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Disclaimer

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Legislation day 2021 (Lecture P1266/ B1266 – 19.32 /25.18 minutes)

Introduction

The initial draft clauses for the 2022 Finance Act were published on 20 July 2021 and include more detail on previously announced proposals. Whilst the Government refers to it as draft legislation for Finance Bill 2021/22, in this commentary, for clarity, it is referred to as Draft Finance Bill 2022. The final contents of the Bill will be subject to confirmation at a later date, expected to be in the Autumn, though it is uncertain whether this will be combined with an Autumn Budget.

Basis period reform for unincorporated trading businesses

The government is introducing a reform of basis periods for unincorporated trading businesses in draft FB 2022 whereby businesses will be taxed on the profits arising in a tax year for 2023/24 with a transitional year in 2022/23. This is different to the current year basis in force at the moment which uses the general rule that a basis period for a tax year is the 12 months ending with the accounting date in that tax year together with additional rules for the opening and closing years of a business and when there is a change in accounting period end. The operation of the current rules in the early years of a business can create overlapping basis periods which result in profits being charged twice and the creation of overlap relief which is usually given on the cessation of the business. The proposed reform aims to make the basis of assessment for trading profits simpler and aligned with other sources of income but also links in with the government's plans for Making Tax Digital which becomes mandatory for self-employed businesses from April 2023.

The changes include:

- from 2023/24 the profits of the tax year will be the profits arising in that tax year with accounting period profits being apportioned by the number of days or another reasonable basis;

- the basis period for the transitional year of 2022/23 will be the current year basis period profits plus the transitional period profits which arise in the period from the day after the current year basis period to 5 April 2023;

- in the transitional year of 2022/23 all overlap relief brought forward must be used and in subsequent years no further overlap relief can be created;

- any additional profits arising for the business under the new rules will be spread over five tax years starting in 2022/23 with an option to elect to accelerate the tax charge;

- trading and property businesses can treat an accounting date between 31 March and 4 April inclusive as being equivalent to ending at the end of the tax year and so would not have to make small apportionments of profits;

- the same basis period reform would apply for businesses which currently use the cash basis to calculate their profits;

- the proposals apply to the self-employed, partnerships, trusts and estates with trading income but the proposals will not affect companies apart from some non-resident companies;

- The government has published a consultation on the proposals which closes on 31 August 2021, alongside a policy paper, draft legislation and explanatory notes. The draft legislation is in clause 1 and 2 of and Schedule 1 to the draft FB 2022.

Structures and buildings allowances (SBAs)-amendment to allowance statement

As announced at tax consultation day on 23 March 2021, FB 2022 will make a relatively minor change to the requirements for SBA allowance statements, to include the date qualifying expenditure is treated as incurred when the allowance period commences from this date.

SBAs (capital allowances on structures and buildings) can only be claimed by a person who makes or obtains an allowance statement to support the amount of their claim. Under the current rules, the allowance statement must include the amount of the qualifying expenditure and the date on which the building or structure was first brought into use, but there is no requirement to state the date when the qualifying expenditure was incurred.

Sometimes qualifying expenditure may be incurred after the building or structure was brought into use, for instance where the expenditure is on a renovation or conversion. The intention of the amended legislation is to ensure that in these circumstances a subsequent purchaser of the building or structure does not miss out on allowances by assuming that the period over which SBAs can be claimed (33 1/3 years, or ten years in freeports) began when the building or structure was brought into use.

The changes will have effect from the date of Royal Assent to FB 2022.

The government has published a policy paper, draft legislation and explanatory notes.

Real Estate Investment Trusts: amendments

Following earlier consultation, the government is introducing amendments to the REIT regime. These aim to reduce administrative burden and unnecessary costs for certain REITs and to increase the attractiveness of the regime.

The changes:

- remove the requirement for REITs to be admitted to trading on a recognised stock exchange where that REIT is wholly or almost wholly (at least 99%) owned by institutional investors (the listing requirement still applies to other REITs);

- amend the definition of an overseas equivalent of a UK REIT so that the overseas entity itself, rather than the overseas regime to which it is subject, needs to meet the equivalence test;

- remove investors in UK REITs who are entitled to payment of property income distributions;

- amend the balance of business test;

- extend the list of exclusions from profits taken into account for the test to include residual business profits resulting from compliance with planning obligations entered into in accordance with section 106 of the Town and Country Planning Act 1990 (this means that non-rental profits arising because a REIT has to comply with certain planning obligations will be disregarded);

- introduce a gateway test based on consolidated accounts, so that a REIT will only have to prepare the required financial statements for each group member if it fails the gateway test (group property rental business profits or assets to be 80% or more of total group profits or assets).

Further changes to the REIT regime will be explored as part of the wider review of funds, such as introducing a close company look through test similar to the one used in TCGA 1992, Sch 5AAA and further changes to the balance of business test.

The changes will have effect from 1 April 2022.

The government has published a consultation outcome, alongside a policy paper, draft legislation and explanatory notes.

Amendments to the hybrid and other mismatches rules

Although the government withdrew its attempt to legislate for this change in Finance Act 2021 (albeit it was then trying to do so by amending the definition of a hybrid entity), it is now introducing an amendment to TIOPA 2010, s 259GB which, in the context of determining the extent of a mismatch, aims to treat certain non-UK transparent entities (i.e. US LLCs) as partnerships.

This change also includes:

- a definition of a 'relevant transparent entity' to which the change applies - this requires:

  - the non-UK jurisdiction in which the transparent entity is constituted to treat all of the entity's income and profits as belonging to its members,

  - that any tax that is (or would be) charged on such member that is resident in that jurisdiction (i.e. the jurisdiction where the entity is constituted) to be charged at a rate other than nil - this should ensure that a transparent entity is not excluded from being treated as a partnership if its members include tax-exempt bodies,

- a definition of a member of a relevant transparent entity being a person that is entitled to a proportion of the profits of the entity as a result of the holding of shares or a similar entitlement if the entity does not have share capital.

The changes will have retrospective effect from 1 January 2017, when the hybrid rules first took effect.

The government has published a policy paper, draft legislation and explanatory notes.

Taxation of asset holding companies in alternative fund structures

Following a two-stage consultation, the government is introducing a new, elective regime for the taxation of qualifying asset holding companies (QAHCs) and some payments that they make. The new measures form part of a wider review of the UK funds regime, launched at Spring Budget 2020, to consider tax and regulatory reforms which could enhance the UK's competitiveness as a location for asset management and investment funds.

To benefit from the new regime, QAHCs must be at least 70% owned by diversely owned, eligible funds (with regulated managers) or certain institutional investors. In addition, they must exist to facilitate the flow of capital, income and gains between investors and underlying investments, with only minimal other activities.

Key features of the new QAHC regime include:

- exempting gains accruing to a QAHC on disposals of overseas land or relevant shares (not including UK property rich assets);

- exempting the income profits of a QAHC's overseas property business where those profits are subject to tax overseas;

- allowing deductions for certain interest payments that would usually be disallowed as distributions on the basis of being paid under profit participating loans and results-dependent debt;

- switching off the late paid interest rules so that in certain situations interest payments are relieved for a QAHC on an accruals rather than paid basis;

- disapplying the obligation to deduct tax from payments of interest on securities held by investors in a QAHC;

- switching off the distributions rules so as to allow premiums paid when a QAHC repurchases its share capital from an individual investor to be treated as capital rather than income where, broadly, these derive from capital gains realised by the QAHC on the underlying investments;

- exempting repurchases by a QAHC of share and loan capital which it had previously issued from stamp duty and SDRT ;

- provisions to guard against the potential for abuse or avoidance.

The aim of the new regime is to remove barriers to the establishment of QAHCs in the UK, by recognising the circumstances where such entities are used to facilitate the flow of capital, income and gains between investors and underlying investments and ensuring that UK investors are taxed broadly as if they invested in the underlying assets directly and QAHCs pay no more tax than is proportionate to the activities they perform.

The QAHC eligibility criteria is intended to ensure that the regime is only available to investment arrangements that involve the pooling of investor funds with professional investment managers.

The measures are not intended to affect the tax treatment of any limited trading activity or other non-qualifying investment activity carried on by a QAHC.

The changes are intended to have effect from 1 April 2022 for the purposes of corporation tax, stamp duty and SDRT, and from 6 April 2022 for income tax and CGT purposes.

The government has published a policy paper, an initial set of draft clauses intended for FB 2022 which cover the core aspects of the new regime, and explanatory notes, as well as a summary of responses to the second-stage consultation that ran until 23 February 2021 which explains the governments approach to the new regime. Not all of the required provisions have been included in the draft legislation published so far, and the government notes that further work is needed ahead of the proposed changes coming into force and stakeholder engagement will continue.

Increasing the normal minimum pension age

Following a consultation on how to implement the changes announced in 2014, the government is introducing an increase to the normal minimum pension age (NMPA) from 55 to 57 by amending FA 2004. The aim of this change is to keep in line with increasing life expectancy and changes to working practices. This follows a change in the NMPA from 50 to 55 in 2010.

The changes include:

- increasing the NMPA from 55 to 57;
- introducing a protection scheme for pension schemes of certain uniformed services where an unfettered right to an earlier retirement age is in place.

The changes will have effect from 6 April 2028.

These changes will have no effect on those able to access pensions early due to ill health; that legislation will not be amended.

The government has published a summary of responses to the consultation, alongside a policy paper, draft legislation and explanatory notes.

Pension Scheme Pays reporting: information and notice deadlines

The government has published draft legislation setting out changes to be included in Draft Finance Bill 2022 to the process known as 'Scheme Pays'.

Under current legislation, if an individual's liability to the annual allowance tax charge for a tax year exceeds £2,000, the individual may arrange for the tax to be paid from their pension benefits ('Scheme Pays'). The individual does this by giving notice to the scheme administrator of a registered pension scheme of which they are a member. The maximum that can be specified is the tax liability on the excess of pension input amounts for that scheme over the amount of the allowance.

The notice must be given no later than the first anniversary of 31 July following the tax year in question, e.g. by 31 July 2021 for the year 2019/20. SI 2011/1793 sets out the information and declarations to be included in the notice.

Under the draft legislation, the deadline in most cases remains 31 July in the year following the year in which the tax year ends. However, where the scheme administrator gives the individual information about a change to the pension scheme input amount for the tax year,

and that information is not given until on or after 2 May in the year following that in which the tax year ends, i.e. 2 May 2022 for 2020/21, the individual has until the earlier of the following in which to give the notice:

- the end of the three months beginning with the day on which the scheme administrator gives the individual the information;
- the end of the six years following the tax year in question.

It is expected that the scheme administrator gives the individual the information within six years after the tax year in question. The extended deadlines do not apply otherwise.

Under current law, the tax is taken as being charged on the scheme administrator in the quarter ended 31 December in the year following that in which the tax year ended. This will be changed to the quarter following that in which the scheme administrator receives the notice from the individual which gives rise to the liability.

This measure will have effect from 6 April 2022 but will apply in any case where an individual receives a retrospective amendment to their pension input amount for 2016/17 or a subsequent year.

The intention is that more individuals will benefit from the Scheme Pays facility. Currently, individuals with a retrospective increase in pension savings for a previous tax year are unable to use Scheme Pays and have to pay the annual allowance tax charge themselves.

The government has published a policy paper, draft legislation and explanatory note.

Electronic sales suppression (ESS)

Following a call for evidence in 2018–19 and announcements at Spring Budget 2021, the government is introducing new measures to tackle ESS, which occurs when a business deliberately manipulates its electronic sales records to reduce or hide the value of its sales while providing what looks like a compliant audit trail from sale to tax reporting.

The changes include:

- establishing substantial penalties for making, supplying, promoting or using 'Electronic Sales Suppression Tools', which includes any software, hardware or other thing that is capable of suppressing electronic sales records and which it is reasonable to assume has a main function of doing so;
- taxpayer protections including removal of penalties where the person in possession of such a tool is unaware that it was an ESS tool; special reduction and appeals;
- ESS-specific information powers to enable HMRC to obtain the details of those involved in the supply of ESS software or hardware and to accuse the developers' source code.

The changes will have effect from Royal Assent to FB 2022.

The government has published a policy paper, draft legislation and explanatory notes.

Insurance premium tax: identifying where the risk is situated

UK insurance premium tax (IPT) is not due where the risk under an insurance contract is situated outside the UK. Since 2009, EU law was used to determine the location of an insurance contract for IPT purposes and, since the end of the Brexit implementation period, retained EU law (i.e. Article 7(6) of Retained Regulation (EC) 593/2008 which refers to Article 13(13) of Directive 2009/138/EU), has been used for this purpose. This change will relocate the criteria for determining the location of an insurance contract into primary legislation but without making substantive changes.

The change will have effect from Royal Assent to FB 2022.

The government has published a policy paper, draft legislation and explanatory notes.

Tracing and security for tobacco products

Following earlier consultation, draft legislation was published on tracing and security for tobacco products aimed at giving HMRC powers to introduce more visible street level sanctions to tackle tobacco duty evasion. The sanctions are to be linked to the Tobacco Track and Trace System (TTS).

The changes will have effect on and after the date of Royal Assent to FB 2022.

The government has published a summary of responses to the consultation, alongside a policy paper, draft legislation and explanatory notes. Penalties for enablers of defeated tax avoidance.

Large businesses - notification of uncertain tax treatment

Following an initial consultation in March 2020 and a second consultation in March 2021, the government is introducing new rules on the requirement for large businesses to notify HMRC when they take an uncertain tax position. The aim of the notification regime is to ensure that HMRC is aware of all cases where a large business has adopted a treatment that is contrary to HMRC's known position and to bring forward the point at which discussions occur in relation to the tax treatment, thereby reducing what the government refer to as the 'legal interpretation tax gap'.

The new provisions include the following:

- the requirement to notify will only apply to relevant companies, partnerships and LLPs that exceed the threshold for being large. The regime will apply to UK resident entities and to non-UK resident entities that have a UK presence (for example, an overseas company with a UK permanent establishment);

- the threshold for what is a large business, and therefore within scope of the notification measure, is modelled on the Senior Accounting Officer (SAO) regime. Broadly, this means businesses that have a turnover above £200 million and/ or a gross balance sheet total above £2 billion in the previous financial year are subject to the requirement to notify. The turnover and balance sheet amounts relate only to the UK presence of the business and, similar to the SAO rules, there are specific provisions around aggregating turnover and balance sheet totals for group companies;

- the scope of the regime will initially be restricted to corporation tax, VAT and income tax including amounts collected via PAYE. Corporation tax for these purposes does not include the banking surcharge, bank levy or amounts due under the controlled foreign companies' legislation;

- a list of relevant returns in relation to each tax covered by the regime is provided. A separate notification is required for each relevant tax where a relevant return is filed that includes an uncertain amount (including where the amount is nil). Where a relevant return includes more than one uncertain amount, only one notification is required covering each such amount. For annual returns, the deadline for notifying is the same as the filing date for the relevant return. For returns that are not annual, the notification is required on or before the date on which the last relevant return for the financial year in question is due;

- a tax treatment will be uncertain if it meets one of three tests (reduced from seven from the second consultation stage). Broadly, the tests cover where a provision has been made in the business's accounts under GAAP in respect of an uncertain tax outcome, where the position taken represents a divergence from HMRC's known position, and where there is a substantial possibility that a tribunal or court would rule against the position taken by the taxpayer;

- a threshold test of £5m applies in relation to an uncertain amount included in a relevant return, below which taxpayers are not required to notify. Under the test, it is only necessary to notify where the net value of the tax advantage which results from the uncertain tax treatment amount (and any related amounts) when compared with the relevant expected amount is more than £5 million in the relevant period. Tax advantage and relevant period are defined separately for each tax;

- a general exemption applies from the requirement to notify where it would be reasonable to conclude that HMRC is already aware of the uncertainty and already have all, or substantially all, of the information that would be required in a notification. Other exemptions and exceptions are also available, including a specific exemption from the requirement to notify in relation to transfer pricing adjustments;

- an initial £5,000 penalty applies for a failure to notify with escalating penalties for repeated failures. No penalty will arise if the taxpayer has a reasonable excuse and it will be possible to appeal any penalty charged by HMRC.

The changes will have effect for returns within scope that are due to be filed on or after 1 April 2022.

The government has published a summary of responses to the second consultation, alongside a policy paper, draft legislation and explanatory notes. The draft legislation is in clause 1 of and Schedule 1 to the Draft FB 2022.

Clamping down on promoters of tax avoidance

Although grouped together as provisions relating to 'promoters of tax avoidance', the draft legislation released on Legislation Day has a wider application than just the promoters of tax avoidance schemes (POTAS) regime and follows the March 2021 consultation.

The expected changes are part of HMRC's drive to stop tax avoidance schemes at the earliest possible stage, ideally before a taxpayer uses the scheme in the first place. They should be considered in the context of the changes to the various anti-avoidance regimes introduced by FA 2021, as these are part of the same aim.

The proposed legislative changes are:

- a new power for HMRC to seek freezing orders that would prevent promoters from dissipating or hiding their assets before paying the penalties that are charged as a result of them breaching their obligations under various anti-avoidance regimes;

- new legislation that would enable HMRC to publish details of suspected tax avoidance schemes and those suspected of being associated with them, in order to better inform taxpayers of the risks of relevant schemes, so that they can identify and steer clear of the schemes or exit them;

- new rules that would enable HMRC to make a UK entity that facilitates the promotion of tax avoidance by offshore promoters subject to a significant additional penalty;

- a new power to enable HMRC to present winding-up petitions to the Court for bodies operating against the public interest.

Each of these provisions is discussed further below.

Freezing orders

This provision is expected to apply to any person against whom HMRC has commenced (or intends to commence within 72 hours) proceedings to charge a penalty:

- for the failure to comply with an obligation under the disclosure of tax avoidance scheme (DOTAS) regime;

- for the failure to comply with an obligation under the disclosure of tax avoidance scheme; VAT and other indirect taxes (DASVOIT) regime;

- for the failure to comply with an obligation under the POTAS regime;

- under the enablers of defeated tax avoidance rules. (Draft FB 2022, cl 1(1)(a), (4), (5))

Under this new power, HMRC could apply to the Courts for an order to freeze the assets of the person before the penalty is charged. To grant the order, the Court must be satisfied that HMRC has a good case in relation to the penalty.

If HMRC has yet to commence penalty proceedings and fails to do so within 72 hours of the order being granted, the freezing order does not take effect. In determining the 72 hour deadline, weekend days and bank holidays are disregarded. (Draft FB 2022, cl 1(1), (3), (5), (6))

HMRC is already able to apply for a freezing order under existing law where there is an enforceable debt and there is a risk that assets will be hidden or moved. The point of the

new provision is to allow for the assets to be frozen in advance of the penalty being charged.

If enacted as drafted, this provision could be applied in relation to any person to whom a penalty (listed above) is determined on or after the date of Royal Assent to FB 2022.

Publication of suspected tax avoidance schemes

New rules are expected to allow HMRC to publish details of suspected tax avoidance schemes and any person suspected of making the scheme available to taxpayers. HMRC will be able to publish any information that the Officer considers appropriate for the purpose of informing taxpayers of the risks associated with the scheme or protecting the public revenue. (Draft FB 2022, cl 2(1), (2))

HMRC currently has multiple powers to publish details of tax avoidance schemes and their promoters under the POTAS, DOTAS and DASVOIT regimes. Due to changes introduced by FA 2021, HMRC can also publish details of suspected tax avoidance schemes and suspected promoters, however this proposed power widens the pool of persons whose identity can be published in connection with the suspected tax avoidance scheme.

Under this power, as well as the suspected promoter, HMRC could also publish the details of any person who it suspects:

- 'controls' or has 'significant influence' over the promoter as defined for the purposes of the POTAS regime;
- is an employee of the promoter;
- is an office holder within the promoter;
- is a shareholder of the promoter;
- has or has had any other role in relation to making the proposal or arrangements available (which has wide application and may include persons such as introducers, finance providers etc);
- in the case of a proposal or arrangements that involve a trust, a settlor, trustee or beneficiary of the trust, or other person involved in the administration of the trust. (Draft FB 2022, cl 2(2), (11))

HMRC must notify the person that it intends to publish their details and give them 30 calendar days to make representations that their information should not be published. In making the decision as to whether to publish the person's details, HMRC must take these representations into account. (Draft FB 2022, cl 2(5), (6))

When considering the meaning of 'suspicion' for the purposes of this new power, it is worth taking into account HMRC's recent guidance on the FA 2021 changes to the POTAS regime. In that guidance, HMRC states that the threshold for suspicion is low and quotes the Court of Appeal as saying a person suspects something if they 'think that there is a possibility which is more than fanciful that the relevant facts exist'. (Draft HMRC_guidance, Section A, para 1.2.5; *R v Da Silva* [2006] 4 All ER 900)

This provision is expected to become effective from the date of Royal Assent of FB 2022.

Additional penalty for UK facilitators of offshore promoters

Some tax avoidance schemes are promoted by non-resident promoters using UK intermediaries. Although offshore promoters are subject to the various anti-avoidance regimes, in practice they tend to ignore their obligations, and so the existing rules attribute their obligations to other persons (e.g. UK resident employees, UK resident facilitators, scheme users). Those other persons are liable to penalties if they fail to comply with the obligations.

HMRC wishes to further disincentivise UK resident facilitators from acting as the intermediary between the offshore promoter and the client. Therefore, it proposes to charge an additional penalty on the UK resident person where that person has either:

- incurred a penalty under the enablers of defeated tax avoidance rules, see Simon's Taxes A4.573A, or

- incurred penalties of £100,000 or more in relation to the failure to comply with one or more obligations under DOTAS, DASVOIT or POTAS. (Draft FB 2022, cl 3, Sch 1, para 1(1), (3), (4))

For these original penalties to trigger an additional penalty, the UK resident and the offshore promoter must be part of the same 'promotion structure' and the original penalties must be charged on the UK resident in relation to their activities regarding the proposals/arrangements promoted by the offshore promoter. 'Promotion structure' is as defined for the POTAS regime. (Draft FB 2022, cl 3, Sch 1, paras 1(2), 8(1))

The amount of the penalty is up to 100% of the total fee received by all the members of the 'promotion structure' in relation to the scheme. (Draft FB 2022, cl 3, Sch 1, para 2)

The draft legislation applies HMRC's information powers under FA 2008, Sch 36 to allow HMRC to check whether the person should be liable to this additional penalty. (Draft FB 2022, cl 3, Sch 1, para 6)

If enacted as drafted, this provision would apply to any UK resident person that incurs the original penalties on or after the date of Royal Assent of FB 2022. Where the original penalty is charged under the enablers of defeated tax avoidance rules, this penalty must relate to arrangements enabled on or after Royal Assent.

Winding-up petitions

HMRC is expected to be given the power to petition the Court to wind-up a 'relevant body' if this is expedient in the public interest for the purpose of protecting the public revenue. The Court may wind-up the 'relevant body' if it is of the opinion that it is just and equitable to do so. (Draft FB 2022, cl 4(1)–(3))

A 'relevant body' means a body, including a partnership, that:

- carries on a business as a promoter for the purposes of the POTAS regime (bearing in mind that the definition was greatly expanded by FA 2021). Note that the draft

legislation makes it clear that this also applies to promoters of indirect tax avoidance schemes (since the POTAS regime has limited application to indirect taxes); or

- is 'connected' to a body caught by the bullet point above, where 'connected' is defined as under CTA 2010, s 1122. (Draft FB 2022, cl 4(4))

In the case of a partnership, Insolvency Act 1986 has effect as if the partnership were an unregistered company. (Draft FB 2022, cl 4(5))

The terms 'expedient in the public interest' and 'protecting the public revenue' are not defined and it is unclear as to whether these will represent sufficient safeguards.

If enacted as drafted, this provision could be applied to any relevant body involved in promoting or enabling tax avoidance and operating against the public interest on or after the date of Royal Assent of FB 2022. Note that any information, non-compliant behaviour or ongoing action by HMRC or any other organisation prior to Royal Assent would be taken into account by the Courts in considering the winding-up petition.

Calls for evidence, consultation responses & research

The following calls for evidence and consultation responses were also published:

- **modernisation of the stamp taxes on shares framework**: following a call for evidence published in July 2020 on the principles and design for a new framework for stamp duty and stamp duty reserve tax (collectively stamp taxes on shares), the Government has published a summary of responses, confirming that it is committed to continuing to explore modernisation and will consider the feasibility and implications arising from the key priority areas identified by respondents. These include a single self-assessed tax on shares, territorial scope and digitisation. Stakeholders are invited to join a working group to help inform the development of future policy.

  Anyone interested in being part of the group should email: sts.consultation@hmrc.gov.uk with their contact details by 10 September 2021.

- The summary of responses document also mentions that the government has already taken action on one of the most requested changes - the temporary COVID-19 electronic stamp duty process has already been made permanent and the physical stamp presses have already been retired. The process allows for electronic notification and the issue by HMRC of a confirmation letter rather than physical stamping of the document and there is no requirement to resubmit instruments processed in this way since March 2020.

- **VAT and value shifting**: a call for evidence ran from 5 January 2021 to 30 March 2021 and sought evidence on proposed revisions to rules for apportioning consideration between supplies with mixed liabilities in a single transaction (to address what HMRC perceived to be exploitation of current provisions). Many stakeholders expressed concerns over the proposals set out in that consultation and HMRC confirmed in its summary of responses on Legislation Day that it was continuing to actively engage with these stakeholders to gain a 'fuller understanding' of views on the proposals. Respondents to the consultation have been contacted

directly but HMRC has indicated that it would also like to engage with other stakeholders to establish more views on the proposals. This is despite the fact that the initial consultation stated that the 'broad principles' of the proposed legislation were set.

- **impact of Making Tax Digital for VAT**: a report was prepared for HMRC by IFF Research (a market research provider) on the impact of Making Tax Digital (MTD) for VAT. A quantitative study was undertaken by IFF which comprised 2,005 interviews with a random sample of businesses for whom the MTD for VAT rules were mandatory. A number of key themes were identified. Changes were identified in record-keeping behaviour with more businesses using software and/or apps in record keeping and an increase in the proportion of businesses updating records on a continuous basis. However, there was still a significant portion of businesses not using fully MTD compatible software. The report also examined the costs of MTD for VAT to businesses and perceived benefits (for example just over half of respondents reported MTD had sped up the preparation and submission of VAT returns).

- **VAT Grouping - Establishment, Eligibility, and Registration:** a call for evidence, which ran from 28 August to 20 November 2020, sought evidence on the establishment provisions, compulsory VAT grouping and grouping eligibility criteria for businesses currently not in the existing legislation. The government has now published a summary of responses and reiterated the announcement made in the Tax Policies and Consultations paper on 23 March 2021 that it has decided not to take this any further.

- **VAT and the Public Sector: Reform to VAT Refund Rules**: the government believes that there is a strong case to reform VAT refunds under VATA 1994, s 41 and had previously published a paper setting out HM Treasury/HMRC internal thinking on how to improve public sector VAT refund rules which invited comments to help refine the policy. The consultation period ran from 27 August to 19 November 2020.

  The government also sought views on the advantages and disadvantages of reforming the way VAT incurred by public bodies in respect of non-business activities is refunded, and the options for implementation of any reform. The government has now published a summary of responses, noting that the responses received illustrate a range of views and concerns. The stakeholders were in favour of reform to the s 41 refund scheme, with the majority of respondents supporting the Full Refund Model (FRM) as the model for reform. However, the responses also identified several specific areas that need to be considered when designing any potential reform.

- **VAT and the Sharing Economy:** a call for evidence, which ran from 9 December 2020 to 31 March 2021, sought evidence to test the government's view of the VAT challenges the sharing economy creates. The government has now published a summary of responses, noting that the responses received illustrate a range of views and concerns. The vast majority of respondents indicated that any reform should follow international best practice where possible. With regard to supplies cross-border B2B supplies of services, the majority of respondents were supportive of some form of technical change to ensure VAT is collected where intended. Respondents were also in favour of using increased data sharing and reporting between platforms and tax authorities in order to improve transparency and VAT compliance.

- **Plastic packaging tax**: this tax is being introduced from April 2022 and primary legislation was included in Finance Act 2021. The government has published draft regulations for consultation, to remove three categories of product from the meaning of a plastic packaging component and add a further category of product.

Future developments

The written statement to parliament from Jesse Norman MP, Financial Secretary to the Treasury, lists three further policy announcements which will be legislation in the autumn:

- **London Capital & Finance compensation payments**: payments made by the London Capital & Finance compensation scheme will not be subject to Capital Gains Tax (and anything received in relation to a bond held in an ISA can return the compensation payment to the ISA without affecting the ISA limits), applying retrospectively from the time the payments were made;

- **Scottish social security payments**: payments made under the Child Winter Heating Assistance (introduced in November 2020) and the Short-Term Assistance (introduced in July 2021) will not be subject to income tax, applying retrospectively;

- **Covid winter scheme payments**: payments made by local authorities under the Covid Winter Grant Scheme and Covid Local Grant Scheme (and equivalent devolved schemes) will not be subject to income tax, applying retrospectively to all payments made from 2020–21 onwards. (Draft legislation, Sch 1 (s 261A(1)–(2)))

What was not published?

There are a number of areas on which we might have expected a development but none was published. These include:

- the review of the corporation tax surcharge on banking companies that was announced at Spring Budget 2021;

- the consultation on the taxation of securitisation companies that closed on 3 June 2021;

- the consultation on raising standards in the tax advice market that closed on 1 June 2021-we understand that responses and draft legislation will be published later this year;

- the consultation on hidden economy conditionality in Scotland and Northern Ireland that closed on 5 July 2021; and

- the possible expansion of the dormant asset scheme, which was announced on Tax Day (23 March 2021)

Adapted from 'Legislation Day 2021 summary' published by Tolley

Personal income tax

Redundancy related inaccuracies (Lecture P1266 – 19.32 minutes)

Summary –Omitting a large sum from the taxpayer's tax return was not deliberate but HMRC did not seek an alternative penalty for careless behaviour.

Angel Rodriguez-Issa was made redundant by Morgan Stanley in July 2016 and subsequently commenced employment with BNP Paribas.

He entered into a Settlement Agreement dated 12 September 2016 under which, Morgan Stanley would pay all outstanding salary, a payment equivalent to three months of salary in lieu of notice and a severance payment. Further, Morgan Stanley would waive its right to repayment of an outstanding loan.

He filed his 2016/17 tax return in December 2017 but omitted just over £176,700 of income received from Morgan Stanley after he had left employment with the firm as well as any reference to his employer having written off the loan.

In October 2018, HMRC opened an enquiry into his 2016/17 tax return and later, both parties agreed that there were inaccuracies in that return such that his tax liability had been understated by £68,000.

HMRC argued that the omissions were deliberate. The sums were large and the settlement agreement specifically stated that he was to be liable for the income tax payable on the settlement sums paid. HMRC contended that Angel Rodriguez-Issa must have been aware that the substantial sum was missing from his return.

Angel Rodriguez-Issa argued that Morgan Stanley had not given him paperwork for these additional amounts, so at the worst his behaviour was careless. He argued that, as in previous years, he had reported income based on returns provided by his employers. He had completed his return using the P45 received from Morgan Stanley and the P60 provided by his new employer, BNP Paribas. He did not appreciate that Morgan Stanley had made further payments that were not included on these documents. He claimed that he was not aware the loan write off would trigger a lump-sum tax liability.

Decision

The First Tier Tribunal were not satisfied that HMRC had discharged the burden of proving that the inaccuracies were the result of deliberate behaviour on the part of the taxpayer.

The First Tier Tribunal accepted that Angel Rodriguez-Issa believed that he had completed his tax return correctly using figures from his P60 and P45 and that he did not understand the tax treatment of the loan waiver. Completing his return without professional advice meant that errors had arisen but these errors were not deliberate.

Surprisingly, HMRC advanced their case on an "all or nothing" basis so that when the Tribunal found that Angel Rodriguez-Issa's actions were not deliberate, no penalties could be charged on the basis of carelessness. The appeal was allowed and the £24,000 penalty was cancelled.

Angel Rodriguez-Issa v HMRC (TC08123)

Unpaid police overtime and allowances (Lecture P1266 – 19.32 minutes)

Summary – The global settlement sum that included compensation, legal expenses and insurance, was only taxable to the extent that it was not used to pay for the legal and insurance costs incurred in bringing the claim.

Keith Murphy was one of a number of police officers with the Metropolitan Police Service who had received payments under a settlement agreement for alleged unpaid overtime and other allowances.

The total payment, or Principal settlement sum included compensation, agreed costs as well as protective insurance to cover the Metropolitan Police Service's legal costs, in the event that the claim was unsuccessful.

Keith Murphy excluded the settlement amount from his tax return considering the total amount to be non-taxable. HMRC raised discovery assessments on the basis that the total settlement sum was employment income.

Agreeing with HMRC, the First Tier Tribunal found that Keith Murphy was subject to Income Tax on the full amount received under the settlement agreement on the basis that the amounts were emoluments from his employment.

Keith Murphy appealed to the Upper Tribunal.

Decision

The Upper Tribunal stated that it was common ground that the amounts paid under the Settlement Agreement could only be regarded as "earnings" within s62(2) ITEPA 2003 by virtue of s62(2)(b) as any "other profit... obtained by the employee".

Referring to Eagles v Levy 19 TC 23, the Upper Tribunal decided that even if the payments were other profits derived from employment, amounts could be deducted in arriving at the taxable amounts, where necessarily incurred to obtain their compensation. In this case, the sum received was more than the just compensation for the unpaid overtime and hardship allowances. Keith Murphy did not make a profit within s.62(2)(b) ITEPA 2003 to the extent that the Principal Settlement Sum was paid to cover the legal success fees and insurance premiums. The additional sums should be deducted.

The Tribunal agreed with Keith Murphy that the taxable employment income should be calculated as his share of the principal settlement sum less his share of each of the legal costs and the insurance premium.

The appeal was allowed.

Keith Murphy v HMRC [2021] UKUT 0152 (TCC)

Payments changing pension arrangements (Lecture P1266 – 19.32 minutes)

Summary –Facilitation payments to pension fund members to compensate the expected lower pension payments and reduction in future employer contributions were taxable as earnings, as the payments arose following a change to future employment conditions.

E.ON UK plc wanted to reduce the costs as well as risks associated with its pension schemes. The company operated a number of different pension schemes. Since 2008, new employees have been eligible to join a defined contribution scheme but before that date, employees had been invited to join a retirement balance arrangement, and before that a traditional final salary scheme.

This case concerned payments made to the 1,100 members of the retirement balance scheme. Following negotiations which unions and employees, the company made an offer to its members consisting of a two year pay deal as well as a one-off cash Facilitation Payment, calculated as 7.5% of salary, subject to a minimum payment of £1,000. The offer also included a number of employment commitments by E.ON UK plc for the next four years.

E.ON UK plc sought HMRC clearance that the Facilitation Payments were exempt from income tax and National Insurance Contributions as they were not "from" the employment within the meaning of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"), s 9(2) and the Social Security Contributions and Benefits Act 1992 ("SSCBA"), s 3(1).

HMRC disagreed and after some discussion, the company paid tax and NICs on all the Facilitation Payments, with the exception of one "test" employee, a Mr Jason Brotherhood. HMRC issued E.ON with a determination of £758 in respect of income tax and a further £987.07 to cover NIC.

It was common ground that the facts of Mr Brotherhood's case and those of other retirement balance members were substantially the same, except in relation to quantum. HMRC accepted in correspondence with E.ON that if it was successful in its appeal before the Tribunal, the tax and NICs on the Facilitation Payments of other retirement balance members would be refunded.

E.ON argued that:

- the Facilitation Payment was compensation for the loss of pension rights and so not from employment;
- the Facilitation Payment replaced a non-taxable sum, being:
  - the more generous pension payments that Mr Brotherhood would otherwise have received from the retirement balance scheme;
  - the higher pension contributions which would have been made by E.ON to Mr Brotherhood's pension pot; or
  - the earnings Mr Brotherhood would need, to make the extra pension contributions necessary to obtain the same level of benefits; and/or
- the Facilitation Payment was not "from" the employment, because it was "from" something else, namely a reduction in the employees' pension rights.

Decision

The First Tier Tribunal agreed with HMRC.

The Facilitation Payments were part of an integrated package that involved several elements, not all of which were pension-related.

The payment was not compensation for loss of pension rights as the employee rights up to the change in conditions were unaffected. The Tribunal acknowledged changes were made to the pension arrangements going forward but that those changes were part of a comprehensive package that included a two year pay deal for all employees, a commitment by E.ON not to make further amendments to the pension arrangements for five years, and a set of "employment commitments", which remained in place for two years.

The Facilitation Payment could not be separated out from the rest of the package and there was "no specific focus on the Facilitation Payment". The Tribunal concluded that the changes were a complete integrated package, with the payments representing "an inducement to…provide future services" but on different terms. The payment arose 'from employment'.

The appeal was dismissed.

E.ON UK plc v HMRC (TC08125)

NIC on car allowance **(Lecture P1266 – 19.32 minutes)**

Summary – Car allowances paid in lieu of a company car were earnings liable to NICs, as the rate was set by job grade rather than business use. The allowances were not exempt 'relevant motoring expenditure'.

Laing O'Rourke Services Ltd is a multinational construction and engineering company. The company operated a car scheme that was inherited when it acquired Laing Construction back in 2001. It is this scheme that is the subject of this appeal.

Under the scheme, rather than having a company car, eligible employees could choose to receive a cash allowance, paid monthly in arrears.

To be eligible for the cash alternative, employees were required to have their own vehicle available for business use. The amount paid varied from £4,000 to £10,000 per annum and was dependant on job grade. The number of business miles each employee completed could vary hugely from year to year and within different categories of staff and between roles. Evidence supplied showed that at least a third of scheme participants did not use a car for any business miles at all and there was no periodic review of the payments made to an employee to take into account any variation in business mileage.

The car allowance was subject to income tax as well as primary and secondary NICs. However, following the Court of Appeal's decision in Cheshire Employer and Sills Development Ltd v HMRC [2010] UKFTT 379 (TC), Laing O'Rourke Services Ltd later claimed a repayment of secondary NICs covering the period 2004/2005 to 2017/2018, totalling more than £2.2 million. The company claimed that an amount of the payments fell within what regulation 22A of, and paragraph 7A of Part VIII of Schedule 3 to, the Social Security (Contributions) Regulations 2001 refer to as the "Qualifying Amount" and, as a result, should not have been subject to NICs.

HMRC disagreed stating that “Qualifying Amount” was limited to payments of “relevant motoring expenditure” defined in regulation 22A and the payments made under the car allowance were not “relevant motoring expenditure”.

The company argued that if the "Qualifying Amount" disregard for NICs is limited to payments of "relevant motoring expenditure" that disregard still applies as the payments were "relevant motoring expenditure". Alternatively, the company stated that the payments were not "earnings" for the purposes of NICs.

Decision

The Tribunal found that the allowance payments were earnings, and not a reimbursement of business expenses. The scheme payments were determined by reference to job grade and were not linked to business mileage or use. There was an element of bounty as the rates were not set by reference to business need; indeed a significant proportion of staff receiving the allowance, undertook no business travel.

The Tribunal found that the scheme payments were not "relevant motoring expenditure", as the allowance payments were made based on the individual's staff grade and seniority, rather than use of the car.

The appeal was dismissed.

Laing O'Rourke Services Ltd v HMRC (TC08161)

HICBC discovery assessment invalid **(Lecture P1266 – 19.32 minutes)**

Summary – A taxpayer who had not submitted a tax return (as he was taxable under PAYE or been issued with a notice to file), was not liable to the High-Income Child Benefit Charge under the discovery provision as the charge was not income to be 'discovered' under s.29 TMA 1970. HMRC should have used other powers to collect the tax due.

HMRC assessed the taxpayer to the high income child benefit charge (HICBC) under the discovery provisions (TMA 1970, s.29(1)(a)) for the years 2014/15 to 2016/17. In that period, his wife had claimed child benefit and his income exceeded £50,000 in each year, but he had not submitted a Self Assessment tax return nor been issued with a notice to file. He was not charged a failure to notify penalty because HMRC considered he had a reasonable excuse.

The taxpayer appealed against the assessments. The First Tier Tribunal decided that, although he was liable to the charge and HMRC had made a discovery, the assessments were not validly raised. The officer had not discovered any 'income which ought to have been assessed to income tax' within s.29(1)(a).

HMRC appealed.

Decision

In summary, the Upper Tribunal agreed with the First tier Tribunal that the discovery assessments raised were invalid. In this case, HMRC was not seeking to tax untaxed income; it was trying to collect an unpaid tax charge.

HMRC argued that on a purposive construction, the word 'income' in s.29(1)(a) could simply be read as including any amount liable to income tax. The Upper Tribunal said HMRC had interpreted the provision too widely. Its purpose is to assess income that ought to have been assessed.

The tribunal noted that HMRC had contacted the taxpayer within the four-year window for issuing a notice to file, so it could have issued a notice to file and, if he failed to submit a return, it could have raised a determination to income tax under s.28C.

Another option would have been to issue a simple assessment under s.28H to which the 20-year time limit provided by s.36(1A)(b) applied.

The tribunal concluded it could not infer from s.29(1)(a) a 'broad intention to cover any shortfall of tax' nor was it 'inextricably linked to the self-assessment regime'.

Further, it could not be fairly said that the officer discovered that there was income that had not been assessed. Rather, he discovered that the taxpayer should have paid the HICBC.

Finally, on HMRC's argument that there was a drafting error, the judges disagreed. They said if s.29 did require amendment this would be more than correcting an error, it would be judicial legislation.

Given that s.29 was not part of Self Assessment and it had not been established that an additional assessing procedure for the HICBC was intended, the Upper Tribunal was not satisfied that such an amendment was required.

HMRC's appeal was dismissed.

HMRC v Jason Wilkes UT/2020/000354

Adapted from the case summary in Taxation (8 July 2021)

Share gifts to employees – PAYE & NIC **(Lecture B1268 – 10.05 minutes)**

Giving shares to employees

Statistics show that companies which gift shares to their employees outperform their competitors.

As well as being a reward for services or for continued loyalty, the share award strengthens the ties between employee and employer and acts as a motivational incentive for the worker who, being a shareholder, now has a vested interest in helping the company to grow its business.

For small and medium enterprises, evidence indicates that employee share ownership improves recruitment and retention as well as promoting growth.

The Government has done its bit in promoting wider employee share ownership by offering tax incentives in the form of “tax advantaged schemes” such as Share Incentive Plans (SIPs) or giving tax breaks on the grant and exercise of options in arrangements such as Company Share Option Plans (CSOPs) and Enterprise Management Incentives (EMIs).

However, these schemes are subject to rigid eligibility conditions, and SIPs and CSOPs in particular have relatively low reward ceilings which will rarely interest or excite the high-flyers and key executives.

For these people, share ownership can be facilitated by a simple gift of shares from their employer company. Such gifts are unlikely to have any tax breaks; we used to call them "unapproved" schemes, but they are now known as "non-tax advantaged" schemes which is a more accurate description.

How to make the share gifts

The company has two choices:

1. It could issue new shares; or

2. It could ask shareholders with existing shares to transfer some of these to the employees.

The second option will trigger a disposal by the existing shareholder for CGT purposes.

For many, this will open up the possibility of a business asset disposal relief (BADR) claim, so a 10% tax rate will soften the blow. But not all disposals will qualify for BADR and the reduction in the lifetime gains ceiling from £10m to £1m doesn't help. Ultimately the viability of a transfer from an existing shareholder will be heavily influenced by the CGT cost.

Issuing new shares avoids any CGT issues for the existing shareholder(s). It could, however, have the effect of diluting the percentage holdings of the existing shareholder(s) which they may object to.

The company could, of course, issue new shares to existing shareholders at the same time which may avoid any loss of control issues, but this isn't an ideal solution and could also create a potential income tax charge in the hands of the existing director-shareholders if the shares are deemed to have been obtained by reason of their employment.

A simpler solution would be to issue shares of a different class (carrying less favourable dividend and voting rights for example) with perhaps a right to convert these to full equity shares at a future date once either retention periods have been satisfied and/or performance targets met.

If new shares are issued, ensure that the legal formalities are properly adhered to. Before issuing shares, check the articles of association to make sure that the company is entitled to issue new shares. Issuing extra shares will then require a resolution to be passed by a general meeting of the shareholders.

Taxation implications of non-tax advantaged share gifts

UK resident employees are chargeable to income tax on the value of the share award as this constitutes earnings by reason of the employment.

The employee will then have "share-related employment income" equal to the market value of the shares at the date they are awarded, less any payments made by the employee to acquire the shares (which is normally nil).

Market value means the price the shares could be sold for to a willing and unconnected third-party buyer and may accordingly be affected by any restrictions attaching to the shares. [If so, the restricted securities rules will need to be googled as a further charge may be triggered when the restrictions are lifted.]

Where the market value of the shares cannot be established with reference to a third party (such as on a sale to an unconnected party or the sale on a recognised exchange), the employer is required to use its best estimate of the value.

Compliance issues

The compliance treatment is driven by whether the shares awarded are "readily convertible assets" (RCA).

If the shares are RCA, both income tax and Class 1 employer's and employee's NIC are collected via PAYE on the share-related income.

An RCA is either:

a) An asset capable of being sold or otherwise realised on a recognised share or investment exchange (UK or non-UK); or

b) Unlisted shares where "trading arrangements" are in existence or are likely to come into existence (covering situations where the employer is either assisting with, enabling or facilitating a sale of the shares by the employee).

If the shares are RCAs, the employee is receiving "PAYE income" and the value of the award must be put through payroll.

If the shares are not RCAs – for example, the company issuing the shares is unlisted and no arrangements have been or will be put in place to enable the employee to convert the shares into cash – then no PAYE needs to be applied. Instead, the employee will pay income tax through the self-assessment system. The employee will then report the award as "share-related employment income" on the employment income supplementary pages. HMRC Helpsheet HS305 is worth looking at should you need to.

If the payment goes through PAYE, the value of the award will be reflected in the form P60 figure, so no separate employee reporting is needed.

Payroll mechanics for RCAs

Where a share award is made by way of an RCA, both income tax and Class 1 NIC (employees' and employers') are due on the value of the shares.

The employing company must account for these payments under PAYE by including the taxable value of the share award as gross pay. In reality, this is a 'notional payment' as the employee does not actually receive the value of the addition in their gross pay; this is just a mechanism to ensure the correct amount of income tax and Class 1 NIC is deducted.

The tax must then be paid over to HMRC by the usual monthly PAYE payment date. Note that the 50% overriding limit for deductions via PAYE does not apply here.

Many employees will not have enough salary in the pay period to cover the extra income tax and NIC on the notional payment. This is very common when employees are paid in RCAs.

In this situation the net pay for the month is reduced to zero. It is important to make the employee aware of this in advance (as bills will need to be paid and children will need to be fed).

The employer must fund the difference to HMRC. The employee must then reimburse the employer for the excess deduction no later than 90 days after the end of the tax year in which the notional payment is made (being 4 July 2021 for share awards in 2020/21). This is typically done by the employee selling enough shares to cover the tax debt. This may need to be pre-planned so that funds are available in good time.

Some employers have 'sell to cover' withholding arrangements whereby the employee acquires beneficial ownership of all of the shares subject to the award, but immediate sells some of them to raise cash to reimburse the PAYE & NIC.

Where the employee does not reimburse the employer by the time limit, the PAYE paid on behalf of the employee is treated as a taxable benefit and reported as such on the P11D. In this case the value of the benefit is recorded in Section B of the P11D under "payments made on behalf of the employee".

This makes things more expensive because Class 1 NIC (employee and employer) is then payable rather than employer-only Class 1A. For NIC purposes, the benefit arises when the deadline is missed (being the tax year in which the 91st day falls).

If the employer decides to meet the extra income tax and NIC liability for the employee, it should do so by making a grossed-up payment to the employee via payroll.

Alternatively, the employer may decide to advance a loan to the employee to enable them to pay the tax. This would normally be linked with a repayment plan from post-tax pay. Assuming the loan exceeds £10,000, the notional interest on the loan should be reported as a P11D benefit.

A popular solution is for the employee to find all but £10,000 of the tax and leave the rest to be funded by employer loan which then gives rise to a zero taxable benefit.

If the loan route is to be pursued, sensible advice is for the company to make it clear to the employee (via a formal loan offer or at least by more informal e-mail) that the excess tax is being loaned and to specify the terms of that loan. HMRC do not look favourably on employers who retrospectively treat the non-reimbursed tax as a loan once the deadline has passed.

Compliance reporting for non-RCAs

If the share award is not disclosed via the PAYE system, it must be reported by the employer to HMRC no later than 6 July following the tax year in which the shares were awarded. There are (inevitably) penalties for late filing of returns.

Notification is made via HMRC's registration portal for Employment Related Securities. This can be accessed through the employer's PAYE online account.

NIC

As already mentioned, if the shares are RCAs, Class 1 NIC (employer and employee) must be accounted for via payroll.

If the shares are not RCAs, there is no NIC. Note that Class 1A NIC will not apply here because the share-related income is not reported as a benefit via the P11D.

The NIC legislation imports the same definition of RCAs as for income tax.

CGT

One of the benefits of employee share ownership is that any growth in value of the shares after the initial award will normally be chargeable to CGT. [There are exceptions for restricted securities where the growth in value between the award and the lifting of the restriction can be chargeable to income tax.]

CGT will be payable at a maximum of 20% (or 10% if BADR applies). The lower CGT rate equates to a higher profit retention when the shares are eventually turned into cash.

The CGT base cost for the employee is the amount chargeable to income tax plus any amounts contributed by the employee for the acquisition of the shares. In most cases this will equate to the value of the shares at the date of the award (but may be different if some of the subsequent growth is chargeable to income tax as it may be for restricted securities).

Contributed by Steve Sanders

Employment related loans –practical issues (Lecture B1269 – 15.55 minutes)

A recap on the basics….

When an employer makes a loan to an employee which is either interest-free or which is made at a rate of interest which is lower than the HMRC official rate (currently 2%), the employee is in receipt of a taxable benefit.

The amount of the benefit is disclosable on form P11D and is liable to employer-only Class 1 A NICs.

There is no voluntary payrolling option for beneficial loans (although tax is often collected on beneficial loans via the employee's tax code).

There is no benefit charge if the aggregate of all employment-related loans outstanding at any time in the tax year does not exceed £10,000. This is the provision which takes public transport season ticket loans etc out of the charge to tax. Where the £10,000 threshold is exceeded, the taxable benefit is calculated on the entire loan (and not just on the excess of the loan over £10,000).

A director's loan account will therefore trigger a benefit charge if the balance exceeds £10,000 at some point in the tax year.

If the borrower is a shareholder in a close company but is neither an employee nor director, there is no benefit charge on the shareholder. Instead, the amount which would otherwise be taxed as a benefit is treated as a dividend. S.455 tax will also then be an issue.

With all this is mind, here are a few practical points on employment-related loans of which you should be made aware….

Interest payments by employees

Amounts "make good" by the employee for the provision of the loan (being payments of interest) will reduce the value of the benefit, so loans made at or above the official rate will not give rise to a charge (although they would still normally need to be disclosed on the P11D).

Interest paid by the employees should be under an obligation that existed during that year (as HMRC do not regard voluntary payments as "interest").

It should be noted here that there is a general deadline of 6 July after the end of the tax year if "making good" payments are to reduce a taxable benefit, but this deadline does not apply to beneficial loans. As long as the interest is "for a year of assessment" and is paid at some point (even if rolled up and added to the loan), it will be deductible.

Loans which roll-up the interest at the HMRC official rate should therefore be tax-free. However, HMRC argue that Class 1A NIC is due on the full cash equivalent of the benefit if the interest is not paid by the Class 1A payment deadline (which is 19/22 July depending on whether the business files electronically or not). This means that the cash equivalent of the benefit would be reduced for income tax purposes but not for NIC.

Close company loans

S.455 CTA 2010 ("loans to participators") must also be considered as there is no rule which precludes a S.455 charge where the cash equivalent of the loan is taxed as a benefit.

A loan to a director / shareholder of a close company will therefore be potentially chargeable to income tax under the ITEPA 2003 benefits code as well as having a 32.5% S.455 charge (albeit that the S.455 tax will be refunded when the loan is repaid or written off).

The £10,000 exemption

The £10,000 exemption applies per employer (or group of employers) and does not apply per person. So an employee with two jobs could have two separate £10,000 loans, neither of which would give rise to a taxable benefit.

This also means that in a "husband and wife" company, both can take advantage of the exemption and have a £10,000 loan without triggering a taxable benefit. However, a couple of points must be borne in mind here:

1) The loan must be made by reason of their own employment and not by reason of that of their spouse / civil partner. So there is no problem in doubling-up the exemption where both spouses / civil partners are employees and/or directors. But if one spouse (say W) is the only director and her husband / civil partner (H) has no involvement in the company, then a loan to H would be treated as assessable on W and effectively added to her loan for taxable benefit purposes.

2) Even if exemption is secured for income tax, the loans are likely to be subject to S.455 tax as the £15,000 exemption for close company loans does not apply if the shareholder has a material interest in the company (being 5% including holdings of associates).

Loans written off

The default position is that the write-off of the loan is treated as employment income of an amount equal to the amount written off. There is no £10,000 exemption here, so a write-off charge will still arise on small loans which may have been exempt from the loan benefit charge.

The amount written-off is not PAYE income but is instead reportable via the P11D.

However, the amount written-off is subject to Class 1 NIC (not Class 1A) which means an NIC charge arises for the employee as well as the employer. The amount written off must therefore be put through payroll as earnings chargeable to NIC (but not income tax).

A CT deduction is available for the amount written off (being in the nature of remuneration).

If the loan is written off as a result of an employee's death, there is no tax charge.

If an employee is made redundant and the loan is written off by the employer as part of the redundancy package, the full amount of the released loan is taxable as earnings. The £30,000 exemption does not apply. In such cases it would be preferrable for the employer to repay the loan in advance of any redundancy settlement being agreed and for the employer to then make a higher ex-gratia redundancy payment (which would qualify for the £30,000 exemption). Clearly these two events should not be linked.

Where a loan is made by a close company to an employee who is also a shareholder, the write-off of the loan is treated as dividend income. This is because S.189 ITEPA 2003 gives priority to the distribution treatment. There is therefore no P11D reporting and no CT deduction. The dividend allowance would be available.

Where a close company loan to an employee / shareholder is written-off, there is no similar provision to S.189 in the NIC regulations. This creates a mismatch between the income tax rules (which tax the loan write-off as a dividend) and the NIC rules which still treat the amount written off as earnings.

In this case the amount written off must be put through payroll as earnings for Class 1 NIC (employer's and employee's) and is accordingly added NICable pay in that pay period (but is not included as taxable pay).

It may be possible to argue that the loan was made to the individual specifically in his capacity as a shareholder (which would then avoid the charge to Class 1 NIC). If this argument is to have any legs, HMRC would expect to see this having been properly documented and minuted at shareholder meetings at the time the loan was made. It is not therefore the sort of argument one could run in hindsight.

Where a loan is written off, any S.455 tax which was paid when the loan was advanced will be repaid.

PAYE & NIC issues for loan write-offs

If a loan is written off, Class 1 NIC is due and must be accounted for via payroll. For employees the charge will either be at 12% or 2% depending on the level of their general earnings in the pay period.

If the employee's NIC on the amount written-off exceeds their net pay in that pay period, the net pay is reduced to nil.

The employer will make the full Class 1 primary NIC payment to HMRC and the employee then has to make good the excess NIC within 90 days.

If the employee fails to do so, the amount which the employer fails to recover is treated as a taxable benefit and is entered on the P11D for the tax year in which that 90th day falls. The unrecovered amount is earnings for Class 1 NIC in the pay period in which the 90th day falls (again treated as NICable pay for payroll purposes but not taxable pay).

Contributed by Steve Sanders

Capital taxes

The interaction of CGT and IHT (Lecture P1267 – 31.38 minutes)

The Office of Tax Simplification (OTS) have been asked in recent years to undertake wide-ranging reviews of both:

- CGT; and
- IHT.

The IHT document

The IHT report, which is entitled 'Simplifying the design of IHT', came first. It was published in July 2019. The scope of this review included looking at the way in which the two taxes link together and the conclusion of the OTS was that the interaction between CGT and IHT is indeed complex and can certainly distort decision-making. It should be borne in mind that there is normally no CGT charge on death. For CGT purposes, the person inheriting is treated as having acquired the asset at its market value on the date of death rather than at the amount originally paid for it. This situation is referred to as the 'tax-free uplift on death' and it means that a chargeable asset can be sold shortly after the owner's death without any CGT falling due. Where an asset is exempted or relieved from IHT (e.g. because it passes to a spouse or represents relevant business property attracting a 100% relief), it can be sold shortly after death without either CGT or IHT being payable. With reference to this latter point, the OTS made the following comment in their report:

'This can put people off passing on assets to the next generation during their lifetime. It distorts and can complicate the decision-making process around passing on assets to the next generation. The OTS have concluded that this distortion would be best addressed by amending the CGT rules rather than changing IHT.'

Illustration 1

Susan is a successful lawyer who retired with cash resources of £200,000. This would of course be subject to IHT on her death. Susan therefore decides to invest the entire £200,000 in a portfolio of AIM-listed shares selected by her financial adviser on the basis that they will qualify as relevant business property once Susan has held them for two years.

The AIM shares increase in value and, on Susan's death several years later, they are worth £450,000. These shares are left to Susan's daughter who sells them for £460,000 shortly after her mother's death.

The tax consequences of these arrangements are:

- The AIM shares qualify for business relief at 100% so that there is no IHT to pay on the daughter's legacy;
- There is no CGT on Susan's death on account of the tax-free uplift. The gain of £450,000 – £200,000 = £250,000 is eradicated. The daughter's subsequent gain of £460,000 – £450,000 = £10,000 will be covered by her annual CGT exemption (assumed still to be £12,300).

The zero tax situation illustrated in (c) above can be contrasted with double taxation where, for example, quoted shares are given to a child and the donor parent then dies within seven years of the gift. In this scenario, there is no CGT holdover relief at the time of the gift so that a CGT liability (usually at 20%) will arise on any gain, but the failed potentially exempt transfer (PET) will attract IHT at a rate of up to 40% with no relief for the CGT previously paid. The only exception to this double taxation regime is that, if, unusually, the CGT on the lifetime gift is satisfied by the donee rather than the donor, S165 IHTA 1984 allows the CGT borne by the donee to be taken into account in determining the quantum of the failed PET for IHT purposes.

Illustration 2

Many years ago, Alastair set up an unincorporated business which has proved to be a great success.

Over the last three decades, Alastair has invested £180,000 in the business, but it is now valued at £780,000. He has reached retirement age and so he decides to hand over the business to his son.

A joint claim for CGT holdover relief under S165 TCGA 1992 means that the son takes over Alastair's business at a base cost of £180,000. There is no CGT uplift because Alastair is still alive at the time when he gives the business to his son.

Under the son's control, the business goes from strength to strength and it is sold two and a half years later for £1,100,000. The son realises a gain of £1,100,000 – £180,000 = £920,000, on which a 10% tax charge of £92,000 is due (this assumes that the son can make a claim for business asset disposal relief). The son invests the net sale proceeds in a holiday home in the south of France.

Unfortunately, Alastair dies a few months later so that the gift to the son turns out to have been made during the seven years prior to Alastair's death. This has the following tax effects:

There is no business relief for the failed PET, given that the son does not own the asset gifted (or a qualifying replacement) at the time of his father's death. This means that there is an IHT charge of up to 40% on the value of the business at the time of the gift (£780,000).

CGT of £92,000 is paid by the son on the sale of the business. No part of this can be taken into account in the calculation of the failed PET. Because of the holdover relief claim, there was no CGT payable at the time of the gift. Therefore, S165 IHTA 1984 is irrelevant (and, even if there had been a CGT charge at that stage, the IHT relief would only have been available if the son – and not Alastair – had settled the CGT liability).

The single recommendation made by the OTS in this part of the IHT report is that, where a relief or exemption from IHT applies in connection with a death estate, the Government should abolish the tax-free uplift on death and instead provide that the recipient is treated as acquiring the asset at the deceased's historic base cost.

The CGT document

The CGT report, which is entitled 'Simplifying by design', appeared in November 2020. It contains a fuller set of suggestions for dealing with the anomalies relating to the interaction of CGT and IHT. The review begins by contrasting the tax position where there has been:

(i) a sale of a chargeable asset shortly before the owner's death; and

(ii) a sale of the same asset, but this time by the legatee after the death.

Illustration 3

Richard, a higher rate taxpayer, owns a buy-to-let property worth £370,000 which he acquired several years ago for £130,000. Given that Richard has already used up his annual CGT exemption for 2021/22 on a previous property transaction, his CGT position when he sells the asset is as follows:

	£
Sale proceeds	370,000
Less: Cost	130,000
CHARGEABLE GAIN	£240,000
CGT @ 28%	£67,200

This leaves Richard with cash of £370,000 – £67,200 = £302,800. Sadly, he dies later in the same year, leaving a sizeable estate. Richard's nil rate band is allocated against other assets so that the cash legacy triggers an IHT liability of 40% x £302,800 = £121,120. His heir receives £302,800 – £121,120 = £181,680.

Alternatively, if Richard had not disposed of the buy-to-let during his lifetime, IHT of 40% x £370,000 = £148,000 would have been payable, but there would have been no CGT when the heir sold the property for £370,000 shortly after inheriting it. Richard's heir would therefore have received £370,000 – £148,000 = £222,000. Thus:

	£
Net receipt where heir sells buy-to-let	222,000
Less: Net receipt where Richard sells buy-to-let	181,680
INCREASE IN NET RECEIPT	£40,320

This increased receipt represents 60% of the CGT saved where the heir effects the sale. It makes clear how generous the tax-free uplift on death actually is.

As mentioned above, the OTS explored this area in their IHT report when they recommended moving to what might be called a 'no gain no loss' approach where an IHT relief or exemption applied. However, in the CGT review, the OTS seem to be taking a wider perspective whereby they suggest that the tax-free uplift concept should be abolished in toto (other than for main residences).

This would of course resolve the Government's dilemma as shown in Illustration 3, given that the position on a sale by Richard's heir under a no gain no loss rule would be:

	£
Sale proceeds	370,000
Less: Inherited base cost	130,000
CHARGEABLE GAIN	£240,000
CGT @ 28%	£67,200

On its own, the establishment of this revised approach would introduce what the OTS call 'a new distortion in favour of lifetime transfers' and so it would be necessary to take into account the asset's unrealised gain which had accrued at the time of death. There are two possible options for dealing with this:

(i) the value of the deceased's estate for IHT purposes could be reduced by the CGT which would have been chargeable had the asset been sold on the date of death; or

(ii) the full rate of IHT could be paid initially, with a tax credit being given on the eventual sale of the asset.

Illustration 4

Value of Richard's estate reduced by potential CGT liability

Under the first scenario, the value of Richard's asset on his death would be:

	£
Value of buy-to-let property	370,000
Less:Potential CGT liability	67,200
	£302,800
IHT @ 40%	£121,120

Richard's heir would end up with:

	£
Buy-to-let property	370,000
Less: IHT payable	121,120
	248,880
Less: Subsequent CGT liability	67,200
NET RECEIPT	£181,680

In other words, Richard's heir would receive the same level of legacy as he would have enjoyed had Richard sold the buy-to-let property shortly before his death – see Illustration 3.

Full rate of IHT being payable followed by tax credit on sale

Under the second scenario, Richard's property would be subject to a full IHT charge. Thus:

Buy-to-let property	£370,000
IHT @ 40%	£148,000

The CGT for Richard's heir on the sale of the property would be:

	£
Sale proceeds	370,000
Less: Inherited base cost	130,000
	£240,000

	£
CGT @ 28%	67,200
Less: Tax credit (40% x 67,200)	26,880
	£40,320

Note: The tax credit is the IHT attributable to the CGT charge.

Richard's heir would receive:

	£
Buy-to-let property	370,000
Less: Full IHT charge	148,000
	222,000
Less: Subsequent CGT liability	40,320
NET RECEIPT	£181,680

There are of course other permutations which might be worth exploring if the Government were not overly concerned about exact fiscal neutrality.

If the Government do decide to abolish the tax-free uplift on a more widespread basis, the OTS made two further recommendations which they feel should accompany such an outcome:

- a rebasing of all chargeable assets, perhaps to the year 2000 (although this would have significant cost implications for the Exchequer – certainly over the first few years); and

- an extension of the holdover relief rules to a broader range of assets such as the UK had prior to FA 1989.

The impact of S165(10) TCGA 1992

Another area where there is an interface between CGT and IHT can be found in S165(10) TCGA 1992. This scenario was not specifically addressed by the OTS in their CGT report. Because the relief is not widely understood, it is worth explaining briefly how the provision operates. Where there is a gift in respect of which holdover relief is claimed under S165 TCGA 1992 and the transaction attracts an IHT charge (e.g. because the donor has died within seven years of making the gift), there is an automatic deduction from a subsequent gain accruing to the donee equal to the lesser of:

- the IHT attributable to the value of the asset gifted; and
- the chargeable gain on the donee's disposal of the asset.

This rule is mandatory and no claim is required.

Illustration 5

Peter and Colin were partners in a trading enterprise. On 1 August 2015, Peter acquired a freehold office for use in their business costing £500,000. On 1 August 2020, Peter gave the property, which was now worth £800,000, to Colin. Holdover relief was claimed by Peter and Colin under S165 TCGA 1992. Peter had a cumulative total of chargeable transfers amounting to £340,000 as of that date. Peter died from COVID-19 on 27 December 2020. As a result, his PET on 1 August 2020 fails.

Because of the death of his partner, Colin decided to sell the premises and close down the business. The property was sold for £820,000 on 1 December 2021. Colin is a higher rate taxpayer for 2021/22.

On the assumptions that Peter had no exemptions available at the time of the gift and Colin agreed to pay any tax due, the IHT position is:

		Gross
	£	£
b/f		340,000
Office	800,000	
Less: Business relief (50%)	400,000	
		400,000
		£740,000

Because Peter's death was shortly after making the gift, the IHT payable by Colin is 40% x £400,000 = £160,000. Note that business relief of 50% is available because the property gifted falls into S105(1)(d) IHTA 1984.

Colin's CGT computation shows:

			£	£
Sale proceeds				820,000
Less:	Cost		500,000	
	Less:	Held over gain		
		(800,000 – 500,000)	300,000	
				200,000
				620,000
	Less:	IHT credit (see above)		160,000
				£460,000
CGT @ 20%				£92,000

Note: There is no deduction for IHT if a holdover claim has not been made under S165 TCGA 1992. It may therefore be worthwhile submitting such a claim, even if the gain is modest, in order to secure IHT relief on a subsequent disposal by the donee.

Conclusion

Will the Government be minded to grasp these particular nettles? With the damage done by COVID-19 ostensibly on the decline (as a greater and greater proportion of the population are vaccinated), it seems likely that there will be major reforms to the capital taxes code in due course. Given that the OTS proposals on CGT and IHT have the capacity to raise additional tax revenues, change may well happen sooner rather than later.

Contributed by Robert Jamieson

Husband and wife companies **(Lecture B1267 – 15.18 minutes)**

If a sale is in prospect for a husband and wife company, advantage should be taken, whenever possible, of Statement of Practice SP 5/89. It is self-explanatory and reads as follows:

> 'Under S35 and Sch 3 TCGA 1992, a person is treated as having held an asset at 31 March 1982 if he acquired it after that date by a transfer, or series of transfers, treated as giving rise to neither a gain nor a loss for capital gains purposes, from someone who did hold it at that date. Shares or securities of the same class in any company which are acquired in this way will be added to any shares or securities of the same class in the same company held by the transferee at 31 March 1982. Where, for rebasing . . . purposes, it is necessary to determine the market value of the shares or securities at 31 March 1982, they will be valued as a single holding.
>
> If the shares or securities in the relevant disposal represent some but not all of those valued at 31 March 1982, then the allowable cost . . . will be based on the proportion that the shares or securities disposed of bears to the total holding.'

It may therefore be beneficial for spouses who have each owned shares in the same private company since before 31 March 1982 to combine their holdings prior to sale so as to ensure a higher rebased cost (*R v CIR, ex parte Kaye (1992)*). This is demonstrated in the illustration below.

It goes without saying that the transfer of shares should be executed *before* a purchaser comes on the scene in order to avoid the risk of HMRC countering the advantage under the *Furniss v Dawson (1984)* doctrine. The impact on each shareholder's business asset disposal relief entitlement should also be considered.

Illustration

Gerrard Ltd, an unquoted trading company, has an issued share capital of 100 ordinary shares of £1 each. The shares are held as follows:

Dick	45
Lesley, Dick's wife	35
Martin, Dick's brother	20

Dick and Lesley are directors of Gerrard Ltd. They have never previously made a qualifying disposal.

Martin is not, and never has been, a director or employee of the company.

All these shares have been owned since before 31 March 1982, on which date it should be assumed that the following values per share applied:

Size of holding	£
0% – 25%	500
26% – 50%	1,000
51% – 74%	1,750
75% – 100%	2,500

It is known that a plc is interested in acquiring Gerrard Ltd for cash and it is expected that a price of around £12,000 per share would be forthcoming if an offer were made.

As things stand, the CGT position for Dick and Lesley will be:

Dick

	£
Sale proceeds (45 x £12,000)	540,000
Less: Market value at 31.3.82 (45 x £1,000)	45,000
	495,000
Less: Annual CGT exemption	12,300
	482,700
CGT @ 10%	£48,270

Lesley

	£
Sale proceeds (35 x £12,000)	420,000
Less: Market value at 31.3.82 (35 x £1,000)	35,000
	385,000
Less: Annual CGT exemption	12,300
	372,700
CGT @ 10%	£37,270

This gives a total CGT liability for Dick and Lesley of £48,270 + £37,270 = £85,540.

If, however, Lesley gave, say, 30 of her shares to Dick before any offer was made by the plc, the couple's tax position would be significantly improved:

Dick

	£
Sale proceeds (75 x £12,000)	900,000
Less: Market value at 31.3.82 (75 x £2,500)	187,500
	712,500
Less: Annual CGT exemption	12,300
	700,200
CGT @ 10%	£70,020

Lesley

	£
Sale proceeds (5 x £12,000)	60,000
Less: Market value at 31.3.82 (5 x £1,000)	5,000
	55,000
Less: Annual CGT exemption	12,300
	42,700
CGT @ 10%	4,270

As a result, the couple's tax liability becomes £70,020 + £4,270 = £74,290, a reduction of £11,250. Note that Lesley is allowed to keep the original 31 March 1982 valuation for the five shares which she retained.

Although there are now fewer and fewer companies being sold with shares which predate 31 March 1982, it is important to be aware that there is a real possibility of a new rebasing arrangement in the light of any reform to the CGT code. If this materialises (so that, for example, assets are rebased to 31 March 2000), this planning point would suddenly become even more important.

Contributed by Robert Jamieson

Grant of lease a separate transaction **(Lecture P1266 – 19.32 minutes)**

Summary – The grant of a commercial lease over a residential property's garage on the same day as the residential property was bought had no effect on the property as a whole being treated as residential property for SDLT purposes.

On 27 July 2018, Brandbros Ltd bought a property with a garage and filed a SDLT return on the basis that the property was residential but a month later the company sought to amend the return. On the day of completion, Brandbros had granted a lease to SFEP Limited to use the garage at the rear of the property as a storage unit. The company claimed that as the commercial lease was granted on the effective date of the property transaction, this was sufficient for it to be classed as mixed-use and that a repayment of just under £10,000 was due.

Following an enquiry, HMRC concluded that the property consisted of residential elements only and on 10 July 2019 issued a closure notice stating that SDLT was due at the residential rate and consequently a refund was not due.

Brandbros Ltd appealed.

Decision

The First Tier Tribunal was satisfied that the garage should be treated as a building or structure in the grounds or garden of the property. Therefore, as a matter of statutory interpretation, the garage was treated as residential property under s.116 FA 2003 regardless of the use to which it was put.

The Tribunal found that the grant of the lease did not alter the classification of the property bought. SDLT is a tax on transactions with the date of transaction being the date of completion. The transaction was the purchase of the property as provided in the contract for purchase and completed by the legal transfer on 27 July 2018. The subject matter of that transaction was of a property which was wholly residential. No lease had been granted over the garage at that time. It was only later, after the completion of the transaction to buy the property that another transaction took place, in the form of the grant of the lease over the garage. The fact that the grant of the lease took place on the same day had no effect on the SDLT treatment of the purchase of the Property.

The appeal was dismissed.

Brandbros Limited v HMRC (TC08126)

Market value versus annuity provisions

Summary – Although the consideration on the transfer of a property was an annuity, market value provisions applied to calculate the SDLT due as buyer and seller were connected.

M & M Builders (Norfolk) Ltd bought a residential property in 2016 from Mr and Mrs Flowerdew, who controlled the company.

The company delivered a land transaction return declaring that the consideration payable was £36,000, being 12 annuity payments of £3,000 each, meaning that no SDLT was payable. In response to the question in the return whether the purchaser and vendor were connected the response was "No". Nearly two years later this was amended by a letter to HMRC dated 25 January 2018.

The market value of the property was £1.2 Million.

HMRC opened an enquiry into the return and on 16 April 2018 they issued a closure notice, amending the return and assessing the land transaction to SDLT of £180,000, calculated using the property's market value as the deemed consideration.

On appeal to the First Tier Tribunal:

- M & M Builders (Norfolk) Ltd argued that chargeable consideration should be determined by applying s.52 FA 2003, that states that consideration for annuities is limited to 12 years' payments.

- HMRC argued that s.53 FA 2003 was in point and that the consideration could not be less than the market value as the transaction took place between connected parties.

The First Tier Tribunal found in favour of HMRC and M & M Builders (Norfolk) Ltd appealed to the Upper Tribunal.

Decision

The Upper Tribunal considered whether the market value rule contained in s.53 FA 2003 that applies when a transaction takes place between connected persons was prevented from applying when s52 FA 2003 applied, as the consideration for the transfer was an annuity

The Upper Tribunal confirmed the First Tier Tribunal's decision. S.52 FA 2003 did not prevent s.53 FA 2003 from applying. The Tribunal stated that it is clear from the wording in the legislation that they are not mutually exclusive.

When considering the application of the anti-avoidance application of s.53, SDLT payable under the annuity rule (s.52) must be compared to the SDLT payable when adopting the property's market value as consideration (s53). The market value calculation produced the higher chargeable consideration and so should be adopted.

M & M Builders (Norfolk) Ltd's appeal was dismissed.

M & M Builders (Norfolk) Ltd v HMRC [2021] UKUT 0103 (TCC)

Rectification of trust deeds (Lecture P1268 – 10.14 minutes)

Background

Trusts may be created for tax or non-tax reasons (or both). Whatever the reasons, the tax implications of creating and running a trust need to be considered in advance.

The tax consequences of a trust may not necessarily be conclusive or clear from reading the trust deed. Clauses of the trust deed might be difficult to interpret, resulting in misapprehensions and mistakes about the tax treatment.

In practice, most settlors and trustees obtain tax advice before the trust commences, and on an ongoing basis. But even if tax advice has been obtained, it may not always be complete and correct; this could have unfortunate consequences in terms of unintended tax liabilities, etc.

The remedy of rectification

However, in some cases, it may be possible for the trust deed to be changed, so that the unintended tax consequences do not arise. This remedy is 'rectification', which requires Court approval.

HMRC will not necessarily oppose an application to have the trust deed rectified, but in any event the final decision rests with the Court.

The legal process of rectification was described in a Court of Appeal case *Allnutt v Wilding* [2007] EWCA Civ 412 (by Lord Justice Mummery):

> "…rectification is about putting the record straight. In the case of a voluntary settlement, rectification involves bringing the trust document into line with the true intentions of the settlor as held by him at the date when he executed the document. This can be done by the court when, owing to a mistake in the drafting of the document, it fails to record the settlor's true intentions. The mistake may, for example, consist of leaving out words that were intended to be put into the document; or putting in words that were not intended to be in the document; or through a misunderstanding by those involved about the meanings of the words or expressions that were used in the document. Mistakes of this kind have the effect that the document, as executed, is not a true record of the settlor's intentions."

Ware v Ware

In the recent case *Ware v Ware* [2021] EWHC 694 (Ch), the claimant and defendant were the trustees of two will trusts. The trusts were created by a deed of variation in October 2005. In 2005 and 2013, deeds of appointment were executed by the trustees. The intention of the 2013 deeds of appointment was to add family members as trust beneficiaries. However, their effect (as well as adding further beneficiaries, as intended) was to terminate the claimant's interests in possession in trust funds and appoint new ones in their place.

Terminating the claimant's interests in possession in the fund also had significant adverse tax consequences:

1. The claimant would be deemed to have made an immediately chargeable transfer for IHT purposes, resulting in an IHT charge of 20% of the value of the underlying property over and above the claimant's available nil rate band.

2. The trust funds would be in the IHT relevant property regime, meaning that they were subject to 10 yearly charges and exit charges of up to 6%.

3. The claimant would have been treated as having made a gift with reservation of the underlying trust funds for IHT purposes while he retained an interest in them.

4. Even though the underlying trust funds were liable to IHT on the death of the claimant under the gift with reservation rules, there would be no CGT-free base cost uplift in the value of the underlying property on his death as there usually is where there is an IHT charge on death.

The claimant applied to the High Court for rectification of the 2013 deeds of appointment, on the grounds that the deeds mistakenly (and unnecessarily) included provisions which terminated the claimant's existing interests in possession and appointed new ones in their place, when they were only intended to add certain persons as additional default beneficiaries.

The High Court addressed the legal principles to be applied when considering the rectification of a document. One of these (which the Court cited from *RBC Trustees (CI) Ltd v Stubbs* [2017] EWHC 180 (Ch)) was:

> "…there must be a flaw in the written document such that it does not give effect to the parties'/donor's agreement/intention, as opposed to the parties/donor merely being mistaken as to the consequences of what they have agreed/intended. *For example, it is not sufficient merely that the document fails to achieve the desired fiscal objective*" (emphasis added).

Fortunately, the evidence in *Ware v Ware* clearly showed that the trustees' intention was limited to adding relatives as additional beneficiaries to the classes in whose favour the trustees' powers of appointment might be exercised. To achieve that result, it was not necessary to terminate or replace the claimant's life interests, and there was no evidence that the trustees intended to do so. The Court therefore granted the order for rectification.

It's all about tax…

By contrast, in *Allnutt v Wilding*, the taxpayer wanted to reduce the IHT that would be payable on his death. He made a gift of £550,000 into a discretionary settlement in 1995, thinking that it would be a PET for IHT purposes. However, the gift was, in fact, an immediately chargeable lifetime transfer. The claimant sought to rectify the trust deed to make the trust interest in possession instead of discretionary, as a transfer of value into an interest in possession trust would have been a PET at that time.

Unfortunately, the Court of Appeal rejected the application for rectification. The settlement correctly recorded the settlor's intention at the time, which was to confer benefits on his three children. In that sense, there was no mistake; the fact that the taxpayer's fiscal purpose had not been achieved wasn't considered to be material.

Conclusion

The remedy of rectification is available to change a trust deed and its tax consequences, if the legal principles for rectification are met.

However, rectification should not be relied on as a solution. The application process can be expensive and unpredictable. Rectification should only really be considered as a remedy of last resort, and expert legal advice is essential.

Contributed by Mark McLaughlin

An inverse argument **(Lecture P1269 – 16.19 minutes)**

The Upper Tribunal decision in *Hyman, Pensfold and Goodfellow v HMRC (2021)* relates to three separate appeals which raise the same point of law about the meaning and effect of S116 FA 2003. This provision contains, in S116(1) FA 2003, a definition of 'residential property' for SDLT purposes. Remember that the purchase of a property which is classified as 'residential' normally attracts a higher rate of SDLT than one which is 'non-residential'.

It is worth quoting the salient part of the relevant subsection:

'"Residential property" means:

(i) a building that is used or suitable for use as a dwelling or is in the process of being constructed or adapted for such use; and

(ii) land that is or forms part of the garden or grounds of a building within paragraph (i) (including any building or structure on such land); or

(iii) an interest in or right over land that subsists for the benefit of a building within paragraph (i) or of land within paragraph (ii)

and "non-residential property" means any property that is not residential property.'

Each of the cases involved the purchase of a house together with a significant area of land:

- *Hyman*: land surrounding the property extended to 3.5 acres (1.42 hectares);
- *Pensfold*: land surrounding the property extended to 27 acres (10.93 hectares);
- *Goodfellow*: land surrounding the property extended to 4.5 acres (1.82 hectares).

It should be noted that, in all three of these acquisitions, the main residence relief limit of 0.5 of a hectare was comfortably exceeded. However, this is not a CGT dispute.

Para 2 of the case report summarises the tax position as follows:

'It was in the interest of the taxpayers . . . to contend that some of the land sold (to them) together with the house was not, and did not form part of, the garden or grounds of the house. That question was determined by the First-Tier Tribunal (at three separate hearings in 2019), in each case adverse to the taxpayers. The taxpayers now appeal with the permission of the Upper Tribunal. The permitted ground of appeal in each case raises essentially one issue as to the interpretation of S116 FA 2003. The taxpayers contend that

land can only be part of "the gardens or grounds of" the house if the land is "needed for the reasonable enjoyment of the dwelling having regard to the size and nature of the dwelling".'

In other words, the taxpayers argued that some of the land surrounding their properties was not part of the 'garden or grounds', with the result that the purchase was not wholly residential in which case a lower rate of SDLT should have applied.

As might be expected, HMRC maintained that the entirety of the land on all three properties represented the 'garden or grounds' of each house.

An intriguing feature of this appeal is that the arguments are exactly the opposite of what would normally be expected in a CGT context. It would be customary for the vendor of a country house with substantial grounds attached to insist that all of the land was required for the reasonable enjoyment of the property so that his CGT main residence relief could extend to a larger area than 0.5 of a hectare (see S222(3) TCGA 1992). HMRC, on the other hand, would typically take a contrary view.

Here we have HMRC asserting that all the surrounding land was part of each house, while the taxpayers contended that a barn, a meadow, stables, a stable yard and a paddock were emphatically not part of the residential property.

As mentioned above, the First-Tier Tribunal found against all three SDLT payers and the two judges in the Upper Tribunal have confirmed these decisions. Remember that, as far as SDLT is concerned, there is no special area limit and no equivalent of the 'required for the reasonable enjoyment of the dwelling-house' let-out in FA 2003.

Despite the most recent judgment, there are some interesting extracts which can be picked out from the original hearings of the *Hyman* and *Goodfellow* cases. For example:

> 'In my view, "grounds" has, and is intended to have, a wide meaning. It is an ordinary word and its ordinary meaning is land attached to or surrounding a house which is occupied with the house and is available to the owners of the house for them to use. I use the expression "occupied with the house" to mean that the land is available to the owners to use as they wish. It does not imply a requirement for active use.' (*Hyman v HMRC (2019)*)
>
> 'Grounds need not be used for any particular purpose and can, as in this case, be allowed to grow wild. I do not consider it relevant that the garden or grounds are separated from each other by hedges or fences.' (*Hyman v HMRC (2019)*)
>
> 'It seems to us, looking at the character of the property as a whole, that the land surrounding the house is very much essential to its character, to protect its privacy, peace and sense of space and to enable the enjoyment of typical country pursuits.' (*Goodfellow v HMRC (2019)*)

How useful might any of these be in future CGT disputes? It should be emphasised that all three passages, although taken from First-Tier Tribunal decisions, were reproduced in full in the Upper Tribunal verdict which presumably indicates a positive level of approval by the two judges there. What will be really interesting is to see whether the boot is on the other foot when, in due course, the Hymans and the Goodfellows come to sell their respective properties!

There is one further matter which should be highlighted. The taxpayers' barrister had unsuccessfully argued that the test for SDLT should be the same as for CGT, even though S116(1) FA 2003 merely refers to 'land that is or forms part of the garden or grounds' of the property whereas S222(3) TCGA 1992 contains the additional condition that the land is 'required for the reasonable enjoyment of the dwelling-house'.

It is clear that this CGT requirement does not feature in the SDLT legislation which should put the point beyond dispute. However, in April 2003, HMRC had published a Statement of Practice (SP 1/03) dealing with a relief which distinguished between residential and non-residential property but which has since been abolished. In SP 1/03, which was relevant for stamp duty (SDLT not having yet come into being), HMRC said that the test which they would use in the context of residential property was 'similar to that applied for the purposes of the CGT relief for main residences'. SP 1/03 went on to add:

'The land will include that which is needed for the reasonable enjoyment of the dwelling, having regard to the size and nature of the dwelling.'

SDLT was introduced towards the end of 2003 and, in the following year, a revised Statement of Practice (SP 1/04) was put out dealing with the same relief for SDLT purposes. The wording of the relevant part was essentially identical.

However, in 2019 (i.e. quite some time after the purchases effected by Hyman, Pensfold and Goodfellow), HMRC revised their guidance as to the operation of S116 FA 2003 and the current version does not refer to S222(3) TCGA 1992 and does not repeat the reference to the land being needed for the reasonable enjoyment of the dwelling. The reason for this is that HMRC now accept that their original view expressed in the Statements of Practice was incorrect.

When, for example, Mr and Mrs Hyman acquired their property near St Albans in October 2015 for £1,515,000, they paid the full amount of residential SDLT on this purchase which amounted to £95,550. Two years later, following advice from their agents, the Hymans claimed an SDLT repayment of £34,950, given that a barn and a meadow were not thought to be part of the garden or grounds of the house. HMRC did not agree to this repayment, despite the fact that the stated definition in the second Statement of Practice was still extant. This of course led to the appeal to the First Tier Tribunal which was heard in July 2019. Unfortunately, the point about SP 1/04 does not appear to have been raised at that juncture and, when the matter was raised before the Upper Tribunal, the judges asserted that words in a Statement of Practice could not be relied upon to alter the meaning of a statutory provision such as S116 FA 2003.

It was open to a Court or a Tribunal to say that the Statement of Practice or other guidance contained in the Stamp Duty Land Tax Manual was simply wrong.

They went on:

> 'It was submitted that the Statements of Practice and guidance prior to 2019 were wrong both as regards the suggested relevance of S222(3) TCGA 1992 and the suggested test that the land must be needed for the reasonable enjoyment of the house.'

This late change of interpretation does not show HMRC in a very favourable light. What about the Hymans' legitimate expectation that the legislation should be construed in line with HMRC's published guidance at the time? Why should they not be entitled to rely on those statements? As one tax expert recently commented:

> 'This is not an honourable position.'

Contributed by Robert Jamieson

Administration

Offsetting CGT overpayments against income tax

CGT UK property returns must be filed within 30 days of completion. With such a tight deadline, this can mean that figures need amending later, once estimated figures are known with certainty.

HMRC is aware that its 2020/21 systems do not allow the CGT payments on account to be set against income tax due for the same year. Unfortunately, updating the system mid-year is not possible. As a temporary solution, taxpayers, or their agents should contact HMRC on 0300 200 3300 (or by using the agent dedicated line) to request that HMRC manually offset the CGT paid against the income tax liability.

https://www.icaew.com/insights/tax-news/2021/jun-2021/Offsetting-overpaid-CGT-against-income-tax

Discovery assessments could not be reissued

Summary – The subsequent reissuing of discovery assessments by HMRC following the withdrawal from an earlier appeal were not allowed.

HMRC received information alleging that Sean Kelly's employer, Direct Assist Ltd had been paying off-payroll cash bonuses to its employees and had been providing them with prestige company cars without declaring the benefits for income tax and National Insurance purposes. This appeal was the lead case against discovery assessments issued in 2017 in respect of those benefits in tax years 2010/2011 through to 2013/2014.

In 2014, following a visit by two officers, HMRC 'discovered' that cars had been made available to employees and in the case of Sean Kelly, he had use of a Range Rover Sport.

HMRC expected that Direct Assist Ltd would settle the unpaid tax due on a grossed-up basis but when the company went into compulsory liquidation, attention turned to assessing the employees. In 2016, HMRC issued them with discovery assessments but following a review, some errors were found in HMRC's calculations. Prior to the hearing, HMRC wrote to Sean Kelly, advising that the assessments were "technically flawed" and would be reduced to nil. They would be "vacated" and consequently there would no longer be an appealable decision for the Tribunal to adjudicate. HMRC said the evidence would be reviewed and further action considered; Sean Kelly would be able to appeal any further assessments which may be issued. At the time, the First Tier Tribunal considered the appeal to be automatically allowed notifying the parties by letter dated 27 February 2017 that stated:

> "The Tribunal therefore allows the appeal and any hearing date is cancelled. If the Tribunal hears nothing to the contrary within 28 days from the date of this letter, the file will be closed."

In 2017, having recalculated the figures, HMRC issued new discovery assessment and it is these assessments that are appealed in this case.

HMRC acknowledged that it was not possible for them to issue the two sets of assessments in relation to the same discovery. They argued that the 2016 assessments had not been disposed of and therefore the 2017 assessments were invalid. Further, they stated that the 2016 assessments stood good unless there was a decision by the Tribunal and they did not accept that the Tribunal's letter of 27 February 2017 in response to HMRC's withdrawal amounted to a decision by Tribunal as it did not indicate that the decision had been taken by a judge in chambers.

Decision

The First Tier Tribunal agreed that there was a discovery made when the spreadsheet was provided which enabled HMRC to issue the 2016 assessments.

Further, the Tribunal stated that the 2016 assessments were still good unless there was either:

1. An agreement between HMRC and Mr Kelly under s .54 TMA; or

2. A decision made by the Tribunal as contemplated by s.50 TMA.

On the first point, the Tribunal found that there was no agreement satisfying the provisions of s.54 TMA. HMRC had notified Sean Kelly that the assessments would be "vacated" so that there was no longer an appealable decision but this letter came out of the blue and was not discussed.

Secondly, the First Tier Tribunal confirmed that the decision described in the letter dated 27 February 2017 to allow the appeal of the 2016 assessments should be treated as a decision for the purposes of s.50 TMA and Sean Kelly's appeal of the 2016 assessments should be recognised as having been allowed. This prevented any further amendments or reissuing

The appeal was allowed.

Sean Kelly v HMRC (TC08131)

HMRC checklist - What to include in Statutory Clearance applications

The CIOT had published a new checklist received from HMRC for use when making statutory clearance applications. Full details can be found by following the link below.

HMRC request that such applications should be communicated with the Statutory Clearance Team by emailing reconstructions@hmrc.gov.uk, with attachments larger than 3 Mb being sent across several emails with the subject line as "Company Name Limited 1 of 4", etc.

Clearance requested

- List all legislation under which clearance is being sought at the top of the application

- Use the current legislation (this can be found on our GOV.UK page at https://www.gov.uk/guidance/seeking-clearance-or-approval-for-a-transaction#statutory-clearance-or-approval)

- Avoid separate applications for linked transactions (e.g. 2 target companies and 1 Holdco; Holdco to acquire each target in share exchange; these transactions can be one application)

The checklist then goes on details what should be included under the following headings:

- Shareholders
- Shares
- The transactions
- Transactions in Securities (s701 ITA07 / s748 CTA10)
- Capital Gains (ss138/139(5) TCGA92)
- Statutory Demergers (s1091 CTA10)
- Company Purchase of Own Shares (s1044 CTA10)

https://www.tax.org.uk/what-to-include-in-statutory-clearance-applications-hmrc-checklist

HMRC's Criminal Investigation Policy (Lecture P1270 – 16.47 minutes)

This article considers HMRC's criminal investigation policy. Most advisers are unlikely to experience one of their clients being subject to a criminal investigation by HMRC. An awareness of the policy may mean that you are even less likely to experience such an occurrence during your professional career.

Why does HMRC have a criminal investigation policy?

The first point to note is that HMRC is not a prosecuting authority. In suitable cases, HMRC will conduct the criminal investigation, but the prosecution will be handled by the relevant prosecuting authority. In England and Wales prosecutions are undertaken by the Crown Prosecution Service; in Scotland they are undertaken by the Crown Office and Procurator Fiscal Service; in Northern Ireland the responsibility is with the Public Prosecution Service Northern Ireland.

HMRC does not have the resources to undertake criminal investigations into every taxpayer who is suspected of fraud, or other criminal offences. In addition, such investigations tend to take longer than civil investigations. Another consideration is that there is a higher burden of proof in criminal investigations (where the case must be proved beyond all reasonable doubt, rather than the civil standard, which is the balance of probabilities. Instead, HMRC operates a selective policy as to the circumstances in which it will conduct a criminal, rather than a civil, investigation. This provides HMRC with the necessary flexibility to manage its resources, and to reserve criminal investigations for the most suitable cases.

Consideration of the policy

HMRC publishes its criminal investigation policy, which can be accessed at: https://www.gov.uk/government/publications/criminal-investigation/hmrc-criminal-investigation-policy.

The policy makes it clear that criminal investigations are an important part of HMRC's overall enforcement strategy. The policy also states that HMRC's preference is to deal with cases of fraud using their civil fraud investigation procedures (under Code of Practice 9, the Contractual Disclosure Facility). Details of that process can be found in a separate session. HMRC reserves criminal investigation for cases where they need to send "a strong deterrent message or where the conduct involved is such that only a criminal sanction is appropriate". This is encouraging news, as, although the civil penalties can be substantial, the prospect of a criminal conviction, a custodial sentence and punitive confiscation proceedings can be far less attractive.

However, under the policy, HMRC "reserves complete discretion to conduct a criminal investigation in any case and to carry out these investigations across a range of offences and in all the areas for which the Commissioners of HMRC have responsibility".

The policy gives the following examples of the kind of circumstances in which HMRC will generally consider starting a criminal, rather than civil, investigation:

- in cases of organised criminal gangs attacking the tax system or systematic frauds where losses represent a serious threat to the tax base, including conspiracy;
- where an individual holds a position of trust or responsibility;
- where materially false statements are made or materially false documents are provided in the course of a civil investigation;
- where, pursuing an avoidance scheme, reliance is placed on a false or altered document or such reliance or material facts are misrepresented to enhance the credibility of a scheme;
- where deliberate concealment, deception, conspiracy or corruption is suspected;
- in cases involving the use of false or forged documents;
- in cases involving importation or exportation breaching prohibitions and restrictions;
- in cases involving money laundering with particular focus on advisors, accountants, solicitors and others acting in a 'professional' capacity who provide the means to put tainted money out of reach of law enforcement;
- where the perpetrator has committed previous offences or there is a repeated course of unlawful conduct or previous civil action;
- in cases involving theft, or the misuse or unlawful destruction of HMRC documents;
- where there is evidence of assault on, threats to, or the impersonation of HMRC officials;
- where there is a link to suspected wider criminality, whether domestic or international, involving offences not under the administration of HMRC.

HMRC does not provide details of all the factors that are taken into consideration when deciding whether to pursue a case as a criminal or civil investigation. The policy does refer to one factor, and that is whether the taxpayer has made a complete and unprompted disclosure of the offences committed. Where fraud has been committed by a taxpayer, careful handling is required to ensure that the case is started, and remains, under the civil fraud investigation procedures. Advisers should note that the policy does not make reference to the issue of materiality, and that is reflected in recent prosecutions, covered below.

The policy ends by noting that HMRC "may observe, monitor, record and retain internet data which is available to anyone". It is a suitable reminder that HMRC will use information gleaned from internet sites, blogs and social networking sites (where no privacy settings have been applied), and other 'open source' material, as part of its investigative activities.

Recent prosecutions

I have looked at several recent prosecutions involving tax fraud. These reflect the diverse approach that HMRC seeks to achieve by its criminal investigation policy. They also demonstrate that materiality is not a consideration, and neither is the age of the taxpayer, when HMRC decide how to conduct a case. With relatively few prosecutions for tax offences, advisers should be able to prevent their clients becoming another prosecution statistic where fraud is established, providing they take a pro-active approach, and specialist advice, to navigate the pitfalls that await.

Contributed by Phil Berwick, Director at Berwick Tax

Deadlines

1 August 2021

- Corporation tax for periods ended 31 October 2020 if not liable to pay by instalments
- 2019/20 SA tax returns subject to a penalty of higher of £300 or 5% of tax due

2 August 2021

- Filing date for form P46(Car) for quarter ended 5 July 2021

5 August 2021

- Quarterly report by employment intermediaries for period 6 April to 5 July 2021

7 August 2021

- Due date for VAT return and payment for 30 June 2021 quarter (electronic)

14 August 2021

- Quarterly corporation tax instalment payment for large companies
- File paper monthly EC sales list —businesses based in Northern Ireland selling goods

19 August 2021

- Pay PAYE/construction industry scheme for month ended 5 August 2021 if by cheque
- File monthly CIS return

21 August 2021

- File online monthly EC sales list —businesses based in Northern Ireland selling goods
- Supplementary intrastat declarations for July 2021
  - arrivals only for a GB business
  - arrivals and dispatch for a business in Northern Ireland

22 August 2021

- PAYE/National Insurance/student loan payments if paid online

31 August 2021

- Private company accounts to Companies House (with 30 November 2020 year-end)
- Public company accounts to Companies House (with 28 February 2021 year-end)
- Corporate tax SA returns for accounting periods ended 31 August 2021
- Annual adjustment for VAT partial exemption claims, May year end

News

5th SEISS grant – Eligibility and turnover test (Lecture B1266 – 25.18 minutes)

The online service for self-employed individuals and members of a partnership claiming the 5th SEISS grant opened in late July 2021 and claims must be made by 30 September 2021.

The grant is subject to income tax and National Insurance and must be reported on the taxpayer's 2021/22 Self Assessment tax return. The grant also counts towards the taxpayer's annual allowance for pension contribution purposes.

Eligibility criteria

To be eligible for the 5th grant, taxpayers must have:

- traded in 2019/20 and 2020/21;
- submitted their 2019/20 tax return by 2 March 2021;
- trading profits of no more than £50,000 and at least equal to their non-trading income for either:

- 2019/20; or
- the average of 2016/17, 2017/18, 2018/19 and 2019/20.

Taxpayers must also declare that they intend to continue trading in 2021/22 and that they reasonably believe there will be a significant reduction in their trading profits due to COVID-19 between 1 May 2021 and 30 September 2021.

As with earlier grants, agents cannot make the claims on behalf of their clients.

Level of the grant

Taxpayers will fall into one of two levels of grant based on how much the taxpayer's turnover has reduced:

1. A turnover reduction of 30% or more - the grant will be 80% of three months' average trading profits, capped at £7,500
2. A turnover reduction of less than 30% - the grant will be based on 30% of three months' average trading profits, capped at £2,850.

HMRC will not ask for any turnover figures if a taxpayer started trading in 2019/20 and did not trade in 2016/17 to 2018/19. These taxpayers will receive a grant based on 80% of trading profits.

Turnover test

Details of how the 30% turnover test works were published on 6 July.

Unlike the earlier grants, it appears that the test is far from straight forward, with taxpayers needing to calculate and then compare two turnover figures:

1. 2020/21 Pandemic year turnover –a 12-month period starting between 1 and 6 April 2020;

2. Reference year turnover - Turnover for 2019/2020 (or 2018/2019 – see below).

HMRC has advised taxpayers to have both figures ready prior to making their claim.

Let's consider each of these in turn.

2020/21 Pandemic year turnover

For this turnover figure, the 12-month period must start on any date from 1 April 2020 to 6 April 2020 so those with a:

- 31 March accounting year end will use the turnover for the 12-months from 1 April 2020 to 31 March 2021;

- 5th April accounting year end will use the turnover for the 12-month period from 6 April 2020;

- Others will need to apportion two year's results.

The guidance states that for businesses that started or ceased during the year, the turnover reported will be for less than 12 months. Presumably this applies for traders who have more than one business, otherwise this would appear to be at odds with the eligibility criteria stated earlier:

Taxpayers must have submitted their 2019/20 tax return by 2 March 2021 so they must already have been trading at the start of 2020/21;

Taxpayers must declare that they intend to continue trading in 2021/22 so ceasing in 2020/21 is not an option.

Taxpayers should include the turnover for all businesses but exclude all other income including COVID-19 support payments, such as previous SEISS grants, Eat Out to Help Out payments and local authority or devolved administration grants.

Reference year turnover

For most, the second turnover figure required will be the total turnover from all businesses as reported in their 2019/20 tax return.

However, where this was not considered to be a 'normal year', taxpayers can use the turnover reported in their 2018/19 return indicating why 2019/20 was not a normal year. HMRC give examples where the taxpayer:

- was on carers' leave, long term sick leave or had a new child;
- carried out reservist duties;
- lost a large contract;
- is eligible for the 5th grant but did not submit a 2019/20 return.

Where a taxpayer has an accounting period that is longer or shorter than 12 months, this must be adjusted to a 12-month figure (see examples below).

Partners in a partnership must provide turnover figures for the whole partnership. However, where they have other businesses, they must use their share of the partnership turnover.

Determining which grant is available

Having calculated the two turnover figures, the two must be compared.

Where the 2020/21 pandemic year turnover is less than the reference period turnover, the 5th SEISS grant is available at either the higher or lower level detailed above.

HMRC' guidance provides some useful examples, some of which are reproduced below.

Higher grant available

A taxpayer has calculated their turnover figures as:

- £20,000 for 2019/20 (Reference year)
- £10,000 for April 2020/21 (Pandemic year)

Turnover reduced by 50% (> 30%) and so the higher grant worth 80% of 3 months' average trading profits is available.

Lower grant available

A taxpayer has calculated their turnover figures as:

- £20,000 for 2019/ 20 (Reference year)
- £16,000 for April 2020/21 (Pandemic year)

Turnover is reduced by only 20% and so only the lower grant worth 30% of 3 months' average trading profits is available.

2019/2020 not a normal year

Taxpayer experienced a long period of sickness in 2019/20 and so chooses to base their reference year on turnover for 2018/19.

Year	Turnover
2018 to 2019	£36,000
2019 to 2020	£12,000
2020 to 2021	£9,000

This means that £9,000 is compared with £36,000 and the higher grant would be available.

Taxpayer with more than one business

A taxpayer has two businesses with the following turnover:

Year	Business A	Business B	Total turnover
2019/20	£30,000	£20,000	£50,000
2020/21	£20,000	£5,000	£25,000

The turnover is combined and the two years are then compared, showing that turnover had reduced by 50% and so the higher grant is available.

Accounting period longer than 12 months

Where a taxpayer has a long accounting period in their return, this must be reduced to 12 months.

For example, a 15-month accounting period with turnover of £45,000 in their 2019/20 tax return is divided by 15 (£3,000) and multiplied by 12 to arrive at the reference period turnover of £36,000.

However, if this method does not produce a fair result an alternative reasonable method may be used.

Accounting period shorter than 12 months

Where a taxpayer has a short accounting period recorded in their 2019/20 return, this must be adjusted to 12 months.

For example, say they had:

- an 8-month period and declared turnover of £16,000 on 2019/20; and
- a 12-month accounting period in 2018/19 and declared a turnover of £24,000.

The 12-month reference period is calculated by adding 4-months of the turnover from their 2018 /19 tax return (£8,000) to the 8-months of turnover from their 2019/20 tax return. (£16,000) to give £24,000 as the reference period turnover.

https://www.gov.uk/guidance/work-out-your-turnover-so-you-can-claim-the-fifth-seiss-grant

HMRC amending SA returns for SEISS (Lecture B1266 – 25.18 minutes)

HMRC has published new guidance on reporting SEISS grants received.

Payments from the first, second or third SEISS grants should be included on the taxpayer's 2020/21 return in the Self-Employment Income Support Scheme grant box as follows:

- 70.1 on the Self Employment (full) page (SA103F);
- 27.1 on the Self Employment (short) page (SA103S);
- 9.1 of the partnership page (SA104);
- 3.10A of the SA200 tax return.

From 19 June 2021, where SEISS grants information does not match HMRC's records, HMRC has been automatically correcting 2020/21 Self Assessment returns and issuing a revised SA302 calculation showing the correction. Taxpayers must check this revised calculation and consider whether their return needs amending further.

Where a taxpayer or their agent submitted an amendment prior to 19 June, HMRC will make the correction to the original return rather than the amended one. Changes made by the taxpayer before 19 June 2020 will not be included in any revised tax calculation. Such taxpayer amendments require no further action as the update will be processed separately.

Correct box but wrong amount

Amendments have been made where SEISS payments were reported in the correct box but the amount reported did not agree with HMRC records.

Incorrect box but correct amount

Where amounts were not recorded in the correct 'approved' box, HMRC has now included the payments in that box. To avoid being taxed on the same income twice, it is important that taxpayers now remove the grant from where they have reported it.

Failure to report SEISS payments

Where a taxpayer has failed to report their SEISS payment(s) at all, HMRC will have amended the tax return and sent the taxpayer a revised tax calculation.

Taxpayers not submitting the relevant Self-Employment or partnership page

Where these pages were not included, HMRC will assume that these taxpayers were not eligible to claim the SEISS grant and will take steps to recover them.

However, taxpayers who were eligible for SEISS but forgot to submit the correct page, should update their return to include the correct page, with the grants received in the correct box.

Amendment by HMRC for a grant that was not received

Where HMRC make an amendment to a taxpayer's return to include a SEISS payment that was never received by the taxpayer, this may suggest that a grant was claimed fraudulently using the taxpayer's personal details. In this case, they should contact HMRC on 0800 024 1222.

Taxpayers who disagree with HMRC's changes

Taxpayers must contact HMRC within 30 days from the date of the SA302 letter advising them of the correction.

https://www.gov.uk/guidance/check-if-you-need-to-change-your-self-assessment-return-for-seiss

COVID-19 antigen test exemption extended

The existing Income Tax exemptions and National Insurance contributions exemption for coronavirus antigen tests has been extended.

The extension means that the exemptions and disregards will apply to any coronavirus antigen test provided by an employer, for the tax year 2020/21 and 2021/22.

They will also apply to any reimbursement to an employee for a coronavirus antigen test for the tax years 2020/21 and 2021/22.

https://www.gov.uk/government/publications/income-tax-and-national-insurance-contributions-exemption-for-employer-provided-coronavirus-antigen-tests

Business Taxation

Nature of expenditure (Lecture B1266 – 25.18 minutes)

Summary – The costs of renovating a run-down farmhouse and cottage were capital in nature and not incurred wholly and exclusively for the purposes of the trade

The Elliot Balnakeil partnership had existed for over 100 years in Scotland, farming sheep and cattle to be sold on to other farmers. The partners spoke of the financial challenges in farming in such a remote location.

Among the partnership's assets was the Balnakeil House, a 'category A' listed building. Until 1992 the house provided accommodation for the general manager. On his death, instead of appointing a new general manager, one of the partners took over the management of the farm, making regular visits from the Borders. The House became increasingly uninhabitable.

A second property, Beach Bothy, was a small one-bedroom outbuilding, historically used as a shepherd's cottage, last used in the 1970s and uninhabitable due to disrepair.

The house, as a listed building, required the partnership to maintain it. An Urgent Works Notice was served requiring the house to be repaired. The partners decided to renovate both the house and bothy to an extent beyond that required by the notice to provide holiday lets and so diversify the partnership business. While the project was being considered, the farming partnership was dissolved. A new partnership 'Andrew & Elizabeth Elliot (Balnakeil)' was formed in January 2012 and it was this partnership that marketed the properties as furnished holiday lets and received the letting income in January 2013.

The deduction for renovation costs in the partnership return for 2011/12 was disallowed by HMRC as being capital in nature. The disallowed amounts were:

- £206,000 for repairs to Balnakeil House;
- £23,000 for repairs to the bothy;
- £36,000 of related legal and professional fees.

Both partied agreed that there were two issues to determine:

- Issue 1 - whether the disputed expenditure was capital or revenue in nature;
- Issue 2 - whether the disputed expenditure was incurred wholly and exclusively for the purposes of the partnership trade.

Decision

The First Tier Tribunal found that all of the renovation costs were capital in nature, and not revenue. Although the repairs were necessary, the level of work undertaken had converted the pretty much uninhabitable house and bothy into luxury holiday lets, so changing their overall character.

Although a decision on the second issue was then not required, the Tribunal stated that, even if found to be revenue in nature, the partnership was not previously running a holiday letting trade and so the expenses would not have been wholly and exclusively incurred for the trade

The renovation expenditure incurred to convert redundant, uninhabitable properties into luxury letting accommodation was not the taxpayer's trade, but rather the new partnership's trade. It was not incurred 'wholly and exclusively' for the purposes of the farming partnership's trade.

The appeal was dismissed.

Messrs Elliot Balnakeil v HMRC (TC08143)

Payments were not loans

Summary – Payments between companies did not fall under the loan relationship rules, nor were they loans to the lending company's controlling participator.

Mr Banks was a director and controlling shareholder of WT Banks & Co (Farming) Ltd, which owned farmland and was engaged in farming in the North of England.

In 2013, Mr Banks became aware of the amount of money which could be made from solar parks when he was paid a very substantial sum to release WT Banks & Co (Farming) Ltd's interest in a site on which solar panels were or were to be installed. Further, if land were leased for a solar farm, the grazing rights would remain with the lessor and at the end of the solar farm lease the land would revert to the lessor. Once planning permission had been given for commercial use as a solar farm, it would be easier to get planning permission for lucrative residential or commercial development at the end of the lease.

WT Banks & Co (Farming) Ltd held some pieces of land which Mr Banks thought would be good sites for solar farms but planning permission would be required. He had known Mr Smith for many years and knew that he had planning expertise. Working together, Mr Banks and Mr Smith formed Solar Energy Parks Limited, with each owning 50% of the shares. Solar Energy Parks Limited applied for planning permission, with the plan being that the company would then lease the land from WT Banks & Co (Farming) Ltd to be able to build the solar farms and sell them on. WT Banks & Co (Farming) Ltd would fund the arrangements by making payments to Solar Energy Parks Limited, who would then repay these sums from the sale proceeds. The deal with Mr Smith was concluded by a handshake and not in written form.

Unfortunately, the planning applications were unsuccessful and in June 2016, Solar Energy Parks Ltd was struck off. WT Banks & Co (Farming) Ltd claimed a deduction under the loan relationship rules for the amounts that it said it was owed, being the amounts paid to Solar Energy Parks Ltd since the arrangements had started in 2014. These totalled close to £500,000.

HMRC opened an enquiry and later concluded that the payments were not an allowable deduction under the loan relationship rules but rather were a loan to a participator, Mr Banks.

The taxpayer appealed.

Decision

The First Tier Tribunal agreed that there was no loan relationship as there was no formal loan agreement between the two companies or any evidence provided as to how the monies would be repaid. With no business plan or indeed budget, the Tribunal likened the arrangement to an informal agreement between friends. The Tribunal was unable to conclude that there was any form of legal obligation or contract under which Solar Energy Parks Ltd was bound to repay those monies to WT Banks & Co (Farming) Ltd with or without interest.

However, despite sums being posted to Mr Bank directors' loan account, these sums were found not to be loans to Mr Banks, as a participator of the company. WT Banks & Co (Farming) Ltd did not make loans to Mr Banks in respect of the sums paid to Solar Energy Parks Ltd, and so Mr Banks did not owe the company these sums. WT Banks & Co (Farming) Ltd's appeal against the s455 CTA 2010 charge was allowed.

The Tribunal concluded that Mr Banks saw a chance for WT Banks & Co (Farming) Ltd to make a profit from the land that it owned and that the payments were made to secure that profit. The payments were expenses of the company incurred in the hope that they would yield a substantial return to the company by using its land.

WT Banks & Co (Farming) Ltd v HMRC (TC08124)

Unamortised revenue expenditure allowed on sale of asset

Summary - The company was entitled to a deduction in computing its property business profits for deferred revenue expenditure on maintenance that remained unamortised when the asset to which it related was sold.

The company owned a power station which was leased to, and operated by, its immediate parent company, Power Ltd. It incurred costs in maintaining the power station which it initially capitalised in its balance sheet and then amortised over four years. In 2011, the company sold the power station to Power Ltd for an amount equal to its net book value. That net book value included £65m in unamortised maintenance costs and the company claimed a deduction for that amount in calculating the taxable profits of its property business for the accounting period in which the sale was made.

Although it was common ground that the expenditure was revenue in nature, HMRC sought to disallow it on two grounds.

1. The sale of the power station was a transaction outside the scope of the property business and therefore the expenditure could not be taken into account in calculating the taxable profits of the property business.

2. Since the expenditure was not brought into account as a debit in calculating the profits shown in the profit and loss account of the company there was no basis for it to claim a deduction in respect of it.

Decision

On the first ground, the First Tier Tribunal disagreed and held that acquisitions and disposals of capital assets which were used to carry on a business should be taken into account in calculating the taxable profits arising from that activity and regarded as taking place in the course of that activity, subject to the statutory rules requiring the exclusion of capital receipts and expenditure.

On the second ground, the First Tier Tribunal held that in effect a net nil amount had been recognised in the profit and loss account in respect of the sale of the power station. This involved bringing into account a credit for the sale proceeds and a debit for the net book value. In calculating the taxable profits, the credit was then required to be disregarded as a capital receipt, and to the extent that the debit related to capital expenditure it was likewise to be disregarded. The two adjustments meant that only the debit in respect of the maintenance costs remained to be taken into account.

Accordingly, the First Tier Tribunal ruled that the expenditure was in principle allowable, leaving the parties to agree the amount.

West Burton Property Limited v HMRC (TC08129)

Adapted from the case summary in Tax Journal (18 June 2021)

Payments were not unlawful share distributions

Summary – Arrangements made between a company and its two shareholders/ directors did not amount to the allotment of shares at a discount.

The taxpayers claimed that the transactions — the Blackstar E share scheme — implemented for the director shareholders should be characterised as unlawful distributions to shareholders, rather than remuneration to directors. Further, they breached S580 Companies Act 2006 in relation to the issue of shares at a discount and the payment of commissions.

HMRC said the transactions should be characterised in the way the company itself had characterised them at the time — as remuneration to its directors.

The High Court dismissed the taxpayers' appeal. The tax consequences of the scheme are being tested in the tribunal and did not form part of this appeal.

Decision

The Court of Appeal upheld the lower court's decision that the shares were not issued at a discount. The directors remained liable to a call for the full nominal value of a share and, if they were, it was up to them to find the funds to do so. They did not have to use the money paid to them by the company. Those payments were not made out of the company's capital. They were made out of trading income — as they had to be in order to attract the intended tax treatment as a deductible expense for the purposes of the corporation tax computation. As a result the question of mistake did not arise. The company's appeal was dismissed.

Chalcot Training Ltd v Ralph, Stoneman and CRC, Court of Appeal

Adapted from the case summary in Taxation (24 June 2021)

Reallocation of corporate partners' profits

Summary – Caught by the mixed partnership anti-avoidance rules, profits of two LLPs allocated to their corporate partner should have been reallocated from the corporate partner to the taxpayer who had the ability to enjoy them.

Nicholas Walewski, a successful investment adviser, had set up a profitable offshore equity fund (Alken Fund) in Luxembourg. He was partner in two UK LLPs that were used to manage the fund (Alken Asset Management LLP) and execute the trading transactions (Alken Finance LLP). Further, he set up set up Walewski Ltd, where he was the sole director and employee. This company became a corporate partner in both LLPs.

Approximately £19 million of profit was allocated to Walewski Ltd by the LLPs, which were then paid to an offshore trust of which Nicholas Walewski's children were the beneficiaries.

Anti-avoidance rules include s.850C ITTOIA 2005 which enables HMRC to increase the profit share of an individual partner who has the power to enjoy the profit share of the corporate partner if other conditions are satisfied. This reallocation should be done on a just and reasonable basis.

In 2014/15, HMRC reallocated the following profit shares which had originally been allocated to Walewski Ltd.

- £18,088,195 of profits from Alken Asset Management LLP;
- £1,372,510 of profits from Alken Finance LLP.

HMRC argued that this was on the basis that these profits were not earned by Walewski Ltd but rather, had been allocated to the company for Walewski to enjoy via the offshore trust fund of which his children were the beneficiaries.

Nicholas Walewski appealed, arguing that the profits were earned by the company, and not by him in his capacity as a partner in the LLPs.

The First Tier Tribunal found in HMRC's favour and Nicholas `Walewski appealed on two grounds.

Decision

Ground 1: Some of the profits reallocated related to a time when Nicholas Walewski had ceased to be a member of the LLP. The Upper Tribunal found that s850 applied for a period of account. Provided he received a share of the profit, it could be reallocated.

Ground 2: Nicholas Walewski was working for the company and LLPs in a single role, the profits should be split evenly. The Upper Tribunal concluded that the First Tier Tribunal had found that the way Nicholas Walewski provided his services was 'utterly fluid'. Walewski Ltd was merely a 'corporate alter ego' to Nicholas Walewski and the First Tier Tribunal's conclusion was entirely consistent with that finding.

In summary the Upper Tribunal agreed with the First Tier Tribunal's conclusions that:

- Nicholas Walewski controlled the two LLPS and the company.
- None of the profits allocated to the company could be said to have been earned by that entity through Nicholas Walewski's activities or services provided as an employee.
- All of its profits were excess profits that were attributable to Nicholas Walewski's power to enjoy.

The appeal was dismissed

Nicholas Walewski v HMRC [2021] UKUT 0133 (TCC)

Loan relationships – Non-GAAP accounting **(Lecture B1270 – 14.06 minutes)**

Introduction

S.308 CTA 2009 states that the amounts to be brought into account are credits and debits in profit or loss are which are computed **in accordance with generally accepted accounting practice** (GAAP).

This is then defined as UK GAAP or UK-adopted IFRS (EU-IAS for periods beginning before 1 January 2021).

Accounts prepared using other GAAP such as US GAAP (unless identical to UK GAAP) are not a suitable basis for UK tax purposes (not just loan relationships, but other areas as well when computing taxable trading profits, for example).

Adjustments may be required for tax purposes where:

1. The accounts are prepared under a different GAAP (e.g. US GAAP), or
2. UK GAAP or UK-IFRS was used but GAAP has not been followed in all respects (perhaps due to materiality).

Example – treatment not in accordance with UK GAAP/IFRS

XYZ Limited raised £100 million on 3 January 2019 by issuing 5% bonds with interest payable half yearly on 30 June and 31 December each year.

The bonds will be redeemed on 31 December 2023. The company incurred fees of £4 million in connection with the issue which it has charged to profit and loss account on the basis that it is immaterial, even though FRS 102 (and IFRS) normally require issue costs to be deducted from the gross proceeds.

It also charges the interest payable for each year of £5 million to profit and loss account each period.

Calculate any adjustments to profit that will be required for the period the bonds are in issue.

Analysis

The issue costs have not been accounted for in accordance with UK GAAP. They should be deducted from the liability of £100 million for the funds raised and recognised in profit and loss by computing an effective rate of interest for each half year period.

Time			**Cash flow**
0	03/01/2019	Proceeds net of issue costs	96.0
1	30/06/2019	Interest	-2.5
2	31/12/2019	Interest	-2.5
3	30/06/2020	Interest	-2.5
4	31/12/2020	Interest	-2.5
5	30/06/2021	Interest	-2.5
6	31/12/2021	Interest	-2.5
7	30/06/2022	Interest	-2.5
8	31/12/2022	Interest	-2.5
9	30/06/2023	Interest	-2.5
10	31/12/2023	Interest plus redemption	-102.5
		Half yearly effective rate	**2.97%**

Half year ended	**Balance b/fwd**	**Interest 2.97%**	**Cash flow**	**Balance c/fwd**
	-	-	96.0	96.000
30/06/2019	96.0	2.849	-2.5	96.349
31/12/2019	96.3	2.860	-2.5	96.709
30/06/2020	96.7	2.870	-2.5	97.079
31/12/2020	97.1	2.881	-2.5	97.46
30/06/2021	97.5	2.893	-2.5	97.853
31/12/2021	97.9	2.904	-2.5	98.257
30/06/2022	98.3	2.916	-2.5	98.673
31/12/2022	98.7	2.929	-2.5	99.102
30/06/2023	99.1	2.942	-2.5	99.544
31/12/2023	99.5	2.956	-102.5	0

Adjustments required

Accounting period	**Debits in P&L**	**Debits required by GAAP**	**Tax disallowance/ (deduction) required**
2019	(4 + 5) £9m	£5.709m	3.291m
2020	£5m	£5.751m	(0.751m)
2021	£5m	£5.797m	(0.797m)
2022	£5m	£5.845m	(0.845m)
2023	£5m	£5.898m	(0.898m)
Total	**£29m**	**£29.000m**	**£0.000m**

Deferred tax needed

The above example creates a timing difference between tax profits and accounting profits.

A deferred tax asset will be needed in the 2019 financial statements as follows:

– 2020 reversal: £0.751m x **17.5%**	£0.131m
– 2021 reversal: £0.797m x **17%**	£0.135m
– 2022 reversal: £0.845m x 17%	£0.144m
– 2023 reversal: £0.898m x 17%	£0.153m
	£0.563m

This created an unusual effective rate in 2019 but will create effective rates equal to the statutory rate in the later years (or would have done had the 17% intended rate of corporation tax not been repealed).

Accounts prepared in accordance with GAAP of other countries

A UK branch of a foreign company will need to prepare its tax computations on the basis that it prepared financial statements under UK GAAP (or UK-IFRS).

The financial statements it files will be those prepared for its head-office reporting purposes and will not necessarily be prepared in accordance with UK GAAP.

Adjustments will be necessary in some circumstances where its local GAAP differs from UK GAAP. Whilst this session focuses on loan relationships, other areas could require adjustment as well (for example, leases).

Example

A UK branch of a foreign company makes a £100 million loan to a foreign subsidiary on 3 January 2020.

The loan carries no interest for the first two years, then interest is charged at 9% for the remaining three years, payable on 31 December each year. The loan will be repaid on 31 December 2024.

No transfer pricing adjustment arises in connection with the loan as it is considered, broadly, to correspond with an arm's length rate.

The foreign company's local GAAP requires interest to be recognised when it arises, so the UK branch does not recognise interest expense for the first two years.

Explain any adjustments required under the loan relationship rules.

Analysis

UK GAAP requires the calculation of an annual effective interest rate of the cash flows of the loan.

Time			Cash flow
0	03/01/2020	Loan granted	-100
1	31/12/2020	Interest	0
2	31/12/2021	Interest	0
3	31/12/2022	Interest	9
4	31/12/2023	Interest	9
5	31/12/2024	Interest plus redemption	109
	Effective rate (IRR)		**5.128%**

Credits under the loan relationship rules

Year ended	Balance b/fwd	Interest 5.128%	Cash flow	Balance c/fwd
	-	-	100	100.000
31/12/2020	100	**5.128**	-	105.128
31/12/2021	105.128	**5.391**	-	110.519
31/12/2022	110.519	**5.667**	-9	107.186
31/12/2023	107.186	**5.497**	-9	103.683
31/12/2024	103.683	**5.317**	-109	0

Adjustments required

- 2020: Increase interest income by £5.128m
- 2021: Increase interest income by £5.391m
- 2022: Decrease interest income by (9 – 5.667) (£3.333m)
- 2023: Decrease interest income by (9 – 5.497) (£3.503m)
- 2024: Decrease interest income by (9 – 5.317) (£3.683m)

No UK deferred tax is needed in this case as the foreign company is not producing UK GAAP financial statements, just adjusting its non-UK GAAP profits for UK tax law.

There might be a requirement to book deferred tax in the country where the foreign company is resident, so the tax adjustments should be explained to the branch.

Contributed by Malcolm Greenbaum

VAT and indirect taxes

HMRC need to know about IOSS

Remember, businesses that are registered with the Import One Stop Shop (IOSS) in the EU can account for supply VAT on eligible sales of low value goods in consignments not exceeding £135 in value on their IOSS return. They do not have to account for import VAT when the goods enter the country.

Businesses selling such goods into Northern Ireland and who are registered for the IOSS in the EU, must inform HMRC of their IOSS registration number.

To able to supply HMRC with the information that they need, businesses must supply:

- Their IOSS registration number;
- The name of the EU country they registered in;
- Their name, address and contact details;
- Their UK VAT registration number, if applicable.

Businesses registered for IOSS as an intermediary representing businesses in the EU for IOSS, must inform HMRC of their IOSS registration number and give the details of each business making supplies of low value goods.

https://www.gov.uk/guidance/tell-hmrc-youre-registered-for-the-vat-import-one-stop-shop-in-the-eu

Revenue and Customs Brief 9 (2021) (Lecture B1266 – 25.18 minutes)

The Brief sets out HMRC's position for the supply of day care services supplied by private bodies following the Court of Appeal's judgment in the joint appeals of LIFE Services Ltd and The Learning Centre (Romford) Ltd [2020] STC 898 (and the Supreme Court's decision to refuse leave to appeal).

The provision of welfare services by private bodies that are not charities is only exempt from VAT if the body concerned is a state-regulated, private welfare institution or agency (VATA 1994 Sch 9 Group 7 item 9). Note (8) to Group 7 defines 'state-regulated', as 'approved, licensed, registered or exempted from registration by any Minister or other authority pursuant to a provision of a public general Act'.

This Brief confirms that the VAT exemption does not apply to private welfare institutions or agencies which supply day care services in England and Wales and are not state-regulated. Providers in Scotland and Northern Ireland are not affected by the judgment because, under devolved provisions, they are required to be state-regulated.

https://www.gov.uk/government/publications/revenue-and-customs-brief-9-2021-vat-liability-of-daycare-services-supplied-by-private-bodies-in-england-and-wales

Revenue and Customs Brief 10 (2021) (Lecture B1266 – 25.18 minutes)

This Brief announces a further extension to the overseas refund scheme that applies to overseas businesses not established in the EU and not VAT registered in the UK.

Applications for refunds under the scheme for the year to 30 June 2020 should have been submitted with a certificate of status no later than 31 December 2020.

Due to COVID-19 and businesses having difficulties getting the required certificate of status from their official issuing authorities, this deadline had been extended to 30 June 2021. This Brief announces a further six-month extension to 31 December 2021.

HMRC will continue to review the situation and, where businesses are still experiencing difficulties, will consider if further easements are possible.

https://www.gov.uk/government/publications/revenue-and-customs-brief-10-2021-repayment-of-vat-to-overseas-businesses-not-established-in-the-eu-and-not-vat-registered-in-the-uk

Production costs not directly linked to catering (Lecture B1266 – 25.18 minutes)

Summary – The Court of Appeal has confirmed the Upper Tribunal's decision that as production costs were not directly and immediately linked with catering supplies, input VAT on the production costs could not be recovered.

The Royal Opera House is a charity that stages ballet and opera performances and as part of the "fully integrated visitor experience" provides extensive catering facilities, quite different to a West End theatre, "where there might be a cramped bar or just ice creams available".

It was agreed that ticket sales for admission to performances is an exempt VAT supply of 'cultural services', while the catering supplies were standard rated.

The Royal Opera House claimed there was a direct and immediate link between the production costs and both admission and catering supplies and on that basis claimed £532,069, the proportion of the input VAT paid between 1 June 2011 and 31 August 2012 relating to the catering activity.

HMRC considered the only direct and immediate link of the production costs was with the sale of tickets so that it was not possible to recover the input tax.

The First Tier Tribunal had ruled in favour of the Royal Opera House, finding that there was an economic link between the production expenditure and the catering supplies. The performances brought in the customers with the customers then purchasing food and drink.

The Upper Tribunal had disagreed finding that the production costs were directly and immediately linked to the performances for which tickets were sold. However, there was only an indirect economic link between the production costs and the catering supplies, as the production costs were not used to make the catering supplies and were not part of the costs of making those supplies.

The Royal Opera House appealed to the Court of Appeal.

Decision

The Court of Appeal concurred with the Upper Tribunal, finding that there was no direct and immediate link between production costs and catering supplies.

Although not necessary, the Court of Appeal briefly considered HMRC's alternative argument that the performances could be viewed as promotional activities generating the catering supplies, creating a direct and immediate link but in a chain of transactions. As the performances were chargeable services, these severed the chain between the costs and the catering supplies.

The Court of Appeal noted that had the performances been provided free of charge, there would be no economic activity in the performance. It might be arguable that this established a direct and immediate link with the catering supplies, resulting in the costs becoming recoverable. Sveda (Case C-126/14) [2016] STC 447). However, the judge did not expand on this since the supply of tickets was exempt.

Royal Opera House Covent Garden Foundation v HMRC [2021] EWCA Civ 910

Closing stock adjustment not needed

Summary – No closing stock adjustment was required when the company ceased to use a bespoke retail scheme that had been agreed with HMRC.

Businesses generating annual turnover of £100 million or more, must agree a bespoke retail scheme with HMRC ("Old Scheme'). Between December 2002 and March 2017, Poundland Ltd had operated such a bespoke retail scheme. Under this scheme the cost of zero-rated stock was identified when it arrived at the stores for sale. This cost was used to calculate the goods' expected selling price, making sure that stolen goods, discounts and returns were adjusted for. For each period, the value of zero-rated sales was deducted from total gross takings, with the remaining sales being standard rated and so subject to output tax.

The company moved to a new bespoke retail scheme, also agreed with HMRC, based on an electronic point of sale (EPOS) system, under which the VAT liability was determined as each sale was made, making it "very accurate and reliable" ('New Scheme').

The Old Scheme used a term 'fundamentally flawed' to refer to situations where that scheme did not produce a fair and reasonable valuation of taxable supplies and therefore of the output tax to be accounted for. Where this was the case, HMRC were entitled to raise an assessment to remedy the position.

Although the Old Scheme did not expressly require a closing stock adjustment, HMRC argued that the Old Scheme was 'fundamentally flawed' because it did not make provision for any closing stock adjustment when Poundland Ltd ceased to use the scheme. HMRC argued that the exclusion of such an adjustment meant that zero-rated sales were counted twice; at the point when the goods arrived in the stores and again when they were sold under the New Scheme. As a result, HMRC raised an assessment for £2,150,777.

Poundland Ltd argued that no adjustment was needed for any period, as the zero-rated purchases figure was only used as a basis for determining an estimate of standard rated supplies in a period.

Decision

The First Tier Tribunal agreed with Poundland Ltd, concluding that the Old Scheme was not fundamentally flawed.

Further, even if it had been flawed, the assessment would be overstated as HMRC had failed to recognise any corresponding opening stock adjustment when Poundland Ltd had first adopted the Old Scheme.

The appeal was allowed.

In Taxation (24 June 2021), Neil Warren commented:

> 'It seems as though HMRC had blinkered vision here. It was happy to raise an assessment for zero-rated “closing stock”, even though it was not required in the bespoke scheme letter, ignoring the fact that there was no “opening stock” adjustment for zero-rated stock when the company adopted the scheme in 2002. This seems to be very unfair. As accountants will testify, opening and closing stock adjustments go together in the same way as Devon and creams teas.
>
> The verdict is also a reminder that a point-of-sale scheme is the most accurate and easiest way for retailers to calculate their output tax liability — any other method can only ever be a “guestimate” of the VAT payable on sales.'

Poundland Ltd v HMRC (TC08138)

Goods given away to connected companies

Summary – Input tax suffered on doors that were purchased and then given away was not recoverable as there was no business purpose.

The Door Specialist Ltd owns commercial properties which are used for a mixture of supplies: two are rented and opted to tax, some are rented which are not opted and some of the properties are derelict.

The Door Specialist Ltd also imported doors from China, which it gave to “Just Doors” to sell on to its customers. “Just Doors” is the trade name used by a number of other companies that were under common ownership with The Door Specialist Ltd. Some of these companies were VAT registered but most were not. There was no VAT group registration.

A repayment claim submitted in October 2017 prompted HMRC to conduct a check into The Door Specialist Ltd*’s* VAT returns. In April and May 2018, HMRC issued assessments for the periods 5/15 to 11/17 that related to input tax which had been claimed incorrectly on the purchase of doors and advertising costs and output tax which was due in respect to rental income from a property which HMRC believed was opted to tax.

Following a review, these assessments were cancelled on the basis that the VAT assessed had not been calculated correctly. The reviewing officer did state that they agreed that the

business should not be entitled to recover VAT for the doors or advertising costs as the reviewing officer had seen nothing to suggest that The Door Specialist Ltd had used either the doors or advertising costs to make onward supplies.

On 1 February 2019, HMRC issued a notice of assessment for £80,000 to recover VAT claimed incorrectly as input tax. As the property concerned had no option to tax, the output tax had been removed.

The Door Specialist Ltd's agent argued that input tax could be claimed on the doors but acknowledged that output tax would be due on the value of the doors given to the "Just Doors" connected companies. However, this meant that HMRC would not be able to reissue a new assessment for output tax errors as it would be time-barred.

Decision

The First Tier Tribunal agreed with HMRC and found that The Door Specialist Ltd bought doors that it gave away, meaning that there was no business activity. S.24 VATA 1994 states that to be able to recover related input tax, an expense must be incurred for the "purpose" of a business. If no sales are made, there is no business purpose.

The related input tax could not be reclaimed and the appeal was dismissed.

The Door Specialist Ltd v HMRC (TC08132)