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Personal tax

Dividends were not wages (Lecture P1386 – 18.22 minutes)

Summary – Backdated payslips did not make earlier payments become salary eligible for Coronavirus Job Retention Scheme grants.

Zoe Shisha Events Limited operated a shisha establishment, based at an outdoor terrace of a central London hotel. It served shisha, drinks, and food.

On 11 March 2020 the company closed due to the COVID pandemic.

The company made claims under the CJRS for:

- its director, Ms Muntean who was paid a salary of £3,000 per month;
- Mr El Sayed, an employee who was paid a salary of £1,280 per month.

HMRC opened a compliance check. When asked to supply evidence to support the salaries paid, the company's RTI returns showed that Ms Muntean was being paid £600 a month but the furlough claim was based on a salary of £3,000 a month. Ms Muntean accepted that prior to January 2020, her salary had been £600 per month but that this had increased to £3,000 per month from the start of 2020. She stated:

> "I was being paid £3,000 a month from January 2020, the accountant was previously putting through £600 a month and they explained that the rest was in dividend. I did repeatedly ask different accountants to change this for me so that everything went through PAYE".

HMRC raised assessments arguing that the RTI figures on which the CJRS claims were based, were overstated.

The company appealed.

Decision

The First Tier Tribunal found that the claim relating to the company's employee was correct as bank statements for the period to 19 March 2020 showed that he was paid £1,280.

Moving to the director's claim, the First Tier Tribunal found that there was no evidence to support the claim that her monthly salary would be increased to £3,000 before 19 March 2020 as claimed:

- The Tribunal recognised that the payments made to Ms Muntean for January and February 2020 exceeded £600 per month, but they were not satisfied that the payments over and above £600 were salary. Rather, they were "most probably dividend payments made in accordance with the advice given by the accountant". The Tribunal stated that the company could have supplied bank statements for earlier periods to demonstrate that there was a change in the way payments were made to in January and February 2020, but it failed to do so.

- The last RTI submissions made by the company were for the period up to August 2019. These submissions showed Ms Muntean's salary as £600 per month. No RTI submissions showing her salary as £3,000 per month were filed with HMRC until after the CJRS was announced and these submissions could not be said to provide contemporaneous evidence that her salary had been increased prior to 19 March 2020.

- The payslips for January and February 2020 showing Ms Muntean's salary as £3,000 per month were not created until June 2020. Those payslips did not, then, provide contemporaneous evidence that Ms Muntean's salary had been increased prior to 19 March 2020.

With the RTI documents and payslips for the relevant period being filed/ created after the CJRS was announced, there was no evidence to support the director's CJRS claim.

Zoe Shisha Events Limited v HMRC (TC08805)

Doctored CJRS documents (Lecture P1386 – 18.22 minutes)

Summary – Bank statements and RTI submissions had been deliberately manipulated meaning that the CJRS conditions were not met.

Top-Notch Accountants Limited, whose sole director is Mr Islam, provided accounting, auditing and tax services.

The company made claims under the CJRS for an employee who had started work in December 2019.

In October 2020, HMRC opened a check into these claims and subsequently noted that the bank statements appeared to have been amended and included a number of transactions where the font had been varied and spelling mistakes made.

HMRC concluded the claims made were not valid because the employee had not been included in a RTI submission before 19 March 2020. Information held by HMRC confirmed that they had only been notified of the employee's earnings on an RTI submission received in April 2020.

Top-Notch Accountants Limited claimed that they had:

- submitted earlier RTI submissions, but HMRC had not received them;

- contacted HMRC several times but HMRC had no record of any calls.

HMRC raised assessments to recover the support payments and the company appealed.

Decision

The First Tier Tribunal stated that the company's director was not a credible witness and the evidence supplied contained 'at a minimum' significant incongruities. Bank statements had been obviously altered, and so too had the RTI submission statements. These contained 'Correlation IDs' supposedly relating to payments made in January, February and March 2020 but which in fact correlated with IDs on submissions received by HMRC in May 2020.

On the balance of probabilities, the First Tier Tribunal found that RTI submission deadline of 19 Match 2020 had not been met, meaning that the claims were invalid.

The appeal was dismissed.

Top-Notch Accountants Limited v HMRC (TC08833)

No CJRS when RTI returns submitted late (Lecture P1386 – 18.22 minutes)

Summary – Claims under the Coronavirus Job Retention Scheme (CJRS) relating to six new employees failed as they had not been included in an RTI return before the 19 March 2020 deadline.

Raystra Healthcare Limited failed to submit RTI returns between 13 November 2019 until 24 April 2020, claiming that this was due to an upgrade in their payroll software, which had been accidentally set to 'test' mode, meaning that RTI returns were not submitted.

The company became aware of the issue on 24 April 2020, and rectified the matter by submitting returns on the same day.

Between 30 April 2020 and 25 August 2020, the company applied for and received payments under the Coronavirus Job Retention Scheme (CJRS). These included payments relating to six new employees who, as a result of the software upgrade issue, had not been included in any RTI return submitted before 19 March 2020.

Following a check on the company's claims, HMRC sought to recover the CJRS payments made, even though failure to submit the relevant RTI returns was due to a technical error.

Decision

The First Tier Tribunal found that there was no flexibility in how the CJRS rules operated and so found in HMRC's favour stating:

> 'Neither the CJRS wording nor the surrounding legislation, provides for any exception to this particular requirement in circumstances where an employee was in fact employed prior to 19 March 2020, and where the failure to submit a RTI return prior to that date showing payment of earnings to that employee was due to circumstances that are not the employer's fault.'

The First Tier Tribunal had no power to allow the appeal on compassionate grounds.

The appeal was dismissed.

Raystra Healthcare Limited v HMRC (TC08838)

Severance payment and ANI (Lecture P1386 – 18.22 minutes)

Summary – With the disability element of her severance payment covered by the disability exemption, the taxpayer was not liable to the high-income child benefit charge.

Nicky Howard-Ravenspine was employed by Norton Rose Fulbright Services and had suffered from ill-health since June 2012.

In April 2016, no longer able to carry out her role due to her ill-health, she reached a termination agreement with her employer.

Under the agreement, she received:

- £12,057.06 in lieu of accrued but un-taken holiday;
- a severance payment of £93,357 as "compensation for loss of office and termination".

In 2019, on the basis that her adjusted net income for 2016/17 exceeded the £50,000 threshold, HMRC raised a discovery assessment to collect the high income child benefit charge (HICBC) that it believed was payable. HMRC believed that none of the payment fell within the disability exemption contained at s.406(1)(b) ITEPA 2003. HMRC argued that although there was a medical condition preventing her from carrying out her employment duties, the payment did not relate solely to that health issue. It was paid for compensation for loss of office as well as disability and so the exemption could not apply.

Nicky Howard-Ravenspine appealed.

Decision

Although the termination agreement stated that the payment was a single sum paid as compensation for loss of office, the First Tier Tribunal found that "a very significant element of the severance payment was on account of disability" and so qualified for the disability exemption.

As stated in HMRC's own guidance –Employment Income Manual at EIM13637 this was not an all or nothing situation and 'an apportionment may be necessary'.

The First Tier Tribunal found that:

- the payment did fall within the disability exemption;
- the taxpayer's adjusted net income for 2016/2017 was less than £50,000;
- she was not liable to the HICBC as assessed by HMRC.

Nicky Howard-Ravenspine v HMRC (TC08831)

Self-employed and employed status (Lecture B1387 – 22.44 minutes)

It is the employer's responsibility to correctly determine an individual's status as to whether they are employed or self-employed.

Their status will depend on the terms and conditions of the working relationship which in most cases will be set out in the contract. It is possible for the worker to be both employed and self-employed at the same time.

The employment status will affect the way tax and national insurance is calculated. HMRC considers employment status is based on facts – there is no choice. The following questions act as a guide to decide whether an individual is an employee or self-employed.

They are probably self-employed if they:

- are in business for themselves, are responsible for the success or failure of their business and can make a loss or a profit;
- can decide what work they do and when, where or how to do it;
- can hire someone else to do the work;
- are responsible for fixing any unsatisfactory work in their own time;
- the “employer” agrees a fixed price for their work which does not depend on how long the job takes to finish;
- use their own money to buy business assets, cover running costs, and provide tools and equipment for their work;
- can work for more than one client.

They are probably an employee if they answer YES to most of the following:

- do they have to do the work themselves?
- can someone tell them what to do, when and where to do it and how to do it?
- are they contracted to work a set number of hours?
- do they receive benefits such as paid leave or a pension as part of their contract?
- can they be paid overtime or bonus payment?
- do they receive a regular wage even if there is no work?
- do they manage other people who work for you?
- can they be moved from task to task?

The Check Employment Status Tool (CEST) is an online tool that can be used to help determine employment status see www.hmrc.gov.uk/employment-status/. It can be used by the worker, the employer or the agent to check the worker’s or contractor’s status. The system is based on HMRC interpretation of established cases and works by asking a series of questions. The outcome is determined by the answers given by the user. The result given by the tool will provide an indication of the worker’s employment status.

The employer can rely on the CEST outcome, say HMRC, provided the answers to the questions accurately reflect the terms and conditions under which the worker provides their services. The employer/engager must also print out or save the enquiry details screen and the CEST result screen as evidence of the decision made.

IR35 and Off Payroll Working - Chapter 8 - ITEPA 2003

The IR35 legislation was introduced by HMRC in 2000 to ensure individuals who worked through their own sole person limited company paid employment taxes like other standard employees.

The individual director/shareholder had to decide whether they fell within IR35 rules. If yes, then taking remuneration as dividends drawn from the company profits and hence saving tax was not permitted. The individual was required to take 95% of the fees derived from the IR35 work as “deemed salary” including employer’s NIC leaving 5% to cover company expenses. Most contractors ignored these rules or were prepared to argue they did not apply. As a result, HMRC introduced rules to make the end client responsible for deciding the contractor’s employment status – Off -Payroll Working. These rules currently apply to end users in the public sector and to large and medium-sized private companies.

NB: These IR35 rules still apply to a contractor working through their own limited company where they work for a “small private company” as that “end client” is not assessing their employment status.

Off Payroll Working Rules - Public and Private Sectors

From 6 April 2017 for engagements in the public sector and from 6 April 2021 for engagements in the private sector the responsibility for deciding whether the off-payroll rules for engagements applies was moved up to the “end client”. Within the private sector the off payroll working decision is only applicable where the client is either a medium or large sized businesses. Small companies are excluded from these rules. The definition of a small business is based on the Companies Act 2006 definition of a small company.

The end client must look at any engagements they have with personal service companies and decide whether the relationship falls under off-payroll working rules. If that is the case, then that end client is responsible for operating PAYE and so deducting tax and national insurance from any payments made in respect of the engagement.

HMRC has indicated that they will not use information obtained from these changes to open an enquiry into earlier years unless they suspect fraud or criminal behavior.

A company is small if 2 or more of the following criteria are met:

- Annual turnover is less than £10.2milllion;
- Balance sheet total assets, before deducting liabilities, is less than £5.1million;
- Average number of employees is less than 50.

A simplified test applies to some clients and considers annual turnover. The new rules must be applied if annual turnover is more than £10.2 million and the client/business is not:

A company

An LLP

An unregistered company

An overseas company

The new rules will apply from the start of the tax year following the end of the calendar year when the conditions are met. There are also rules which cover connected and associated companies. If the parent of a group is medium or large, their subsidiaries will have to apply the off payroll working rules.

Checking Employment Status

The end user, public or private sector, must look at any contracts issued for the work and the ways of working or can use the HMRC "Check employment status for tax" service, CEST, to find out if the intermediaries legislation applies to the engagement. If this is unclear the IR35 Helpline should be contacted. The off payroll working rules will apply if the person providing their service would be an employee if there were no intermediary or they were an office holder for the client. Each engagement should be assessed separately as the results could differ. It is the end client who must make the decision as to whether or not off payroll working rules apply and issue the Status Determination Statement (SDS).

If the worker disagrees with the SDS issued by the end client they can appeal, For the private sector the fee payer must provide a response within 45 days of receiving the appeal. And for the public sector 31 days Failing to respond within the timescale will result in the fee payer being responsible for the worker's PAYE and NIC.

When off payroll working rules do apply the worker is treated as an employee for payroll purposes BUT does not benefit from any employment related benefits.

Calculating the Deemed Direct Payment

The deemed direct payment is the amount paid to the worker's intermediary that should be treated as earnings for off payroll rules.

- Work out the value of the payment deducting any VAT charged;
- Deduct the cost of any materials charged as used in providing the service;
- Deduct expenses that would have been deductible if worker was an employee;
- Remaining figure = deemed direct payment;
- If NIL or negative no deemed direct payment.

The employer/fee payer must deduct PAYE and employee NIC from the deemed direct payment pay employers NIC if applicable. The figures are reported on the FPS, alongside all other employees, indicating that this worker is an "off payroll" worker. The starter declaration is used to report "employee" to HMRC and tax is usually deducted at 20% until HMRC issue a different tax code. When the contract ends the leaving date is reported to HMRC and the worker is given a P45. Form P60 is issued at the end of the tax year when individual remains "employed" on payroll at 5 April.

As Class 1 NIC is being paid the payments to the worker should be included in the annual pay for the Apprenticeship Levy. But student loan repayments, statutory payments and workplace pensions are not relevant. Additionally the employer/fee payer is not responsible for:

- Deducting student loan repayments;
- Auto enrolment of the worker – this done through intermediary;
- Statutory payments – SMP, SAP etc. – these come from the intermediary;

- No entitlement to holiday pay or other employment rights.

Where the off payroll working rules apply the cost of travel and subsistence cannot be claimed. The reason is that the worker is being treated as an employee and so travel costs are considered the cost of “ordinary commuting”. Each engagement is taken as a new employment and each workplace as a permanent place of work. This brings their working into line with those working as temporary staff through an employment agency.

Contributed by Alexandra Durrant

HICBC and divorce (Lecture P1386 – 18.22 minutes)

Summary – Despite being divorced and having remarried, the taxpayer was still liable to the High Income Child Benefit Charge (HICBC) as he was still entitled to the Child Benefit paid to his ex-wife.

Mr Meades married in March 2010 and just over two years later his wife had a child. He claimed Child Benefit, which was paid into the bank account of the child’s mother.

By April 2019, the couple had divorced, with the child and their mother remaining in the family home and Mr Meades paying the household bills, including the mortgage and maintenance.

In November 2019, Mr Meades married his second wife and they lived together for the whole of 2019/20.

Having enquired into Mr Meades’ 2019/20 tax return, HMRC issued a closure notice increasing his liability by £1,076 on the basis that he was liable to HICBC as his Adjusted Net Income (ANI) exceeded £50,000, and Condition B applied.

Mr Meades appealed.

Decision

Condition B would have applied if the child’s mother had been Mr Meades partner during 2019/20. The First Tier Tribunal found that this was not the case as during this time he had been living with his new partner.

The First Tier Tribunal decided it was necessary to consider whether Mr Meades came within Condition A.

Firstly, Mr Meades needed to be entitled to Child Benefit in 2019/20. Although the child’s mother was entitled to Child Benefit because the child lived with her, Mr Meades was also entitled because he provided financial support for the child. With the Child Benefit having already been awarded to Mr Meade, the benefit remained with him.

Secondly, the First Tier Tribunal observed that it was surprising that Mr Meades’ liability to the HICBC could depend on the income of his second wife, who was not related to the Child. Bizarrely, if Mrs Meades had the higher ANI, Mr Meades would not be liable to the HICBC. However, in this case, Mr Meades did have the higher ANI and he was so liable.

Finally, the Tribunal commented that had Mr Meades cancelled the Child Benefit claim before 6 April 2019, the child's mother could have made a fresh claim and Mr Meades would not have been liable to the charge.

The appeal was dismissed.

Mr Meades V HMRC (TC08844)

Divorce and Domicile (Lecture P1387 – 25.08 minutes)

The recent case involving Jeremy Coller put the spotlight back on questions of domicile and, in particular, how and whether separation and divorce effect one's domicile status.

Since 1974, husbands and wives have had independent domicile. There is no requirement that the domicile of one's spouse should be reflected in the domicile of the other. However, inevitably marriage changes people's decisions about where to live and their family connections and often divorce will do the same.

A quick reminder of the main determinants of domicile is in the list below: -

- the main family home,
- relatives, friends and other connections,
- club memberships and,
- Where given certain circumstances they wish to settle permanently and ultimately their final days. In this context an individual's will and indeed burial plot can sometimes be decisive.

Clearly separation and divorce will normally effect family connections, but it tends to have an impact on all three elements: -

- Permanent Residence
- Family
- Settled existence?

Domicile of Origin

It is however important to note that if one has acquired a domicile of origin in the UK then it is notoriously difficult to prove that one's domicile has changed even after spending a number of years outside the UK. In addition, the rules regarding former UK domiciles returning (FDR's) make relatively short stays back to the UK potentially costly, if the taxpayer is basing his tax strategy on remaining non-UK domicile.

FDRs will typically be British individuals who left the UK and acquired a foreign domicile either by choice or dependency, but who have since returned to live in the UK whilst preserving their non-UK domicile status under common law.

Anyone born in the UK with a UK domicile of origin will always be an FDR if they resume residence in the UK irrespective of how many years they have lived abroad or whether they have any connections to the UK.

Deemed Domicile

The rules since 2017 have introduced the concept of a deemed domicile position for tax purposes in addition to the legal domiciles of origin, dependency, and choice. It is therefore possible to maintain a legal domicile outside the UK but acquire a tax domicile inside the UK.

- Non- UK domiciled individuals who have been UK resident for at least 15 of the previous 20 tax years are deemed to be domiciled in the UK for all tax purposes.

- This is known as the "15/20 rule" and means that non-domicile status cannot be permanent for tax purposes. ITA 2007, s.835BA (4) For an individual who has been continuously UK resident, deemed domicile is triggered under the 15/20 rule with effect from the start of their 16th tax year.

- An individual does not need to have 15 consecutive years of UK residence to trigger the 15/20 rule.

- Two or more separate periods of residence could be counted.

Clore and Coller

Forty years separate the Clore and Coller cases but some of the issues remain relatively similar. Both individuals were divorced which implied the opportunity to change the central connections of their lives.

Sir Charles Clore did actually move to Monaco and took steps to weaken some of his connections to the UK. However, as in the detail below, reproduced from Tolley's Tax Cases, his Executors were unsuccessfully in proving his non UK domicile status at the time of his death and it remains a cautionary tale on how not to let tax planning dominate one's life to the exclusion of everything else.

- Sir Charles Clore had parents who, before his birth, fled Czarist Lithuania to escape persecution and settled in England: they never joined their relatives in the United States of America. About three years before his death, Sir Charles' father went to live in Palestine.

- Towards the end of his life Sir Charles spent part of each year abroad and after 13 February 1977 he was regarded by the Revenue as neither resident nor ordinarily resident in England. Later Sir Charles gave instructions for the sale of his properties in England. In leaving England he was following his advisers' recommendations in order to mitigate his tax liability.

On 5 April 1978 Sir Charles was redesignated as resident in Monaco for exchange control purposes; he bought an apartment there to which he moved some of his furniture and gave instructions for a large part of his United Kingdom assets to be removed to Jersey. Sir Charles resigned from the chairmanship of his main company, although he remained a director, and he became an overseas member of his club. He also resigned from Lloyds.

As well as purchasing a property in Monaco Sir Charles showed interest in purchasing properties in Israel, France, the United States of America and Switzerland; during the last two and a half years of his life he spent more time in Paris than anywhere else, although he never settled in any one place after leaving England.

Sir Charles died in London on 26 July 1979. On the questions whether Sir Charles' domicile of origin was English and if so whether, before his death Sir Charles had acquired a domicile of choice in Monaco. There had to be convincing evidence that Sir Charles had formed a settled intention permanently to reside in Monaco before the court could hold that he had lost his domicile of origin and since, on the evidence, it could not be said that Sir Charles had ever formed that intention it followed that Sir Charles died domiciled in England

Coller

In the Coller Case, he got divorced in 2012 but failed to take sufficient steps to weaken his ties to the UK and strengthen them elsewhere. He also failed in his assertions that either of his parents were not domiciled in the UK at the time of his birth and therefore he had acquired a UK domicile of origin. A precis of the case is shown below.

The taxpayer's father came to England in 1938 from Austria to escape Nazi persecution. The taxpayer's mother was born in Ireland but had lived in England since 1953. The taxpayer was born in England and lived here all his life. A dispute arose as the taxpayer's domicile. He claimed in essence that he had never decided to make the UK his home – he was a 'global person' and could settle in other countries, in particular the US or Israel. HMRC said he was domiciled in the UK. It seemed clear that he had no intention to move to Israel until after his divorce in 2012. So irrespective of the domicile of his parents, the taxpayer was UK domiciled at birth and had not lost that domicile. The taxpayer's appeal was dismissed.

Conclusion

In conclusion although divorce offers the opportunity to reconsider one's domicile position, it needs to be followed up by concrete steps to weaken ties to the UK and strengthen them elsewhere on a consistent basis for an individual to lose his UK domicile status.

Contributed by Jeremy Mindell

Capital taxes

Gains on destruction of business property (Lecture B1390 – 14.35 minutes)

In this article we are going to consider the implications for a trader whose main business premises is completely destroyed by fire.

Insurance proceeds are received split into loss of earnings, loss of equipment and loss of the building.

The loss of earnings will be taxed as income for the business and the compensation for the loss of equipment will be dealt with through capital allowances, with the proceeds being disposal proceeds for this purpose. The complication arises with the commercial building.

The clients have not yet decided if they are going to rebuild since the land may have greater value if they can get planning permission to rebuild as residential, rather than commercial, property. They will not be able to make a decision about this until they have consulted with planning officers.

Before considering the specific issues that this scenario raises, it might be worth starting by considering the legislation which underpins this situation.

S.24 TCGA 1992 states that there is a disposal of an asset on the occasion of ‘the entire loss, destruction, dissipation or extinction’ of that asset. If no proceeds are received, you would effectively get a capital loss arising equal to the allowable costs.

However, it appears that HMRC treat this as only applying where no disposal proceeds are received.

S.22 TCGA 1992 brings into charge as a disposal of an asset any sums received as compensation (typically by way of insurance but it would cover any compensation) for the damage or destruction of property. S.22(2) specifically states that the date of disposal is treated as being when the sum is received.

S.23 TCGA 1992 then allows for such a receipt not to be treated as a disposal where the capital sum is applied in replacing the asset.

There are two sets of provisions. The first is where the asset is not wholly lost or destroyed. In that case, the whole of the sum has to be used in restoring the asset, other than an amount which is small compared to the total receipts. In that case, the amount not used does not become chargeable, but instead is deducted from the base cost of the asset such that the gain on any subsequent disposal is reduced. If the base cost is very low such that you cannot deduct the full amount of the unused monies, the balance comes into charge.

In this context, the HMRC guidance at Capital Gains Manual paragraph 15703 states that ‘small’ represents 5% or less of the capital sum that has been received. If this is not met, so if more than 5% of the receipt is not utilised in replacing the asset, then the whole of the insurance receipt will become subject to tax.

The second set of provisions apply where the asset is wholly lost or destroyed. If the monies are used in replacing the asset, then there are specific provisions to mitigate the gain arising on the receipt. The mechanism is slightly different.

The consideration for the disposal of the old asset is treated as if it were of an amount so that no gain or loss arises on the disposal of the old asset. The excess of the consideration over this amount reduces the base cost of the new asset so that the gain on that asset going forward would be greater.

This will only apply if the money is used within one year of receipt although the legislation does say 'or such longer period as the inspector may allow'. The HMRC guidance states that officers may extend the period to two years but cannot extend it beyond this point without referral to the technical specialists. The relief under s.23 has to be claimed and the guidance states that an extension to the replacement period can only be considered once the replacement asset has been acquired (or built in this case).

So, which of these provisions applies?

There is an issue with the interpretation of that provision when we are talking about buildings. This is because any building on land is part of the underlying land. You cannot destroy land so even if the buildings are completely destroyed, you do not the entire loss of the asset as the land remains. However, the legislation treats the land and building as two separate assets. This means that the second set of provisions will apply.

In this current scenario, if there is a replacement of the property, the insurance proceeds are not subject to tax other than any amounts not utilised. It is correct that CGT would be due on any money remaining after the rebuild. It should be noted that the legislation refers to replacement of the asset. It does not have to be an absolute 'like for like' rebuild but it has to have the same function and facilities as the asset it replaced.

The caveat here is the timing of the rebuild. If there is a delay, then there may be a refusal by HMRC to apply the provisions of s.23 such that the whole of the insurance proceeds would fall within the charge to CGT. As noted, HMRC will not give an indication of whether they will extend the time limit until the project is complete.

As noted above, the date of disposal if any amounts become liable to CGT would be when the money is received. If it was thought that the buildings would be rebuilt, but then a decision was made not to do so, then any return that had been submitted on the basis that no gain would be arising (due to the rebuild) would have to be amended. It is appreciated that a decision has not yet been made, and may not be able to be made, before planning has been explored. If an amendment had to be made to an earlier return, HMRC would take that into account in determining if reasonable care had been taken in completing the earlier return. Interest would still arise on any tax which was paid late.

If the decision is made not to rebuild, then the insurance proceeds will be treated as disposal proceeds and the costs relating to the part of the assets destroyed (i.e., the building) will be allowable as a deduction in computing the potential gain. So, you would need to ascertain the value of the original build cost of the building that was destroyed.

You can do this in one of two ways and it appears that HMRC will accept either. If you know the original build costs for the property (and presumably it will be the cost of the original barns not the rebuilt barns) then you can use that.

Otherwise, you would get a value of the land now and apportion the original purchase price for the whole site using the formula:

Cost x A/(A+B)

Where A is the insurance proceeds and B is the value of the land which remains.

In each cost, the proceeds would be net of allowable costs.

Again, the tax point is when the proceeds are received.

There is a provision which enables relief under s.23 to be obtained if you construct a replacement building somewhere else. However, it would have to be a replacement for the building that has been destroyed. Whilst there is no commentary on this in the HMRC manuals, it is likely that HMRC would focus on the use to which any new building is to be put. HMRC would expect the same use to be made of the new building.

If it was not a replacement of the existing building, then CGT would be payable as indicated above in relation to the situation where no rebuild occurs at all. This would apply in this scenario if the decision was made to build a residential unit on the same land although it is not clear whether they would seek planning and then just sell the land to a developer.

If they were to decide to sell the land for development but then buy a new piece of land to build on for the business, then HMRC might argue against this being replacement of the old asset, so there is no guarantee again that the tax can be mitigated.

There are also complications from a compliance perspective if the gain is not included on the tax return on the assumption it is to be reinvested and then that does not happen. Interest and late payment penalties will become due on the tax which has to be paid and there is the risk that HMRC could argue there has been an incorrect return submitted with consequential penalties.

Contributed by Ros Martin

Trial extended - Downloadable paper CGT property return

The CIOT has published HMRC's announcement that the downloadable paper CGT property return (Form reference PPDCGT) trial has been extended until the end of September 2023.

HMRC will continue to monitor the usage and effectiveness of the downloadable form, and further developments will be issued via the Agent Updates.

HMRC have also advised that use of the latest version of the form rather than photocopies of previous versions helps prevent delays to processing.

https://www.tax.org.uk/downloadable-paper-cgt-property-return-trial-extended

UK domicile of choice **(Lecture P1386 – 18.22 minutes)**

Summary – With no compelling evidence to support a planned move back to India, the deceased had acquired a UK domicile of choice.

Anantrai Maneklal Shah was born in 1929 in Karachi. Despite his parents moving to Tanzania, he attended both school and university in India, living with a member of the extended family. On graduation, he moved to Tanzania to live with his parents.

Around 1954 he moved to the UK to study pharmacy but on graduation in 1957 he returned to live in Tanzania, with his family, following his father's death. Later, he married in Mumbai, India but continued to live in Tanzania with his wife and later, his two children who were born there.

When Tanzania became independent from the UK in 1961, he gave up his Indian Citizenship and became a British citizen. In 1972, believing Tanzania to be no longer safe, the family moved for a short period to India but about a year later, the family (including his mother) moved to the UK, where he worked as a pharmacist, owning his own business for a period but having sold that business in 1994, he then locumed until at least 1997.

His daughter and wife having died, Anantrai Maneklal Shah spent two months in intensive care in 2010; further, he had both knees replaced, a pacemaker fitted and two cataract operations. He sold his house and moved into a rented flat in London to be near his son and his family.

In 2014 he made two wills, one under UK law for UK assets and one under Indian law for non-UK assets. Neither will mentioned funeral arrangements or for a ceremony to be held in India. He owned no Indian property and had no Indian bank account.

He died on 7 June 2016, having only ever made two trips back to India since the 1970s. HMRC issued a notice of determination under s.221 IHTA 1984 stating that he was domiciled in England and Wales at the time of his death.

Arguing that he had intended to return to India but had died before he could realise this wish, his executor appealed, claiming that his place of domicile was India.

Decision

The First Tier Tribunal found that, at best, Mr Shah had only 'a vague and floating idea' of returning to India at some point.

A Form DOM1 was presented at appeal but this had not been filed with HMRC. Indeed, he had no real connections with India. His close family remained in the UK. No compelling evidence was presented to demonstrate that he had plans in place to retire back to India. Consequently, with his life settled in the UK, he had a domicile of choice in the UK.

Ameet Shah (as Executor of the Estate of Anantrai Maneklal Shah Deceased v HMRC (TC08842)

The impact of S162B(7) IHTA 1984 (Lecture P1388 – 15.47 minutes)

From an IHT perspective, care must always be taken with mortgages and other liabilities.

If a loan is charged on a business asset, relief is only given on its net value (S162(4) IHTA 1984). This has the effect of wasting the benefit of business relief.

If that loan, despite having been taken out to acquire, say, a close company shareholding, was secured on the shareholder's *private* property (e.g., their home or a portfolio of quoted shares), business relief used to be available on the full value of the relevant business property. Any income tax relief for interest paid on the loan is not affected by the nature of the collateral – see s.392 ITA 2007.

In a surprising announcement which appeared to be an attack on what had previously been regarded as relatively unaggressive and sensible tax planning, HM Treasury stated in FA 2013 that the rules dealing with deductible liabilities for IHT purposes were being tightened up in respect of liabilities incurred on or after 6 April 2013.

In relation to what the legislation calls 'relievable property', the relevant provision is s.162B IHTA 1984. This section covers liabilities incurred to finance – directly or indirectly – the purchase of property which qualifies for business relief (or agricultural relief).

If the liability has been incurred to acquire, maintain or enhance property which is eligible for business relief, s.162B(2) IHTA 1984 provides that this liability reduces the value of the relevant business property (rather than any other property on which the loan may be secured) so that only the *net* value of the property will attract relief. This has put a stop to the widespread practice of borrowing against the collateral of (typically) a valuable main residence and using the loan to acquire an AIM portfolio which, in two years' time, should attract 100% relief.

If the liability has been incurred to acquire, maintain or enhance farmland and farm buildings which are eligible for agricultural relief, s.162B(4) IHTA 1984 provides that this liability reduces the agricultural value of the farmland and farm buildings so that only the *net* agricultural value of the property will attract relief.

Where assets which qualify for business relief (for example) have been acquired using borrowed funds and the liability has been secured against other chargeable assets, it would still be possible to obtain full relief and a deduction for the liability by:

(i) giving away the relievable assets before death; but

(ii) retaining the liability within the estate.

As has been seen, s.162B IHTA 1984 requires that the liability is set against the value of the relevant business property, but with any excess value over the amount of the liability qualifying for relief. However, at death, the transferor's estate would no longer include relievable property and so the provisions of s.162B IHTA 1984 would not apply. The liability could then be deducted against the death estate under s.162(4) IHTA 1984.

In an effort to prevent this, s.162B(7) IHTA 1984 stipulates that, where a liability has already been taken into account to reduce the value transferred by a chargeable transfer, the liability cannot then be taken into account to reduce a subsequent transfer made by the same transferor.

As HMRC put it:

> 'The wording used is important. The liability must reduce the value transferred by a chargeable transfer (i.e., a transfer which is immediately chargeable or a failed PET). If the lifetime transfer was a PET and the transferor survives seven years, the transfer is an exempt transfer. So, the liability may still be deducted from the estate on death as it will not have (been) taken into account by an earlier chargeable transfer.'

Example 1

Denis, who has an estate worth £5,000,000, borrows £750,000 from his bank and uses this to purchase relevant business property. Three years later, Denis gives the business property (now worth £900,000), to Elizabeth, his daughter. However, Denis retains the liability.

Denis has made a transfer of value when he gives the business property to Elizabeth and the value transferred is the loss to Denis' estate of £900,000. S.162B(2) IHTA 1984 has the effect of reducing the £900,000 value of Denis' gift by the amount of the loan (£750,000) to £150,000. This figure of £150,000 is then eligible for 100% business relief, reducing the value transferred to nil.

When Denis dies four years after making this gift (i.e., a failed PET), leaving an estate of £5,000,000, the liability of £750,000 cannot be taken into account for a second time because of s.162B(7) IHTA 1984. Instead of the transfer on Denis' death being (£5,000,000 – £750,000) £4,250,000, it is the full £5,000,000 which is charged to IHT with no deduction for the bank loan.

Example 2 – exempt transfers

Frank and Geraldine are an elderly married couple who are resident and domiciled in the UK. Frank owns assets (including the family home) valued at £2,800,000 in his own name, while Geraldine has property worth £1,200,000. They are therefore worth a total of £4,000,000.

Frank borrows £600,000 which is charged against the value of the main residence. He uses this money to finance the purchase of an AIM share portfolio which he transfers to Geraldine one month later. Frank dies three years after the gift of shares to his wife.

The gift to Geraldine is an exempt transfer between spouses by virtue of S18 IHTA 1984. This transfer is not reduced by business relief and so S162B(1) IHTA 1984 does not apply. The liability which Frank incurred in order to acquire the AIM shares is not taken into account in connection with this lifetime transfer.

The chargeable transfer which is deemed to occur on Frank's death is not reduced by business relief and so s.162B(1) IHTA 1984 is not in point. Because the subsection does not apply, the liability of £600,000 incurred by Frank can be deducted from the value of the house on which the debt is secured, as long as the provisions of s.175A IHTA 1984 are met (i.e., that the liability is discharged out of Frank's estate – which it presumably will be).

It follows that Frank, at the date of his death, has assets worth £2,800,000 – £600,000 = £2,200,000 (the rest of his estate is assumed not to have changed in value).

Geraldine's estate is now worth £1,800,000 (her original asset value of £1,200,000 plus the share portfolio gifted by Frank). However, in her case, the AIM shares will qualify for 100% business relief, leaving a chargeable estate of £1,200,000.

Between the couple, Frank and Geraldine's combined chargeable estate of £4,000,000 has been reduced by £600,000 to £2,200,000 + £1,200,000 = £3,400,000.

Notice that, if Frank had kept the shares in his estate, the transfer on his death would have included both the relevant business property and a liability to acquire relievable property. S.162B(1) IHTA 1984 would then have been in point and so the liability of £600,000 would be taken to reduce the value of the share portfolio before the application of business relief. With no business relief available, Frank's estate would have remained at £2,800,000. Geraldine's estate would have been unaltered at £1,200,000, giving a combined chargeable estate of £4,000,000.

Contributed by Robert Jamieson

Tax pool issues for discretionary trusts (Lecture P1389 – 22.59 minutes)

Since the early 1970s, the trustees of discretionary (and accumulation) trusts have been obliged to maintain a running total of income tax suffered less income tax treated as deducted from their income distributions which are known as annual payments. This is commonly referred to as the trust's 'tax pool' and is computed by taking the balance brought forward (if any) from the previous tax year, adding the tax paid by the trustees for the current year and subtracting the 45% tax treated as deducted from annual payments in that year.

Example 1

On 6 April 2023, the Angela Family Settlement (a discretionary trust) had a tax pool balance brought forward of £506.

During 2023/24, the trustees receive non-dividend income of £2,800, on which they pay:

	£
On first 1,000 @ 20%	200
On next 1,800 @ 45%	810
	£1,010

Towards the end of that tax year, the trustees exercise their discretion to distribute income of £1,320 to a beneficiary. This is treated as a gross annual payment of £1,320 x 100/55 = £2,400. The trustees must account to HMRC for the 45% tax (£1,080) which is deemed to have been deducted from this payment, but of course they have a credit of £506 + £1,010 = £1,516 so that no further tax is payable. The trustees are left with a balance of £1,516 – £1,080 = £436 to be carried forward in the tax pool.

This sounds straightforward enough, but, where the trust includes dividends, there are problems. In 1999, when the then Chancellor decided that dividend tax credits should no longer be repayable, he ordained that they were not to go into the trust's s.497 ITA 2007 tax pool. Only tax actually paid over to HMRC was allowed to enter the tax pool for the purpose of franking the tax on income distributions to beneficiaries.

However, in 2023/24, dividend tax credits no longer exist and so the question to determine is how much of this income tax goes into the tax pool in line with ss497 and 498 ITA 2007. Since the end of the 1990s, non-repayable tax credits were not permitted to be added to the tax pool because of concerns that this could otherwise lead to them becoming repayable in the hands of an appropriate beneficiary.

Rather oddly, the 2016 dividend tax legislation contained no express announcement about a change in the tax pool provisions. This was clearly anomalous. Eventually, it was confirmed at the Committee Stage that this was a drafting oversight. Accordingly, an amendment was tabled to Sch. 1 FA 2016 which ensures that all of the income tax paid on dividend receipts will be included in the tax pool.

Having said all this, where, say, a discretionary trust regularly distributes all of its dividend income, this can give rise to a somewhat capricious result.

Example 2

The Edward Discretionary Settlement received dividends totalling £1,360 in 2023/24. At the end of the year, the net trust income was distributed to one of the discretionary beneficiaries. Assume that there is no undistributed income in the trust and that the tax pool is empty.

The trustees' tax position is as follows:

Dividends received	£1,360
The trust's tax liability for 2023/24 is:	
	£
On first 1,000 @ 8.75%	87
On next 360 @ 39.35%	142
	£229
The trust's distributable income (ignoring expenses) is:	
Dividends received	1,360
Less: Income tax paid by trustees	229
	£1,131

A net payment of £1,131 is made to the beneficiary in question and the trust certificate will show a tax figure of 45/55 x £1,131 = £925. But, in view of the fact that only the £229 paid by the trustees goes into the tax pool, the end result of an income distribution of £1,131 is:

	£
Tax certified (45/55 x 1,131)	925
Less: Tax paid by trustees	229
Tax due under s.496 ITA 2007	£696

In other words, the trustees have effectively overdistributed and they must pay this sum to HMRC.

If, in Example 2, the trustees had chosen simply to rely on the trust dividend income to fund both the payment to the beneficiary and their s.496 ITA 2007 charge, they will only have sufficient funds to release 55% of their dividend receipts, i.e., 55% x £1,360 = £748. This translates into gross income for the beneficiary of £1,360, from which tax of £612 has been deducted. The trustees' s.496 ITA 2007 liability is £383 (£612 less the £229 which goes into the tax pool). As a result, the trustees will have paid £748 to the beneficiary and £383 to HMRC. This exactly equals the £1,131 cash which the trustees had in hand.

An article in Issue 39 of 'Tax Bulletin' suggested that there was nothing untoward with the above analysis. However, the only realistic conclusion which can be drawn from all this is that, where a discretionary trust is wholly or mainly invested in equities and where the trustees distribute all or most of their available income to the beneficiaries, there is a tax penalty for holding such investments via a discretionary trust.

If, in Example 2, an additional rate taxpayer had personally held the shares which paid the dividends of £1,360, his after-tax position – he is assumed already to have utilised his dividend tax allowance – would have been as follows:

Dividends received	£1,360
Tax @ 39.35%	£535

In other words, the taxpayer would have ended up with net cash of £1,360 – £535 = £825.

On the other hand, if this same individual were a discretionary trust beneficiary and if he received the maximum distribution which the trustees could make out of their income (£748), his after-tax position is rather different:

Trust income (x 100/55)	£1,360
	£
Tax @ 45%	612
Less: Tax deducted at source	612
Tax payable	£NIL

Thus, he would have net cash amounting to £748, i.e., £77 less.

If taxpayers were attempting to gain some sort of advantage by holding shares in discretionary trusts, it would be understandable that the Government might wish to end such a benefit. But this is not the case. The truth of the matter is that the Government are penalising those who hold shares in this way.

Consequently, it may be worth converting some discretionary trusts into settlements with a revocable life interest. Not only would this end the handicap of artificially high tax rates suffered by discretionary trusts, but it would:

- allow beneficiaries to receive the dividend tax allowance; and
- remove the need for beneficiaries with taxable incomes of less than £125,140 to claim tax repayments.

There should be no IHT or CGT drawbacks to the creation of a revocable life interest trust.

Since FA 2006, there has been no IHT charge on a transfer from a discretionary trust to a life interest trust;

S.71(1) TCGA 1992 should not normally be relevant for CGT purposes.

Contributed by Robert Jamieson

Administration

Non-payment of tax during judicial review

Summary – The taxpayer did not have a reasonable excuse throughout the period. His delay in paying the tax due was unreasonable once the Court of Appeal had reached their decision, when the reasonable excuse came to an end.

William Archer appealed against surcharge notices issued totalling just over £1.4 million for failure to pay tax, claiming that:

- he had a reasonable excuse for not paying the tax due;
- he paid the tax without delay once that reasonable excuse came to an end.

He claimed that there was an obvious defect in the closure notices and so he sought to challenge their validity by applying for judicial review. He argued that payment of the tax would have undermined the judicial review proceedings and so it was reasonable not to pay the tax until the judicial review was finally concluded and his appeal rights exhausted.

Having filed a claim for judicial review in March 2016, at the same time, he made an application for urgent interim relief to restrain HMRC from issuing a statutory demand or commencing any bankruptcy proceedings until further order. The interim relief was granted.

He failed on his appeals to the First Tier and Upper Tribunals, and so he appealed to the Court of Appeal, where his case was dismissed.

He sought to appeal to the Supreme Court but was refused permission to appeal on 13 June 2018 on grounds that the application did not raise an arguable point of law. William Archer accepted that once his application to the Supreme Court was refused, his appeal rights were exhausted, and so 22 June 2018 he paid the tax plus interest due totalling £22,541,746.78.

However, he appealed against the surcharge notices issued on the basis that he had a reasonable excuse for non-payment of the tax.

Decision

In reaching its decision, the Court of Appeal considered three distinct periods.

1. Determination of judicial review (Up to February 2017)

The Administrative Court dismissed the application for judicial review, discharged the order for interim relief and refused permission to appeal". William Archer sought permission to appeal from the Court of Appeal, which was granted. The interim relief was reinstated until the appeal was determined, with the judge saying that:

> "I consider that it would be wrong in principle for HMRC to initiate or pursue bankruptcy proceedings against [the appellant] at a time when, according to the judge, the closure notices were ineffective for failure to specify the amount of tax due, that failure was incapable of remedy under s 114, and there was accordingly no statutory debt due under section 59B of TMA 1970."

The Judge stated that:

> "The whole point of the judicial review was to establish whether the tax was payable at all, and there was a risk that the judicial review would be undermined or rendered nugatory if the tax was paid."

The Court concluded that a reasonable excuse did exist until the judicial review had been concluded.

2. Determination by the Court of Appeal (February 2017 to November 2017)

The Court of Appeal unanimously dismissed the appeal, refused permission to appeal to the Supreme Court, and refused an application for further interim relief. He was told "in clear terms that he owed the tax." At this time, although William Archer was allowed to seek permission for a second appeal to the Supreme Court, this did not provide him with a reasonable excuse for continued non-payment.

The Court stated that if he "had adduced some further evidence for this period, to fill in the gaps and explain why payment was not made, and to establish that the judicial review as it was ongoing really was the reason for non-payment, it might have been possible to reach a conclusion in his favour."

3. The date on which tax was paid (November 2017 to 22 June 2018)

William Archer had a reasonable excuse up to the date of the Court of Appeal's decision on the judicial review, but this ceased shortly after November 2017. It was found that by mid-December 2017, a responsible taxpayer, benefitting from expert legal advice should have paid the tax. His reasonable excuse ceased by this date, but he did not pay the tax until 22 June 2018.

The appeal was dismissed.

William Archer v HMRC [2023] EWCA Civ 626

Changes to Alternative Dispute Resolution (Lecture P1390 – 14.46 minutes)

HMRC's Alternative Dispute Resolution ("ADR") is a non-statutory process for resolving personal tax and business tax disputes between HMRC and a taxpayer. In a previous session, I covered the process, including how to apply for it, and what cases are suitable. Following recent changes to the process by HMRC, it is time for an update. This session provides an overview of the process and considers the recent changes.

Overview of Alternative Dispute Resolution

Under ADR, an online application is made, and a mediator (a trained HMRC officer not connected to the case) assists the taxpayer and the HMRC caseworker to resolve their dispute. Not all disputes are suitable for ADR, and HMRC provides details of cases that will not be accepted into ADR (see below). HMRC can reject applications that are not considered appropriate for ADR. As the process is not statutory, there isn't a right of appeal if HMRC rejects an application for ADR. Where there is uncertainty about whether a case should be included in ADR, there is an ADR Panel (made up of HMRC staff) which considers such cases.

HRMC’s policy is that an application for ADR can be made at any stage of an enquiry, and an appealable decision is not needed, which is an advantage for the taxpayer.

Discussions under the ADR process are generally held on a “without prejudice" basis (but see below). HMRC state, at ADRG01800, that, in the context of ADR, “without prejudice” means that “the parties are able to propose and explore solutions to the dispute under consideration without having to worry that their discussions will in some way be regarded as an admission should the parties not reach an agreement”.

HMRC manual

HMRC have produced a manual, Alternative Dispute Resolution Guidance (“ADRG”), which replaces previous information sheets. The manual, which was published in February 2023, covers the ADR process, from the beginning to the end. Sections include guidance on the use of external mediators (see below), the role of the mediator, and the types of cases that are, and aren’t, suitable for ADR. Much of the guidance will be familiar to advisers who have used the ADR process, but there are some important changes. Advisers facing a dispute, even those with experience of ADR, should review the manual to consider the new information.

Using external mediators

HMRC’s default position is that their own mediators are used for the ADR process. These are HMRC officers who are training in mediation skills and techniques and are independent of the case team. The mediator acts as a neutral third party without forming a view on who is right and wrong.

Not all taxpayers will want to use a HMRC mediator, particularly in those cases where there has been a breakdown in communication with the HMRC officer. HMRC give taxpayers the option to involve a “professionally accredited” mediator from outside HMRC. This is done at the taxpayer’s expense. In addition, there are various conditions that apply to the use of an external mediator. The appointed external mediator must work with an assigned HMRC mediator, who has final control over the mediation process. The external mediator must accept and apply HMRC’s terms and conditions of the ADR process, including the conditions set out in HMRC’s manual.

Use of information

The general premise is, as noted above, that ADR discussions are held on a without prejudice basis. An exception to this is in relation to “tax facts”. HMRC define these as a fact “which has legal and technical implications for a taxpayer’s liability”. Examples of tax facts given in HMRC’s manual include the receipt of a payment, and the identity of a customer. A tax fact is distinguished from a situation where there is negotiation about what the facts might be. The mediator should make clear at the start of the mediation that any “tax fact” provided in the course of the ADR discussions is not covered by the “without prejudice” rule.

Advisers need to be mindful of the implications of making proposals which include the assertion, even implicitly, of a tax fact. At the end of the mediation, details of any tax facts that either party may wish to rely on in future proceedings, should be included in the Record of Outcome, if both parties agree. If there is no agreement, HMRC should set out details of the tax fact to the taxpayer in writing at the end of the mediation.

If the mediation is unsuccessful, and there is a dispute about the tax facts, HMRC may seek legal disclosure of the documentation. The taxpayer will have the same right, where appropriate.

The HMRC manual acknowledges that participants can take notes during the mediation if they wish. The mediator will encourage note-taking to be kept to a minimum during the joint sessions, so that the focus is on listening to the other side. HMRC will make a note of any "tax facts" supplied by the taxpayer.

It is likely that that mediator will also take notes. Any such notes are to be factual and should not include any personal opinions. The mediator's notes are kept separately within HMRC, and are not available to the caseworker, or other HMRC personnel working on the case. Advisers should be aware that the mediator's notes may be disclosable if the case proceeds to the tribunal.

Specified cases excluded from Alternative Dispute Resolution

There are specific areas of tax which HMRC currently excludes from ADR. The excluded areas include the following (the full list is given at ADRG02900):

- Cases that HMRC's criminal investigators are dealing with;
- Complaints and disputes about HMRC delays in using information or giving misleading advice;
- Payment or debt recovery issues;
- Extra Statutory Concessions;
- Pension liberation schemes;
- Automatic late payment or late filing penalties;
- Accelerated payments and follower notices;
- Cases the First-tier Tax Tribunal have categorised as 'paper' or 'basic'.

If your client has asked for a formal HMRC review of a decision, then ADR will not be offered at the same time. If a review decision has been made, and the client has formally appealed against it, and this appeal has been accepted, then the client can make an application for ADR.

Other points

In my previous session on the ADR, I referred to various timelines under the process. The new manual extends these, and states that HMRC's intention is that ADR cases are generally concluded within four months. This means that the case is either settled within that timeframe, or out of the ADR process. Advisers may take cases to ADR not expecting settlement, but wish to seek clarification of HMRC's position. In addition, the mediator is now required to ensure that the ADR process is not used to either delay HMRC's compliance activities, or the need for tribunal proceedings. If the mediator considers it appropriate, the mediation can be terminated.

At the end of the mediation, there will be a formal Record of Outcome, which both parties will be asked to approve. The document provides a record of what has been agreed, partial agreements, and points where agreement has not been reached. The document is usually prepared at the end of the mediation, but the HMRC manual allows extra time, where necessary, although the record should be finalised within a week of the mediation. There are certain cases where the mediation solution is deemed as provisional until approved by a “Dispute Resolution Board” or similar panel within HMRC.

Practical considerations

Advisers need to ensure that early representations are made to the mediator if they are seeking in-person meetings during the mediation. Given the limited resources available to HMRC, pressure will be on mediation officers to hold meetings by the default methods wherever possible. Advisers, and their clients, may need to be flexible on this aspect, particularly where the attendance of HMRC specialists at the mediation is desirable.

Advisers may be tempted to appoint a non-HMRC mediator. However, advisers need to be mindful of the restrictions that apply, as well as the responsibility of the client to meet the costs involved. Advisers also need to be mindful of the circumstances in which information provided during the mediation will not be treated as confidential.

It is important to ensure that the appropriate HMRC officers are present for the mediation. The mediator should ensure that a decision-maker is there for HMRC (usually the caseworker’s manager), but the adviser should consider whether there is a need for a technical specialist from HMRC to also be present.

Despite the changes that have been introduced by HMRC, ADR can still bring time and cost savings over formal litigation. However, it is important for the adviser to consider each case on its merits.

In my previous session on ADR, I expressed the opinion that ADR should be a consideration for advisers when their clients have a dispute with HMRC (in conjunction with statutory review, where available). That remains my view, but extra caution is needed. Advisers may want to seek specialist advice before embarking on the ADR route. They can help assess the merits of using ADR in the client’s circumstances. In addition, advisers may find that a specialist consultant is able to engage with HMRC and reach an acceptable outcome for the client, thereby avoiding the need to pursue an ADR application.

Contributed by Phil Berwick (Director at Berwick Tax)

Deadlines

1 August 2023

- Corporation tax for periods ended 31 October 2022 if not liable to pay by instalments
- Outstanding 2021/22 tax returns subject to a penalty – higher of £300 or 5% of tax

2 August 2023

- Filing date for form P46(Car) for quarter ended 5 July 2023

5 August 2023

- Quarterly report by employment intermediaries for period 6 April to 5 July 2023

7 August 2023

- Due date for VAT return and payment for 30 June 2023 quarter (electronic)

14 August 2023

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

19 August 2023

- Pay PAYE/construction industry scheme for month ended 5 August 2023 if by cheque
- File monthly CIS return

21 August 2023

- File online monthly EC sales list (business based in Northern Ireland selling goods)
- Supplementary intrastat declarations for July 2023 – arrivals for a GB business, arrivals and despatch for a business in Northern Ireland

22 August 2023

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

31 August 2023

- Filing deadlines at Companies House
  - private companies with 30 November 2022 year end
  - public limited companies with 28 February 2023 year end
- Corporate tax self-assessment returns for accounting periods ended 31 August 2023

- Annual adjustment for VAT partial exemption claims, May year end

News

Finance Act receives royal assent

The Finance (No. 2) Act 2023 received royal assent on Tuesday 11 July 2023.

Registering for Self Assessment

From 2023/2024 onwards, the Self Assessment threshold for taxpayers taxed through PAYE only, will increase from £100,000 to £150,000.

Individuals will still need to submit a tax return if their income taxed through PAYE is below £150,000 but they are:

- in receipt of any untaxed income;
- a partner in a business partnership;
- liable to the High Income Child Benefit Charge;
- self-employed, with gross income of over £1,000.

Where individuals submit a 2022/2023 return showing income between £100,000 and £150,000 taxed through PAYE and they do not meet any of the other criteria for submitting a Self Assessment return, HMRC will send out a Self Assessment exit letter.

https://www.gov.uk/government/publications/agent-update-issue-108/issue-108-of-agent-update#sa-threshold-change

Interest rate rises

Following the Bank of England's decision to increase the base rate to 5%, HMRC is increasing interest rates once more.

From 3 July 2023 the rate:

- for late paid corporation tax quarterly instalment payments is 6%;
- paid on overpaid quarterly instalment payments and on early payments of corporation tax not due by instalments increases to 4.75%.

From 11 July 2023, the new rate for other late paid taxes is 7.5%. and repayment interest rate rises to 4%.

https://www.gov.uk/government/publications/rates-and-allowances-hmrc-interest-rates-for-late-and-early-payments

Business Taxation

Appeal struck out for the third time (Lecture B1386 – 18.49 minutes)

Summary – The issue of capital allowance computations was not a new matter and so the appeal was struck out by the First Tier Tribunal.

Between 2009/10 and 2012/13, Waterloo Car Hire bought second hand cars and made them available for use by its self-employed mini cab drivers. In 2012, the cars were included in the cost of sales figure as purchases.

HMRC opened an enquiry into the partnership's 2012 return and subsequently issued closure notices and discovery assessments disallowing the purchase of cars and also their sales. The cars should have been included in the capital allowance section of the tax return.

In 2016, the First Tier Tribunal concluded that the cars were fixed assets, subject to capital allowance legislation, and not items that could be included in cost of sales.

In 2017, permission to appeal against this decision was refused by the First Tier and Upper Tribunals. In refusing permission to appeal, the partnership was not precluded from seeking to agree capital allowance figures with HMRC, in order to take account of the conclusion that vehicles were capital assets subject to capital allowances.

In March 2019, the partnership lodged a further appeal which was struck out on the grounds that the 2019 appeal was based on grounds which entirely sought to re-litigate the 2016 appeal, which was outside of the First Tier Tribunal's jurisdiction.

On 28 August 2020, the partnership lodged it's third appeal against HMRC's decision relating to the capital allowance treatment of cars. HMRC applied to have the appeal struck out arguing that the partnership was bound by the original decision in the 2016 appeal as the 2019 and 2020 appeals related to the same cause of action as the original matter. On that basis, the appeal should be struck out under rule 8(2)(a) of the Procedure Rules.

Decision

The burden of proof rested with the partnership to show that the assessments raised by HMRC were incorrect. The First Tier Tribunal stated that:

> "unless the Appellant can produce evidence to show that, on the balance of probabilities, it has been overcharged by the Assessments, the Assessments shall stand as good."

The Tribunal stated that during the 2016 appeal the partnership had never submitted the capital allowance computations now sought to be relied on. The Tribunal found that the subject matter and the underlying right of appeal in this third appeal was the same as during the two earlier appeals. The issue of capital allowance computations was not a new matter as they were a necessary part of the decision in the first appeal. As stated earlier, capital allowances was an area where the taxpayer could seek to agree figures with HMRC in order to take account of the conclusion that vehicles were capital assets subject to capital allowances.

The Tribunal was satisfied that the appeal must be struck out under rule 8(2)(a) of the Procedure Rules

Waterloo Car Hire (A Partnership) v HMRC (TC08848)

Basis Period Reform online tool (Lecture B1386 – 18.49 minutes)

HMRC are launching an online tool on 29 August 2023 that will allow businesses, the self-employed and their agents to request details of overlap profits where that data is held by HMRC.

An online 'g-form' will be available, with submissions processed by a dedicated team in HMRC who will then respond by email.

The form will be able to handle requests by agents covering multiple clients and will be publicised by HMRC ahead of its launch.

In the meantime, overlap figures can continue to be requested from HMRC by letter.

https://www.att.org.uk/technical/news/

Company trading loss carry back claims (Lecture B1388 – 13.43 minutes)

Background

Where a company makes a trading loss, there are several possible ways for that trading loss to be relieved, subject to certain conditions and restrictions.

For example, the trading loss can be carried forward against total profits of later years, so long as the trade continues (CTA 2010, s.45A); the company could claim to offset the loss against its total profits of the same accounting period (CTA 2010, s.37(3)(a)); if there are no other profits of the same accounting, or to the extent that profits of the same accounting period have been fully relieved, a claim can generally be made for the trading loss to be carried back and offset against total profits of the preceding 12 months (CTA 2010, s.37(3)(b)).

Losses carried back

As indicated, where the amount of trading loss exceeds the profits of the same accounting period, the company may claim to carry back the excess against the profits of preceding accounting periods. The preceding accounting periods are those falling wholly or partly within the 12-month period ending immediately before the start of the loss-making accounting period. The loss relief is given against total profits, including chargeable gains.

The company cannot choose to restrict the claim to cover only particular items of income or gains. In addition, a claim must first be made to offset losses against profits of the current accounting period, before carrying back any balance of unused losses against profits of preceding accounting periods. A company cannot claim to carry back losses without first setting them off against profits of the current period.

Trading losses may only be carried back against profits of a preceding accounting period if the company was carrying on the relevant trade in that accounting period, and only if the trade was not carried on wholly outside the UK. However, HMRC accepts it is not necessary for the trade to have been carried on for the whole of the preceding accounting period. If the trade was carried on at any time in an accounting period, losses may be set-off against the profits of the whole of that accounting period (see HMRC's Company Tax Manual at CTM04510).

However, where only part of an accounting period falls within the 12-month carry back period, the profits of that accounting period available for set-off are restricted to profits apportioned to the part of the accounting period falling within the 12-month period (CTA 2010, s.38).

Claiming the relief

A claim to carry back losses to accounting periods within the previous 12 months must be claimed. The time limit is generally two years after the end of the loss-making period. However, HMRC may allow a longer period at its discretion (CTA 2010, s.37(7)).

In practice, loss relief claims are normally made in the company's tax return for the loss-making accounting period. However, if the claim has not been included in the company's tax return (or in an amendment to the return), it may be possible to make a claim under the provisions for claims not included in returns (TMA 1970, Sch 1A).

If the loss relief claim needs amending, and the claim was made in the company's tax return, it may be amended at any time up to 12 months from the statutory filing date for the return. The effect is that the claim is treated as an amendment to the return (FA 1998, Sch 18, para 58(2)).

Alternatively, if the company cannot make the claim in a company tax return or an amended return, so that the claim is within the rules regarding claims not included in returns, the time limit is within 12 months of making the claim. Effect is given to the claim by discharge or repayment of corporation tax (FA 1998, Sch 18, para 58(3)). If the company discovers that it made a mistake in a claim, it can make a supplementary claim within the time allowed for making the original one (FA 1998, Sch 18, para 56).

Claims after HMRC enquiries, etc.

Where additional tax has been brought into charge by an amendment to the company's tax liability following an HMRC enquiry closure notice or discovery assessment, in some cases it is possible to make claims against the additional tax liability arising, after the normal time limit for doing so has passed (FA 1998, Sch 18, para 61). Those cases include the amendment of a company tax return following an HMRC enquiry closure notice, or where HMRC makes a discovery assessment.

The extended time limit for claims in such cases is one year from the end of the 'relevant accounting period', i.e., the accounting period in which the tax return enquiry amendment was issued, or the discovery assessment was made by HMRC (FA 1998, Sch 18, para 62(1)). The liabilities that can be reduced include the further liability resulting from the amendment or assessment.

A company can normally vary or revoke a claim previously made or given (unless it is irrevocable). However, if the company varies or revokes the claim, it must do so in the same way the claim was made. If a consequential claim is made, the reduction in tax liability resulting from the claim is restricted to the additional tax liability resulting from the amendment or assessment (FA 1998, Sch 18, para 64).

Careless or deliberate conduct

The general rule about consequential claims following an HMRC closure notice or discovery assessment is subject to restriction in certain circumstances. If HMRC assesses the company for a loss of tax brought about carelessly or deliberately by or on behalf of the company, an additional claim can still be made. However, the only claims the company can make are those that can be given effect in that assessment. The claim must therefore be made before HMRC issue the assessment, or in the appeal period relating to that assessment (FA 1998, Sch 18, para 65; see CTM90665).

Civic Environmental Systems Ltd v HMRC

In Civic Environmental Systems Ltd v Revenue and Customs [2023] EWCA Civ 722, the appellant company ('CES') commenced trading on 8 June 2006. Its first accounts for the period 8 June 2006 to 30 April 2007 showed a profit before tax of £142,039. The corporation tax return for the 2007 period showed corporation tax of £41,372.

CES made a loss in the year ended 30 April 2008 of £444,747. It claimed to carry back that loss and set it off against its profits for the 2007 period, which were then considered to be £142,039, and HMRC repaid the corporation tax for the 2007 period of £41,372. That left remaining losses of £302,708 to be carried forward to set off in later years. However, the First-tier Tribunal (FTT) subsequently ruled that CES's profits for 2007 had been understated by £540,000. Both the FTT, and on appeal the Upper Tribunal (UT), decided that notwithstanding this increase to CES's profits for 2007 it remained that only £142,039 of the 2008 loss could be set off against the 2007 profits. CES appealed.

The Court of Appeal considered that CES's loss relief claim was not given effect to as an amendment to its 2007 return. It was therefore correct for it not to be taken into account by HMRC in the closure notice or the FTT in their decision. Instead, it was given effect to as a freestanding claim under TMA 1970, Sch 1A, which had resulted in the tax repayment. The court held that there was no mechanism to enable that claim to be re-opened on the basis that the profits for the period had subsequently been increased by HMRC or FTT. CES's appeal was dismissed.

Contributed by Mark McLaughlin

Nature of payment to government agency

Summary – £33.5 million was neither deductible as a loan relationship debit, nor allowable enhancement expenditure for capital gains purposes.

Swiss Centre Limited paid £33.5 million to an Irish government agency and claimed the payment should be seen in two component parts:

1. An amount paid to the government agency for the release of the agency's security over the property that the company was developing (the Swiss Centre);

2. A payment made in relation to a guarantee which the company had given in respect of another company's debts to secure continuing access to development finance for the Swiss Centre.

HMRC said the company made the payment because it was in the interests of the wider group of companies of which the taxpayer was a member and in the interests of two individual shareholders/directors.

Decision

The First Tier Tribunal decided first that the payment was not deductible as an expense in the taxpayer's profit and loss account. In essence a report provided on behalf of the taxpayer by an expert accountant was based on an assumption of facts which were not consistent with the findings made by the tribunal. Nor was it deductible as a debit paid under the loan relationship rules.

On whether a deduction was available in calculating the capital gain on the disposal of the property, the tribunal said the taxpayer had not shown that the amount had been paid wholly and exclusively for enhancing the value of the Swiss Centre. It was clear the payment was made to benefit several companies of which the taxpayer was a member.

The appeal was dismissed.

Swiss Centre Ltd v HMRC (TC08825)

Adapted from the case summary in Taxation (22 June 2023)

Oil royalties paid to bank are not subject to UK tax

Summary – Contractual payments received linked to the exploitation of a UK oil field were not subject to UK tax under the UK/Canada double tax treaty.

The Royal Bank of Canada made loans through its Canadian head office to a Canadian oil company, Sulpetro Ltd, to fund exploration in the UK continental shelf.

That company sold its interests to the BP group in exchange for various sums, including an entitlement to contingent royalty payments on production from the oil field.

Sulpetro Ltd went into receivership and its rights to future payments were assigned to the Royal Bank of Canada.

BP later sold its interests to another company which then became responsible for making the payments. It accounted for these as a deduction from the ring-fenced profits of its UK oil exploitation trade.

The bank, which had written off the loan, treated the payments as recovery of the bad debt.

HMRC considered the payments were taxable in the UK as profits of a ring-fence trade.

The First Tier Tribunal and Upper Tribunal dismissed the bank's appeal and it appealed to the Court of Appeal.

Decision

On the taxpayer's assertion that the Upper Tribunal had erred in its interpretation of the UK/Canada double tax treaty, the Court of Appeal agreed that it had. Lady Justice Falk said this ground of appeal was concerned with the meaning of the fifth limb of the second sentence of the definition of immovable property in Article 6(2), namely 'rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources'. She concluded that this was confined to rights to payments held by a person who has a continuing interest in the land in question to which the rights can be attributed.

Here, the judge said the Royal Bank of Canada had never held any interest in the oil field. It could not therefore be taxed under the fifth limb. Rather it had acquired a contractual right to receive payments calculated by reference to the sale proceeds derived from sales of oil. The bank accepted that it 'stood in the shoes' of Sulpetro Ltd as regards its entitlement to the payments, but this did not alter the fact that it had 'at no stage held an interest' in the oil field.

The taxpayer's second ground of appeal was that the Upper Tribunal was wrong to conclude that Sulpetro Ltd rather than SUKL (a UK subsidiary of Sulpetro Ltd) had the right to extract oil.

The bank said the payments could not be consideration for a 'right to work' within the fifth limb because Sulpetro Ltd never held that right. The judge agreed. She said Sulpetro Ltd had the right to direct the work, but this did not amount to a right to work. That right was held by SUKL.

The taxpayer's appeal was allowed on the basis that the treaty did not permit HMRC to tax the payments in the hands of the bank.

Royal Bank of Canada v HMRC [2023] EWCA Civ 695

Adapted from the case summary in Taxation (29 June 2023)

Residence and the UK/USA double tax treaty

Summary - The Upper Tribunal allowed the company's appeal against a decision of the First Tier Tribunal that it was not entitled to double tax relief under the UK/USA treaty.

G E Financial Investments was a UK-resident member of the GE group and was the limited partner in a Delaware limited partnership.

The general partner in the limited partnership was a USA-resident group member (G E Financial Investments Inc).

G E Financial Investments and G E Financial Investments Inc were 'stapled entities' for the purposes of the US federal income tax because the shares in one could not be transferred without the shares in the other also being transferred to the same transferee. The effect was that G E Financial Investments was subject to US tax on its worldwide income. It claimed double tax relief in respect of the US tax for six consecutive accounting periods.

HMRC rejected all of the claims.

The First Tier Tribunal dismissed the company's appeal, holding that it was not resident in the USA under article 4 of the UK/ USA double tax treaty and that it was not carrying on a business in the USA through a US permanent establishment within article 7 of the treaty.

The case moved to the Upper Tribunal.

Decision

The first issue for the Upper Tribunal was whether the share staple had the effect that G E Financial Investments was a resident of the USA under article 4 of the double tax treaty.

The criteria for residence in article 4 were all commonly accepted ways in which worldwide or 'full' taxation was imposed, 'nothing more and nothing less'.

The Upper Tribunal saw no basis for the additional requirement used by the First Tier Tribunal for there to be a legal connection between the corporation and the USA. US federal income tax treated a stapled foreign corporation as a domestic corporation and subjected it to full taxation in the same way as such a corporation. G E Financial Investments was therefore resident in the USA for the purposes of the double tax treaty.

This conclusion was sufficient to determine the appeal in G E Financial Investments' favour, but the Upper Tribunal went on to consider whether G E Financial Investments, through its participation in the limited partnership, was carrying on a business in the USA through a permanent establishment. On this issue, the Upper Tribunal upheld the decision of the First Tier Tribunal that G E Financial Investments was not carrying on a business.

In GE Financial Investments v HMRC [2023] UKUT 146 (TCC)

Adapted from the case summary in Tax Journal (7 July 2023)

Corporation tax from 1 April 2023 (Lecture B1389 – 18.30 minutes)

HMRC guidance can be found at https://www.gov.uk/hmrc-internal-manuals/company-taxation-manual/ctm03900.

From 1 April 2023, there is a small profit rate of 19% where augmented profits are up to £50,000 and a main rate of 25% where augmented profits are above £250,000 per annum.

Augmented profit is taxable profit plus exempt distribution income.

Marginal relief applies to profits in between the two limits. The taxable profit is initially taxed at 25% then reduced by:

3/200 x (Upper profit limit – augmented profit) x taxable profit ÷ augmented profit

The marginal rate between £50,000 and £250,000 is 26.5% (higher if company has dividend income), so this is where, for example, optimum loss relief is obtained.

The profit limits are apportioned for short accounting periods and associated companies (see later).

The 25% rate also applies, irrespective of the size of profits, for:

1. Close investment-holding companies (does not include letting land to unconnected 3rd parties);

2. Non-resident companies on their profits from a UK PE or UK property business;

3. UK companies on any chargeable CFC profits.

Associated companies

Two companies are associated if at any time within the preceding 12 months:

- One company has control of the other, or
- Both companies are under the control of the same person or group of persons

As well as affecting the profit limits for determining the rate of corporation tax, this will affect whether a company is large or very large for quarterly instalment purposes, whether a company can elect to use small claims treatment for Patent box, and the £100,000 limit for long-life asset expenditure to be pooled in the 6% pool.

Control (s450 CTA 2010)

Can the person exercise or acquire direct or indirect control over the company's affairs?

This is definitely the case if the person owns or can acquire:

1. more than 50% of share capital, or

2. the majority of the voting rights, or

3. Entitlement to a majority of the distributable profits, or

4. Entitlement to more than 50% of the assets available to participators

This includes where two or more persons satisfy these conditions.

But when attributing rights of others (e.g., associates such as spouse, siblings etc.) companies are only associated if there is substantial commercial interdependence between them.

Substantial commercial interdependences are as defined in Schedule 1 paras 3 - 6, NIC Act 2014 (for employment allowance purposes) as "the degree to which the companies are financially interdependent, economically interdependent and organisationally interdependent".

Interdependence meanings

<u>Financially interdependent (Sch 1, para 4)</u>

One company gives financial support (directly, or indirectly – e.g., a guarantee) to the other, or each company has a direct or indirect financial interest in the other's activities.

Economically interdependent (Sch1, para 5)

Both companies seek to the realise the same economic objective, or the activities of one benefit the other, or there are common customers.

Organisationally interdependent (Sch 1, para 6)

Common management, employees, premises or equipment.

HMRC Guidance

CTM03950 - “it is not necessary for all three types of links to exist. For example, if there is a sufficient financial link, one company will be an associated company of another even if no economic or organisational links exist”

But the law says, ‘degree to which the companies are financially… economically…..and organisationally interdependent’.

An ordinary reading of this is that all 3 need to be present, but case law will need to evolve to understand if HMRC is correct in its assertion.

HMRC gives examples where it believes there is significant financial interdependence at CTM03785, significant economic interdependence at CTM03790, and organisational interdependence at CTM03795.

This shows the sort of arrangements that HMRC might enquire into, but it is not the law.

Attribution of rights of others

If no substantial commercial interdependence exists between companies, the normal attribution of rights held by certain connected persons (s451 CTA 2010) is ignored.

Each shareholding is considered in isolation.

Husband and wife scenarios

If husband (H) and wife (W) each own (say) 50% of A Ltd and of B Ltd, the two companies are associated as they are under the common control of both H&W (the ‘same person or persons’). It takes the combined shareholdings to achieve control in each company.

If H owns 100% of A Ltd and W owns 100% of B Ltd, normally we would attribute H’s interest to W and W’s interest to H, but A Ltd and B Ltd will only be associated if there is substantial commercial interdependence between them. If they operate separately, they will not be associated.

What if H owns 90% of H Ltd and W owns 10%, W owns 90% of W Ltd and H owns 10%?

We look at smallest group of people that combine to control each company. So, H controls H Ltd without W, W controls W Ltd without H. The two companies will only be associated if there is substantial commercial interdependence.

Effect on quarterly instalments

The £1.5m and £20m limits will be divided by the number of associated companies (rather than 51% groups) for <u>accounting periods beginning</u> from 1 April 2023.

Example 1

Adam Chan owns 100% of AC Properties Limited and 100% of AC Consultancy Limited.

Both companies have made profits in their year ended 31 March 2023 accounts in the region of £1 million to £1.2 million and are expected to do so for the foreseeable future.

Explain when these companies will need to pay their corporation tax over the next 3 years.

Profit limit = (£1.5m ÷ 2) £750,000, so both must pay QIPs from 2025 (because year ended 31 March 2024 is a period of grace).

Analysis

<u>Accounting period</u>	<u>Payment date(s)</u>
Year ended 31 March 2023	1 Jan 2024
Year ended 31 March 2024 (grace)	1 Jan 2025
Year ended 31 March 2025	14 Oct 2024 (25%) 14 Jan 2025 (25%) 14 Apr 2025 (25%) 14 Jul 2025 (25%)

Example 2

What difference would it make if the companies in example 1 had a December year end?

Year to 31 December 2023 – tax payable 1 October 2024 (AP begins pre 1 April 2023)

Year to 31 December 2024 – first year of instalment regime – period of grace

Year ended 31 December 2025 – QIPs required for first time - instalments payable

1. 14 July 2025
2. 14 October 2025
3. 14 January 2026
4. 14 April 2026

Contributed by Malcolm Greenbaum

VAT and indirect taxes

Services provided by cosmetic clinic (Lecture B1386 – 18.49 minutes)

Summary - Supplies of aesthetic, skincare and wellness treatments did not constitute medical care, making them standard rated.

Dr Shotter holds a number of medical degrees, including an MBChB in medicine and surgery from the University of Leeds. She is registered with the GMC. She was training to become an anaesthetist, but in about 2012, she decided to focus on what she called 'aesthetic medicine'. Initially, she traded as a sole trader, treating patients from her own home, and through three salons. During this time, she was also working for the NHS.

In 2014, she set up Illuminate Skin Clinics Ltd and registered for VAT. Through this company she ran her private clinic offering a range of aesthetic, skincare and wellness treatments, including fat freezing, thread lifts, chemical peels, fillers, facials, intravenous drips and boosters.

Following a visit by HMRC in February 2019, HMRC:

- concluded that the company's supplies were standard rated and not exempt;
- rejected the company's February 2017 VAT repayment claim;
- raised a best judgment assessment for underpaid output VAT.

Following a statutory review, the company appealed to the First Tier Tribunal arguing that its supplies fell within Item 1, Group 7 Schedule 9 VATA 1994 as the exempt provision of medical care by a person on the register of medical practitioners.

There was also a dispute as to whether the appeal extended to Item 4 as the "The provision of care or medical or surgical treatment and, in connection with it, the supply of any goods, in any hospital or state-regulated institution".

Decision

The First Tier Tribunal found that the dispute was to be resolved only with reference to Item 1. The Tribunal stated that:

- the grounds of appeal only made reference to Item 1 only; and
- item 4 required a state-regulated institution. The company's premises were registered with the Care Quality Commission but only from August 2018, after the period 12/16 being considered in this case.

It was accepted that Dr Shotter was on the register of medical practitioners, which meant that the only point in dispute was whether the company's supplies constituted 'medical care'.

The First Tier Tribunal stated that the term medical means 'diagnosing, treating and, in so far as possible, curing diseases or health disorders.'

Illuminate Skin Clinics Ltd treatments were being supplied for cosmetic rather than medical reasons within the proper meaning and effect of the legislation. It was possible that the treatment might also improve the self-esteem and self-confidence of a person, but the clients had not been referred to the clinic on the grounds of helping to treat mental health issues.

The supplies should have been standard rated.

The appeal was dismissed.

Illuminate Skin Clinics Ltd v HMRC (TC08846)

No time-to-pay arrangement in place (Lecture B1386 – 18.49 minutes)

Summary – Paying VAT via the National Direct Debit Service *did not change the statutory VAT due date. With no Time to Pay arrangement in force, the default surcharge penalty was valid.*

W. W. M. Rose & Sons Ltd is a wholesaler of agricultural machinery, equipment and supplies. The company submits VAT returns on a quarterly basis and normally settles the VAT due through the National Direct Debit Service.

On 12 March 2021, a Surcharge Liability Notice was issued to the company for failing to pay the VAT due for its 01/21 VAT return on time, giving a surcharge period of 12 March 2021 to 31 January 2022.

This case concerned the company's return and payment for its 01/22 return. The due date for the VAT return and payment was 7 March 2022.

- The company's VAT return was received by 7 March 2022, showing VAT due of £96,802.73;
- VAT for the period was paid via the National Direct Debit Service on multiple dates, but after the due date.

The company was issued with:

- a default surcharge on 17 March 2022, calculated as 2% of the outstanding VAT that was due for that period;
- a Surcharge Liability Notice of Extension, notifying that the surcharge period was extended until 31 January 2023.

However, the company believed the due date of payment for the period 01/22 was 10 March 2022, as HMRC allow three days additional days for direct debits to clear. On that date, one of the directors had telephoned HMRC's VAT helpline to advise of the difficulty in paying VAT on time and sought to agree a Time to Pay arrangement. He took this conversation to mean that a Time to Pay arrangement had been agreed. On this basis, the company believed that no surcharge penalty should have been charged.

Decision

The Tribunal stated that one of the conditions for cancelling a surcharge penalty was where a Time to Pay arrangement had been agreed by the normal payment date.

Legislation states that a VAT return and payment is due one month after the end of the VAT period but that this is extended by seven calendar days if the return is submitted electronically. In this case, the relevant date was 7 March 2022. The Tribunal confirmed that where payments are collected via the National Direct Debit Service, HMRC do allow three days for direct debit payments to clear but that the due date remains unchanged.

Due to cashflow problems the year before, the company was already within the default surcharge regime and so should have known that a subsequent default would result in penalties. As no Time to Pay arrangement was in force by 7 March, the default surcharge was validly issued. In fact, even if the due date had been 10th March 2022, no Time to Pay arrangement had been put in place by that date.

W. W. M. Rose & Sons Ltd v HMRC (TC08830)

Free personal protective equipment (Lecture B1386 – 18.49 minutes)

Summary - Input tax relating to obtaining BSI approval and a CE mark for the product was recoverable in full, while input tax claimed relating to general overheads and manufacturing costs was to be apportioned between that incurred for non-business and business purposes.

On 26 March 2020, 3D Crowd CIC was incorporated as a community interest company (CIC). The company was used to enable a group of individuals with access to 3D printers to produce personal protective equipment (PPE) in the form of protective face shields to be used during the COVID pandemic.

The company wanted to be able to sell the face shields to the NHS, but without BSI approval and a CE mark for the product, this was not possible. While accreditation was being sought, the company decided to donate masks to the NHS and give them away for free to care homes and other medical institutions. To fund their activities, the company raised £150,000 from public donations through a "Go Fund Me" account.

Given its intention to make taxable supplies, the company registered for VAT and HMRC accepted this had been done correctly.

By the end of May 2020, the company had enlisted many thousands of volunteers and over 200,000 face shields had been donated to the NHS and care homes.

Unfortunately, by the time that accreditation was received in September 2020, demand for PPE had diminished, resulting in no supplies for consideration.

The company sought to recover VAT in its return for the period 08/20. This related to costs incurred:

- in connection with seeking accreditation which was only achieved on 21 September 2020);
- on general overheads;
- on materials bought to produce face masks.

HMRC accepted that the company was properly registered for VAT but stated that by giving away all the PPE it produced, the VAT incurred was not linked to taxable supplies and so is not deductible. HMRC's decision was contained in a review letter dated 24 November 2020.

Any appeal by the company should have been made within 30 days of the date of the review letter but was out of time when made on 22 January 2021. However, HMRC did not object to the Tribunal allowing the out of time appeal. The Tribunal stated that HMRC were at pains to make it clear that they sympathised with 3D's position and were aware of the importance of their actions. Sadly, they were bound by the legislation.

Decision

The First Tier Tribunal stated that it was "3D's task to establish (to the ordinary civil standard of the balance of probabilities) their right to deduct the VAT in question as input tax."

The First Tier Tribunal found that the company was a taxable person, accepting that its intention was to make taxable supplies once accreditation had been granted.

The Tribunal moved on to consider whether there was a sufficient link between the input tax being claimed and the future taxable supplies that would be made.

The First Tier Tribunal found that the VAT incurred:

- in obtaining the company's accreditation as a supplier was recoverable in full;
- on general overheads and manufacturing costs was to be apportioned between that incurred for non-business and business purposes.

The Tribunal stated that:

- some of the donated items could be treated as samples for securing future contracts, so enabling VAT recovery on a proportion;
- unfortunately, the large volume of gifted masks meant this argument could not be applied across the board;
- apportionment should be agreed between the parties with encouragement to take a pragmatic approach given the circumstances.

3D Crowd CIC v HMRC (TC08837)

Overstated input tax claims (Lecture B1386 – 18.49 minutes)

Summary – Having failed to produce the required evidence to support the input tax claims, the Tribunal found HMRC's assessment and related penalties were correct.

Adekunle Omisakin-Adeyela was the director and owner of Coonley Trading Ltd, *a* plumbing and drainage, heating and plumbing contracting franchise.

The company registered for VAT on 5 April 2017.

Having submitted VAT returns for the period 1 August 2017 to 31 July 2019 showing a combined deficit between gross outputs and inputs of £154,862.70, HMRC wrote to the company to arrange a visit to check the company's records.

On arrival, HMRC were told that the VAT records were held in storage. This was despite having specifically requested that the company's records for the periods from 1 August 2017 to 31 July 2019 should be available at the visit. The director declined an offer of assistance to retrieve the records citing health and safety as a reason as there was heavy equipment within the unit. Instead, two weeks later, he informed HMRC that he had visited the storage unit but was "unable to locate the laptop and the relevant paperwork therein". He said that he was considering closing the company due to continuing financial losses.

The director was unable to provide tax invoices to support many of the company's input tax claims and so HMRC issued:

- an assessment for £25,272, which was later reduced to £11,400;
- a separate penalty for £7,281 for 'deliberate not concealed' behaviour which was transferred to the director by issuing a personal liability notice.

Both the company and the director appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal case report stated that HMRC gave the director every chance to support the input tax claims but that evidence was not forthcoming.

Where evidence was lacking or the purpose of an expense was unclear HMRC had, in many cases, given the company the benefit of the doubt.

Having supplied no evidence to support the claimed capital that was introduced to fund the loss-making business, the Tribunal found that it was reasonable to conclude that the company 'did not have the funds to make the alleged purchases'.

The First Tier Tribunal found that HMRC's assessment was correct. Further, the behaviour leading to the inaccuracies on the VAT returns arose due to the director's deliberate behaviour. Consequently, the penalties had been correctly calculated and were upheld. Finally, the decision to issue the director with a Personal Liability Notice, making him liable to pay 100% of the VAT penalty, was correct.

The appeal was dismissed.

Coonley Trading Ltd and Adekunle Omisakin-Adeyela *v HMRC (TC08828)*

Unoccupied hotel rooms in Mauritius

Summary - The UK's Privy Council held that a Mauritian hotel operator was obliged to account for VAT on rooms paid for in advance by travel operators which ultimately went unoccupied.

This is an unusual case in which an appeal relating to the tax system of a Commonwealth country is heard by the UK's Privy Council as the highest court of appeal.

Although the case relates to the Mauritian VAT code, it will be of interest to UK practitioners because it was heard by a panel of senior UK judges and because all sides agreed that the terms of the Mauritius VATA 1998 should be construed in line with the corresponding provisions in the UK's VATA 1994.

Blue Lagoon Beach Hotel & Co Ltd (Blue Lagoon) operated a hotel in Mauritius. It entered into one-year contracts with travel operators who reserved and paid for rooms in advance which they could then sell on to their clients.

When Blue Lagoon received money from a tour operator, but no client ultimately arrived at the hotel, this income was treated as 'special income'. Blue Lagoon took the view that this special income was not consideration for any supply of services and therefore no VAT was chargeable.

The Mauritius Revenue Authority and the Assessment Review Committee (ARC) of Mauritius disagreed with this approach, contending that the special income nonetheless represented consideration for a supply of services and was therefore subject to VAT.

Decision

Analysing the key UK and EU case law relevant to retained deposits, including Air France-KLM v Ministère des Finances et des Comptes publics (Cases C-250/14 and C-289/14) and Société Thermale d'Eugénie-les-Bains v Ministère de l' Économie, des Finances et de l'Industrie (Case C-277/05), the Privy Council concluded that the ARC was correct to find that the service provided by Blue Lagoon to the tour operator was the reservation of accommodation which the tour operator could confidently sell onto its clients. This was rightly subject to VAT.

The Privy Council observed that the fact that there was a tripartite arrangement and no direct relationship between Blue Lagoon and the end client did not affect the nature of the services offered.

Blue Lagoon Beach Hotel & Co Ltd [2023] UKPC 24

Adapted from the case summary in Tax Journal (14 July 2023)