters. Between 1 September 2015 and 8 September 2015 Beigebell Limited made six purchases of memory cards from a single supplier and sold these on in five deals to Hi View Trading.

HMRC denied the company £144,000 of input tax, believing that the company's transactions in memory cards were connected with fraud, and the company ought to have known of that connection.

Beigebell Limited stated that they did not normally trade in memory cards; it argued that, although there was a defaulting supplier in the chain, this supplier was not connected to Beighbell Limited and they had not been fraudulent. Until HMRC's visit, Beighbell Limited had no knowledge of MTIC fraud. The director who signed the deals admitted that, after the completion of the initial deals, he did not feel comfortable and had refused later offers.

Decision

The Tribunal concluded that the 'no other reasonable explanation' test was not met. Having examined the purchase history for the memory cards, the Tribunal understood that the deal had been put forward by an old friend who had given:

- the company genuine and profitable business in the past;
- plausible explanations for the arrangements.

The Tribunal concluded that the director had been naive but ultimately, he was a man with sound moral standards.

The appeal was allowed.

Beigebell Limited v HMRC (TC07163)

Car leasing under a salary sacrifice scheme

Summary - Northumbria Healthcare NHS Foundation Trust could recover all of the VAT it paid on the cost of leasing cars to employees under a salary sacrifice scheme.

Northumbria Healthcare NHS Foundation Trust offered cars to its employees and those of other NHS trusts in the same divisional VAT registration, under a salary sacrifice scheme.

The trust claimed over £14m of input tax relating to the cars on the basis that this was not a business supply (s41(3) VATA 1994). Their logic was that when an employee opts into the salary sacrifice scheme, they take a salary reduction in return for the provision of a leased car and the salary reduction is not subject to output tax under Reg 2 of the VAT (Treatment of Transactions) Order 1992 (SI 1992/630). This is effectively a de-supply order, such that the supply is deemed not to have taken place and, according to the trust, no output tax was therefore due on the provision of a car by the employer to the employee.

HMRC considered that the effect of the de-supply order was that de-supplied transactions were no longer supplies for consideration, but they remained part of an economic activity. They argued that the Trust could only claim 50% of the VAT paid. (The 50% VAT recovery rate applies for a business that leases a car that has some business and private use (see VAT Notice 700/64, para 4.2).

As a claim under s41(3) does not fall within the scope of any provision conferring a right to appeal, the trust sought judicial review of HMRC's decision.

Decision

Due to the de-supply order, the Upper Tribunal found that the:

- provision of the cars by the trust to the employees could not be regarded as a supply of services because they had been de-supplied by the de-supply order;

- leasing of cars by the trust could not be an economic activity.

The condition in s41(3)(a) VATA 1994 relating to NHS trusts was satisfied and the trust was entitled to recover 100% of the input VAT.

The Upper Tribunal found that, disregarding the effect of the de-supply order, the provision of cars by the trust under the car scheme would be an economic activity. However, the fact that the NHS 100% recovery rate would be different to the 50% rate claimed by a commercial business was not considered to be relevant.

Northumbria Healthcare NHS Foundation Trust v HMRC [2019] UKUT 170

New build, demolition and reconstruction (Lecture B1146 – 19.23 minutes)

Summary - The Glasgow School of Art could not recover input tax incurred on a building let to its students' union. The original invoicing arrangement reflected the economic and commercial reality of the project.

The Glasgow School of Art is a Higher Education Institution Art School specialising in fine art, design and architecture.

Between 2011 and 2014, the school demolished two buildings, partially demolished and then reconstructed the Student Union Assembly Building, and also constructed a new building, called the Reid Building.

As the construction of the two buildings was tendered as a single construction contract, during the period of construction the contractor invoiced monthly with the combined cost, and charged VAT. In 2011 the contractor produced a one-page summary of the costs divided between “New Build” and “Assembly Building”. The VAT on the costs had initially been treated as residual, and had recovered it according to an agreed combined partial exemption special method that had operated since August 2009.

The Art School argued that the two buildings should be regarded as separate buildings, that the Assembly Building was being used wholly for taxable purposes by leasing it to the Student’s Union. The input tax on the costs attributable to the partial demolition, reconstruction and refurbishment of the Assembly Building ought to have been treated as fully recoverable. They sought and obtained from the contractor separate invoices identifying the costs of the Assembly Building works, along with credit notes covering the previously issued (and paid) invoices relating to the whole project.

There were two issues:

1. Did the works carried out on the Assembly Building constitute a separate supply. If one supply, the input tax would be residual but if two separate supplies, then….

2. Was the input tax incurred in relation to the Assembly Building supply recoverable on the basis that the school was making taxable supplies, by leasing the VAT opted building, to the students’ union?

The Assembly Building retained its original facades on three sides and the roof. Following the redevelopment, it shared a party wall with the new Reid Building, which wrapped around and above the Assembly Building, but at one end it rested on the Assembly Building. The only common facilities for the two buildings were the sprinkler and air handling systems that were centralised in the Reid Building, and the heating that was centralised in another nearby building together with that for other premises.

Decision

The Upper Tribunal concluded that the:

- economic and commercial reality of the construction contract was a single development of the site as a whole. Although the Art School wanted and obtained two separate premises with different functions, there was a single delivery strategy with a single contract with invoices issued for the whole project;

- lease and facilities were provided as part of the school’s necessary support of the Union at well below market value and so not as an economic activity;

- school was not making taxable supplies to the Student’s Union.

The taxpayer's appeal was dismissed.

Glasgow School of Art v HMRC, [2019] UKUT 173 (TCC)

Bad debt relief and fraudulent employee (Lecture B1146 – 19.23 minutes)

Summary – The employee was not acting legitimately within the course of his employment but rather on a 'frolic of his own'. Bad debt relief was allowed.

The employee had arranged things so that when a customer made a payment by phone, using a credit or debit card, the monies were not paid to the company's bank account but rather syphoned to his bank account.

The company accounted for the output tax due on the telephone sales but when the directors discovered what the employee had done, they claimed bad debt relief on a later VAT return.

HMRC's argued that a supply had taken place with the employee acting for and on behalf of the company and thus the company was paid for the goods/services when the customer gave his/her credit or debit card details

The company appealed.

Decision

The issue in this appeal was whether, when the dishonest employee procured payment for the various goods/services, he was acting legitimately in the course of his employment or dishonestly on a frolic of his own?

The Tribunal concluded that the answer was self-evident because it is not possible to conclude that an employee acting as they did was acting legitimately within the course of his employment. There was no dispute that the company did not receive the funds that the dishonest employee caused to be credited to one of his personal banking facilities. It is untenable to argue, as HMRC seems to argue, that this dishonest manager received those funds as agent for the appellant company.

The company was entitled to claim bad debt relief and the appeal was allowed.

Total Catering Equipment Limited v HMRC (TC07184)

Restriction on lower rate for energy saving (Lecture B1146 – 19.23 minutes)

Currently, the 5% reduced VAT rate applies to the installation of energy-saving materials such as insulation, solar panels and other technologies in residential properties. The restricted rate lowers the cost for homeowners to install these energy-efficient products in their homes.

For many years, the European Commission has argued that the scope of our reduced rate for such installations was too wide and in 2015 the CJEU agreed. While we remain a member of the EU, the UK is obliged to comply with this decision. Failure to do so would result in the European Commission issuing infraction fines against the UK.

Consequently, the UK is amending its legislation to limit the scope of the reduced rate on the installation of energy-saving materials. From 1 October 2019, The Value Added Tax (Reduced Rate) (Energy-Saving Materials) Order 2019 brings UK law into line with EU law.

The reduced rate will no longer apply for the installation of wind and water turbines, which are not deemed to be improvements to residential accommodation. These are energy generating rather than energy saving products.

The good news is that the amendments will maintain the reduced rate on all installations of energy-saving materials for recipients who are aged 60 or over or on certain benefits, for relevant housing associations, and where the installations are in buildings used for relevant residential purposes, such as care homes. The relief will be maintained on other cases where the cost of the materials does not exceed 60% of the total cost of the installation, even where the recipient is not a qualifying person.

http://www.legislation.gov.uk/uksi/2019/958/made

Reverse charge for construction services (Lecture B1149 – 27.13 minutes)

Legislation

The Value Added Tax (Section 55A) (Specified Services and Excepted Supplies) Order 2019 brings in the reverse charge for construction services with effect from 1 October 2019. The final version of the law provides that the charge will only apply to supplies for which payment must be reported for construction industry scheme (CIS) purposes. The summary of the SI states that it acts to:

- apply a VAT reverse charge to construction services;
- define certain terms which appear in this Order;
- provide that the reverse charge will apply to services of a description specified in article 4 and that the supplies specified in article 8 are excepted from the reverse charge;
- specify construction services as being services to which the reverse charge applies;
- define construction services, specifying what services are and are not included within the term;
- provides for exceptions so that the reverse charge will only apply where construction services are supplied to other construction businesses;
- provide that certain exceptions may not apply where other construction services are being supplied by the same supplier to the same recipient in relation to the same construction site and those other services do not qualify as excepted supplies;
- make provision for supplies of construction services comprising a number of elements to be excepted from the reverse charge only when all of those elements would be excepted if separately supplied;
- provide that section 55A(3) of the Value Added Tax Act 1994 (which makes provision for reverse charge supplies to be treated as supplies made by the recipient for the purposes of VAT registration limits) shall not apply in relation to construction services as defined in this Order.

Under "Impact", the Explanatory Note says the following:

> *The impact on business, charities or voluntary bodies is potentially significant for those supplying construction services because it is estimated that up to 150,000 businesses could be required to use it on supplies they make or receive. Only businesses that receive supplies where payments are reported through the Construction Industry Scheme will have to apply the reverse charge. In cases where a non-construction business falls within the scope of the Construction Industry Scheme because of the high value of its purchases of construction services, it may nevertheless come within the "end user" exception.*

SI 2019/892

Reverse charge guidance

HMRC have updated their guidance on the Domestic Reverse Charge that will apply from 1 October 2019. This now makes a number of issues clearer than was the case with the previous version; it is obviously worth reading in detail for those directly affected, but the following extracts appear important.

Scope of the DRC

The reverse charge will affect supplies of building and construction services supplied at the standard or reduced rates that also need to be reported under CIS. These are called specified supplies.

There is an important difference between CIS and the reverse charge where materials are included within a service. The reverse charge applies to the whole service whereas CIS payments to net status sub-contractors are apportioned and no deductions are made on the materials content.

The reverse charge does not apply if the service is zero rated for VAT or if the customer is not registered for VAT in the UK.

It also does not apply to some services. These are those supplied to end users or intermediaries connected with end users.

Employment businesses who supply staff and who are responsible for paying the temporary workers they supply, are not subject to the reverse charge.

<u>Supplies within the scope and outside the scope</u>

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The reverse charge does not apply if the service is zero rated for VAT or if the customer is not registered for VAT in the UK.

It also does not apply to some services. These are those supplied to end users or intermediaries connected with end users. Find out more found in the End users and intermediary supplier businesses section.

Employment businesses who supply staff and who are responsible for paying the temporary workers they supply, are not subject to the reverse charge. Read the Applying the domestic reverse charge for construction services to certain sectors or types of transactions section for more information.

You will have to apply the reverse charge if you supply any of these services:

- *constructing, altering, repairing, extending, demolishing or dismantling buildings or structures (whether permanent or not), including offshore installation services*
- *constructing, altering, repairing, extending, demolishing of any works forming, or planned to form, part of the land, including (in particular) walls, roadworks, power lines, electronic communications equipment, aircraft runways, railways, inland waterways, docks and harbours*
- *pipelines, reservoirs, water mains, wells, sewers, industrial plant and installations for purposes of land drainage, coast protection or defence*
- *installing heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems in any building or structure*
- *internal cleaning of buildings and structures, so far as carried out in the course of their construction, alteration, repair, extension or restoration*
- *painting or decorating the inside or the external surfaces of any building or structure*
- *services which form an integral part of, or are part of the preparation or completion of the services described above - including site clearance, earth-moving, excavation, tunnelling and boring, laying of foundations, erection of scaffolding, site restoration, landscaping and the provision of roadways and other access works*

Services excluded from the domestic reverse charge

The following services are not subject to the reverse charge:

- *drilling for, or extracting, oil or natural gas*
- *extracting minerals (using underground or surface working) and tunnelling, boring, or construction of underground works, for this purpose*
- *manufacturing building or engineering components or equipment, materials, plant or machinery, or delivering any of these to site*
- *manufacturing components for heating, lighting, air-conditioning, ventilation, power supply, drainage, sanitation, water supply or fire protection systems, or delivering any of these to site*
- *the professional work of architects or surveyors, or of building, engineering, interior or exterior decoration and landscape consultants*

- *making, installing and repairing art works such as sculptures, murals and other items that are purely artistic*
- *signwriting and erecting, installing and repairing signboards and advertisements*
- *installing seating, blinds and shutters*
- *installing security systems, including burglar alarms, closed circuit television and public address systems*

Flowchart

There is a flowchart which goes through the logical process of deciding to apply the DRC:

1. *Does the supply fall within the scope of CIS? YES*
2. *Is the supply standard rated or reduced rated? YES*
3. *Is your customer VAT registered? YES*
4. *Is your customer registered for CIS? YES*
5. *Has your customer provided confirmation that it is an end user? NO*

DRC applies

"Light touch" for six months

The peculiar comment about "claiming end user status" that featured in the first version of the guidance notes has gone. Instead, the guidance now says:

HMRC officers may assess for errors during the light touch period, but penalties will only be considered if you are deliberately taking advantage of the measure by not accounting for it correctly.

Other matters

As a result of the reverse charge some businesses may find that, because they no longer pay the VAT on some of their sales to HMRC, they become repayment traders (their VAT Return is a net claim from HMRC instead of a net payment). Repayment traders can apply to move to monthly returns to speed up payments due from HMRC.

Supply with other elements

If any of the services in a supply chain are subject to the reverse charge, all other services (even if that service would be excluded if it were being supplied as a single service) will also be subject to it.

Supply and fix works will be subject to the reverse charge. For example, a joiner constructing a staircase offsite then installing it onsite is making a reverse charge service, even if the charge for installation is only a minor element of the overall charge.

In addition, if there has already been a reverse charge service between 2 parties on a construction site, and if both parties agree, any subsequent construction supplies on that site between the same parties can be treated as reverse charge services.

If there is doubt whether a type of works falls within the definition of a specified service, as long as the recipient is VAT registered and the payments are subject to CIS, the reverse charge should apply.

<u>End users</u>

The reverse charge does not apply to consumers or final customers of building and construction services. Any consumers or final customers who are registered for VAT and CIS will need to ensure their suppliers don't apply the reverse charge on services supplied to them.

For reverse charge purposes consumers and final customers are called end users. They are businesses, or groups of businesses, that do not make onward supplies of the building and construction services in question, but they are registered for CIS as mainstream or deemed contractors because they carry out construction operations, or because the value of their purchases of building and construction services exceeds the threshold for CIS.

<u>Intermediary suppliers</u>

Intermediary suppliers are VAT and CIS registered businesses that are connected or linked to *end users.*

To be connected or linked to an end user, intermediary suppliers must either:

1. *share a relevant interest in the same land where the construction works are taking place*

2. *be part of the same corporate group or undertaking as defined in s.1161 Companies Act 2006*

<u>Reverse charge treatment of end users and intermediaries</u>

The concept of intermediary suppliers means that if a number of connected businesses are collaborating together to purchase construction services, they are all treated as if they are end users and the reverse charge does not apply to their purchases.

For example, a property-owning group may buy construction services through one member of the group and recharge those services to either other group companies, their tenants or both. All the members of the property owning group and their tenants will be end users and the reverse charge should not apply.

Landlords, lessors, licensors, tenants, lessees or licensees and any persons 'connected' to them have a relevant interest in land. Having an agreement for lease is also a relevant interest in land. However, having a relevant interest in land does not include temporary rights to occupy land to carry out building and construction services.

You cannot choose whether you are an end user or an intermediary supplier because it is a matter of fact.

Asking suppliers about end user or intermediary status

You may not be sure whether you are supplying a customer who is an end user or intermediary supplier. In this situation, you should ask the customer if they are an end user or intermediary supplier and keep a record of the answer. It will be up to the customer to make the supplier aware that they are an end user or intermediary supplier and that VAT should be charged in the normal way instead of being subject to reverse charge.

Sometimes it may be obvious that the customer is an end user, for example if there is a repeat contract, and it will be acceptable for you to charge VAT in the normal way.

Examples of end users include UK VAT registered mainstream or deemed contractors under CIS rules. With the exception of property developers, they are typically not construction businesses and are found in the retail, manufacturing, utilities and property investment sectors as well as public bodies.

Intermediary suppliers can call themselves end users in all communications which should be in writing (either digitally, or on paper). There is no set wording, but this is an example of suitable wording:

'We are an end user for the purposes of section 55A VAT Act 1994 reverse charge for building and construction services. Please issue us with a normal VAT invoice, with VAT charged at the appropriate rate. We will not account for the reverse charge.'

If the reverse charge treatment depends on the customer's end user status and the treatment adopted is found to be incorrect (for example, because the customer is an end user but has not provided written confirmation resulting in the reverse charge being applied incorrectly) HMRC will expect the customer to notify the supplier that it is an end user and request a corrected invoice.

In the case of self-billing, a new invoice will have to be issued and the VAT will have to be paid to the supplier.

Verifying the VAT status of customers

Before you can apply the reverse charge, you need to be satisfied that your customer is VAT registered. You can check that your customer's VAT number is valid and belongs to them on the European Commission website.

Verifying CIS registration of customers

You do not need to verify the CIS registration of existing customers if your contract is within CIS (but you should keep evidence of this where you have it, such as a deductions certificate as part of your VAT records).

You should ask new customers to provide details of their registration as a contractor for CIS purposes, or a copy of their CIS verification of you, and retain these.

However, if you are registered for CIS as a contractor HMRC recommends you use the CIS verification system. You will still be asked to confirm that you have placed an order with a sub-contractor before completing the verification, but for VAT purposes you can confirm this even though an order has not been placed by you.

There are also specific comments about contracts straddling the change in the rules, paperwork and entries on VAT returns, cash accounting and the flat rate scheme.

www.gov.uk/guidance/vat-domestic-reverse-charge-for-building-and-construction-services

Reverse charge problem

There is a reverse charge on construction services in Hungary. In 2010 and 2011, a Hungarian company paid invoices from construction companies in connection with a motorway project. The suppliers charged VAT and the appellant deducted it. In 2015, the tax authority carried out an audit, assessed for tax of about €275,000, and added penalties and late payment charges.

The company's domestic appeal was based on an argument that the reverse charge should not have applied to the transactions. The company also claimed that the tax authority had denied them the right to deduct input tax, and had not considered the possibility that the suppliers had accounted for the output tax, resulting in potential double taxation. The tax authority ruled that the proper course was for the suppliers to correct their invoices to reflect the reverse charge.

The referring court asked whether the tax authority was obliged to investigate whether the supplier had accounted for the tax, and also whether the supplier was able to refund the output tax and claim it back from the tax authority. The questions referred to the principles of proportionality, fiscal neutrality and effectiveness, suggesting that the referring court was concerned that the tax authority had taken an unduly harsh line.

The CJEU took an equally hard line. It considered that the reverse charge regime imposed a "substantive requirement" for the right of deduction on the claimant – that the claimant must also account for the output tax that is to be claimed as input tax. As the appellant had not done so, it was not entitled to the deduction.

The Hungarian government had made representations to the court that there were domestic procedures for the customer to claim the overpaid VAT back from the supplier. The court noted that "if, in a situation where the VAT has actually been paid to the Treasury by the supplier of the services, the reimbursement of the VAT by the supplier to the recipient of the services is impossible or excessively difficult, in particular in the case of the insolvency of that supplier of services, the principle of effectiveness may require that the recipient of the services concerned be able to address its application for reimbursement to the tax authorities directly. In such a case, the Member States must provide for the instruments and the detailed procedural rules necessary to enable that recipient of services to recover the unduly invoiced tax in order to respect the principle of effectiveness."

The appellant had argued before the court that one of the suppliers was insolvent. The court suggested that this would be a circumstance that would make correction of the situation impossible or excessively difficult. If that was the case, and it was established that the supplier had accounted for the output tax to the authorities, the appellant would have a claim for direct reimbursement of the overpaid VAT. However, that was a matter quite separate from the point at issue: the claim for input tax was incorrect, because it should have been dealt with under the reverse charge procedure.

The tax authorities were under no obligation to check the supplier's position before disallowing the claim to input tax, and a direct claim for reimbursement would be a subsequent procedure for the appellant to enter into, subject to different rules.

CJEU (Case C-691/17): PORR Építési Kft v Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága

Article: Taxation 17 January 2019

In an article in Taxation, Neil Warren points out a significant side-effect of the new reverse charge for the construction industry for small businesses. Because reverse charge supplies are excluded from the FRS, a construction business using the FRS will not have to account for any VAT on such supplies to HMRC; but it will also not collect any VAT from its customers, and will still not be entitled to deduct any input tax on its costs. It will therefore lose the benefit of using the FRS in relation to that part of its business that is subject to the reverse charge, and should consider whether the FRS remains beneficial after 1 October 2019.

Article: *Taxation 24 January 2019*

In an article about the Finance Bill debates in Taxation, Richard Curtis noted debate about the detailed rules on the effect of reverse charge supplies on registration liability. What is now FA 2019 s.51 inserts a new ss.(9A) into VATA 1994 s.55A, providing that "An order made under subsection (9) may modify the application of subsection (3) in relation to any description of goods or services specified in the order." S.55A(3) provides that reverse charge supplies count for registration liability purposes. There appeared to be a concern that more small builders would be made registrable by the new rules because their costs would be added to their outputs in determining whether they had exceeded the threshold, but the government minister responded that the provision would allow an order preventing this unintended effect. This demonstrates how many complicated and often unpredictable consequences may arise from such a change.

Contributed by Mike Thexton

A VAT conundrum **(Lecture B1150 – 7.31 minutes)**

National Car Parks Ltd (NCP) are the largest car park operator in the UK with more than 600 sites and it was recently announced that the company makes almost £690,000 a year from automatic ticket machines which do not give change to motorists who use their parking facilities.

Between June 2009 and December 2012, NCP retained more than £2,400,000 in overpayments on which they accounted for VAT. During this period, the rate of VAT was 15%, rising to 17.5% and then going up to 20% in January 2011. The company went to court to try and recover what they claimed was an excessive VAT charge on the ground that they had not provided any services in return for this cash!

NCP lost their argument before both the First-Tier Tribunal and the Upper Tribunal and so the latest instalment of this long-running dispute has seen them doing battle with the tax authorities before three Court of Appeal judges in National Car Parks Ltd v HMRC (2019).

The leading judgment was delivered by Newey LJ who cited the following hypothetical scenario:

> ‘A customer enters an NCP pay and display car park wishing to park for one hour. She parks her car in an available space and locates the pay and display ticket machine. The prices stated on the tariff board next to the pay and display ticket machine are:
>
> Parking for up to one hour – £1.40
>
> Parking for up to three hours – £2.10
>
> The pay and display ticket machine states that change is not given but overpayments are accepted and that coins of a value less than 5p are not accepted.
>
> The customer finds that she only has change of a pound coin and a 50p piece and puts these into the pay and display ticket machine. The machine meter records the coins as they are fed into the machine, starting with the pound coin. When the 50p piece has been inserted and accepted by the machine, the machine flashes up “Press green button for ticket” which the customer does. The amount paid is printed on the ticket, as is the expiry time of one hour later. The customer displays the ticket in her car and leaves the car park.’

It is important to emphasise that, where an overpayment is made, the machine does not recognise any additional parking time. As a result, it was NCP’s contention that overpayments should be regarded as ex gratia amounts and therefore outside the scope of VAT.

In a unanimous decision, the Court of Appeal, agreeing with the rulings in the lower tribunals, dismissed NCP’s claim. Newey LJ and his colleagues held that it is necessary to adopt an objective approach when determining what has been agreed in a contractual context. The Court considered that the tariff board and the clear notice that overpayments were accepted with no change being given indicated that NCP were willing to provide parking for either the price as per the tariff board or a higher price. The contract was essentially brought into being when the customer pressed the button for the ticket, thus accepting the offer made by NCP to provide parking for the actual price paid. The customer could not claim a refund and so the contract price was the amount paid. There was no question of the price being uncertain in any individual case – it was whatever sum, equal to or in excess of the tariff price, which the customer had paid into the machine.

The decision in favour of HMRC will be disappointing news for a number of car park operators who have substantial claims outstanding in relation to the VAT liability for parking overpayments. Note, in this context, the comment of the AA President (Professor Edmund King):

> ‘The best way out of this would be to give motorists change in the first place.’

Drivers who have wanted to pass left-over parking time to another motorist but who were prevented from doing so by these arrangements which have been deliberately designed to stop tickets being transferred will undoubtedly give a wry smile when they read about the Court of Appeal’s judgment. The good news is that most car park operators nowadays offer a credit card option.

Contributed by Robert Jamieson

Revenue & Customs Brief 6 (2019)

R&C Brief 6 (2019): Changes in accounting for VAT after prices are altered explains HMRC's new rules from 1 September 2019 for adjustments to VAT following increases or reductions in the price of goods or services.

HMRC believes there is evidence that some businesses are trying to gain a tax advantage through the current regulations by making VAT adjustments for reductions in price without refunding their customers. Some businesses also attempt to treat errors as price adjustments so as to avoid relevant time limits.

Under the new rules:

- the time an increase in price occurs is when the change is agreed by both the supplier and the customer – a debit note must be issued no later than 14 days after the price increase – the supplier must account for the increase in VAT in the VAT period in which the change occurs;

- a decrease in price occurs when a supplier makes a refund to a customer, or other person entitled to receive the payment – a supplier has 14 days to issue a credit note from the time the decrease occurs – a supplier must account for the decrease in the VAT period in which it takes place – a VAT-registered customer must reduce the amount of VAT it has claimed by the same amount, this does not prevent a supplier issuing credit notes in advance of refunds being made, but ensures that it is issued no later than 14 days after the payment

https://www.gov.uk/government/publications/revenue-and-customs-brief-6-2019-changes-in-accounting-for-vat-after-prices-are-altered/revenue-and-customs-brief-6-2019-changes-in-accounting-for-vat-after-prices-are-altered