Tolley®CPD

December 2016

Disclaimer

Tolley CPD takes every care when preparing this material. However, no responsibility can be accepted for any losses arising to any person acting or refraining from acting as a result of the material contained in these notes.

All rights reserved. No part of these notes may be reproduced or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written permission of Tolley CPD.

Tolley® Tax intelligence from LexisNexis®

Contents

Autumn statement (Lectures P986/ B986 – 13.06/ 11.38 minutes)	**4**
Personal Taxes	**18**
Tax treatment of care home fees paid by a company	18
Late application for enhanced protection	19
Discretionary bonus and SMP	19
Was the taxpayer a self-employed partner or an employee?	20
Creating a loan account for pension contributions? (Lecture P987 – 6.41 minutes)	21
High income taper for pension relief (Lecture P988 – 9.49 minutes)	22
Capital Taxes	**25**
CGT and a forfeited deposit (Lecture P989 – 12.23 minutes)	25
SDLT – Sum of lower proportions (Lecture P990 – 18.12 minutes)	26
Administration	**31**
Does the UK government have the power to trigger article 50?	31
Permission to appeal against a construction industry scheme penalty	32
Late filing of stamp duty land tax form – Christmas post	32
Penalty for not filing RTI return	33
Reliance on professional advice	34
Opting out of cost-shifting regime	35
Validity of a discovery assessment	35
Statutory records	36
Partner payment notices	37
HMRC's change of policy and costs	38
Same evidence may serve more than one purpose	39
HMRC Deadline Dates	**41**
HMRC News	**42**
Eclipse may cost its investors dear	42
Updated code of conduct will discourage number of avoidance schemes	42
Taskforce launches criminal and civil investigations into Panama Papers	43
Making Tax Digital	45
Digital tax should not be a burden to businesses	47
Tax-Free Childcare: Top things childcare providers should know	47
Consultations	49

Business Taxation 50
Relevance of an application to rectify a deed of trust 50
Employer pension contributions (Lecture B987 – 11.51 minutes) 50
Donations by a subsidiary to its parent charity (Lecture B988 – 13.20 minutes) 52
Corporation tax loss relief reform (Lecture B989 – 20.49 minutes) 54

VAT 58
Lack of export documents 58
Transactions concerned with VAT fraud 58
Liability to register for VAT 59
Was internet provider of hotel accommodation acting as agent or principal? 60
Are subsidiaries of a non-profit making entity eligible bodies? 61
Hire purchase supplies and bad debt relief 62
Was a car available for private use? 64
Change to pre-registration input tax 64
Development in phases and the capital goods scheme 66
DIY building scheme and occupation restrictions 66
Input tax claims on new cars (Lecture B990 – 10.32 minutes) 67

Autumn statement (Lectures P986/ B986 – 13.06/ 11.38 minutes)

The Chancellor of the Exchequer, Philip Hammond, delivered his first Autumn Statement speech to the House of Commons on 23 November 2016. This is the first such announcement since the UK voted to leave the EU in June's referendum.

Interestingly, Mr Hammond announced reforms to the tax policy-making process which means that this would also be his last Autumn Statement. There will be two Budgets in 2017, the first being the usual Budget in the Spring, and a second in the Autumn. Thereafter, there will only be one major fiscal announcement each year, in the Autumn. A Spring Statement will be made from 2018 onwards and Mr Hammond has confirmed that this is unlikely to contain major fiscal changes, unless particular matters need to be addressed prior to the Autumn Budget.

Going forward, Finance Bills will be introduced following the Autumn Budget. Under the new process, it is expected that the Bills will receive Royal Assent before the start of the tax year, which is earlier than under the current process.

Documents relating to the Autumn Statement are available on the GOV.UK website. Further information will be available when the 'Overview of legislation in draft' is published alongside draft Finance Bill 2017 on 5 December 2016. Explanatory notes, tax information and impact notes (TIINs), and responses to consultations will also be published on this date.

Personal tax

Personal allowance and income tax higher rate threshold

George Osborne had announced in Summer Budget 2015 that, by the end of the Parliament, the Government would raise the personal allowance to £12,500 and the higher rate threshold to £50,000. As a step towards this, in 2017/18 the personal allowance will be £11,500 and the higher rate threshold (personal allowance plus the basic rate band) will be £45,000. Once the personal allowance reaches £12,500 it will be up-rated in line with CPI.

Scottish taxpayers

When considering the personal allowance and higher rate threshold, it is worth bearing in mind that the Scottish Government has the right to set its own tax rates and thresholds which apply to income which is not savings or dividends.

It is expected that it will begin exercising this power from April 2017 and it has said that the "higher rate threshold...will be raised in line with inflation (and by no more than inflation) in the following years".

Based on the Chancellor's announcement, this will mean that the Scottish taxpayers will be subject to different thresholds depending on the type of income (as the higher rate threshold which applies in the rest of the UK will also apply to the savings and dividend income of Scottish taxpayers). It is also a potential trap for advisers when dealing with Scottish clients.

Note that the Scottish Budget takes place on 15 December 2016 and should contain details of the income tax rates and thresholds that will apply to Scottish taxpayers from 2017/18.

National living wage (NLW) / National minimum wage (NMW)

The Chancellor announced that the NLW, which applies to all employees aged 25 or older, will increase to £7.50 per hour from 1 April 2017. The NLW, which is effectively the highest rate of NMW, is currently set at £7.20 per hour.

The other rates of NMW will also go up in April 2017. The changes in all NMW and NLW rates are as follows:

		Current hourly rate	Hourly rate (1.04.17)
Workers 25 and over	NLW	£7.20	£7.50
Workers 21 and over	NMW: standard adult rate	£6.95	£7.05
18-20 year olds	NMW: youth development rate	£5.55	£5.60
16-17 year olds	NMW: young workers rate	£4.00	£4.05
Apprentices	NMW apprentice rate	£3.40	£3.50

Of these, the increase to the NLW is likely to have the biggest impact, as employers used to paying staff at the current rate will not only have to fund an additional 4% on their paybill but will also, in most cases, have to pay employer's NIC on the uplift too.

There is to be a further £43 million made available to HMRC to strengthen its NMW enforcement activity in parallel with additional support for small businesses and an awareness campaign.

PAYE and Class 1 NIC

There has been a certain amount of speculation as to whether PAYE and Class 1 NIC could be aligned to simplify matters for employers, stimulated by the work done by the Office of Tax Simplification (OTS) on that topic. In the Autumn Statement, the Chancellor has picked up on a couple of the more minor recommendations made by the OTS:

- from 5 April 2017, the primary and secondary thresholds for Class 1 NIC will be permanently aligned - the figure for 2017/18 will be £157 per week
- the debt recovery period for NIC is to be aligned with that for income tax as from April 2018, by removing NIC from the effects of the Limitation Act; HMRC will consult on the details of this proposal

However, the Chancellor stopped short of full reform to achieve full alignment between PAYE and Class 1 NIC which would have meant Class 1 NIC moving to an annual, cumulative basis. In a letter to the OTS he explains his view that such a change would represent a major upheaval for employers and the time is not right for such a major reform.

Company cars

As is usual in an Autumn Statement, the Chancellor gave an indication of what the 'appropriate' percentages will be for company cars several years from now, in 2020/21. It is not unknown for these rates to change before they come to be applied in practice but the headline is that new lower bands will be introduced for the cars with the lowest levels of CO_2 emissions and that the appropriate percentages for all other cars will increase by 1% over the 2019/20 levels.

Employee shareholder shares (ESS)

After only being in effect for just over three years, the income tax and capital gains tax reliefs in relation to ESS are being scrapped, as a precursor to the whole concept of employee shareholder status being abolished at some future point. This is in response to HMRC's findings that these reliefs are primarily being used for tax-planning purposes by wealthier employees.

ESS are shares given to an employee (or prospective employee) in exchange for giving up certain employee rights. The tax advantages associated with the award for the employee is that no income tax is charged on the first £2,000 worth of shares awarded and when the employee comes to sell those shares, there is a limited capital gains tax exemption on up to £100,000 of gains. If the employee sells the shares back to the employer, special rules ensure that the payment for them is not treated as a distribution.

The Chancellor announced that these tax advantages are being repealed for agreements entered into on or after 1 December 2016 (2 December 2016 in cases where the potential employee shareholder receives professional advice in relation to the share offer on Autumn Statement day before 1.30pm).

This change should not affect the majority of employers.

Employer-provided legal support

The Chancellor announced that from April, no employee called to give evidence in court would have to pay tax on legal support provided by their employer. There is no further detail provided, but this would appear to be an extension to the deduction in ITEPA 2003, s 346 which only applies where the employee is facing allegations made against him as holder of the employment. More detail may be available once the draft clauses for Finance Bill 2017 are published on 5 December 2016.

Salary sacrifice

Following on from the consultation held over the summer, the Chancellor confirmed that, from April 2017, salary sacrifice arrangements may only be used to achieve tax and NIC savings in the case of:

- employer pension contributions and advice
- employer-provided childcare
- cycle to work schemes
- ultra-low emission company cars

For any other tax-exempt benefits, their exempt status will be lost if they are provided in exchange for a salary sacrifice.

In the case of taxable benefits provided as part of a salary sacrifice arrangement, the law will be changed so that the employee is charged to tax on the higher of:

- the cash equivalent of the benefit as set out in the benefits code, or
- any amount of salary sacrificed in exchange for the benefit

It is worth noting that although the law will be changed as from 6 April 2017, any arrangements in place before that date can continue unaffected until 2018 (with a further extension until 2021 for existing longer term agreements covering cars, living accommodation and school fees). This means that employers should have sufficient time to renegotiate remuneration packages for affected employees.

Termination payments

In its response to its previous consultation on the simplification of the tax and NIC treatment of termination payments, HMRC has already indicated that the Government intended to make changes from 2018/19 to:

- remove the distinction between the taxation of contractual and non-contractual payments in lieu of notice (PILONs) and to make all PILONs both taxable and subject to Class 1 NIC
- retain the £30,000 threshold but to make amounts above it subject to secondary Class 1 NIC as well as income tax under s 401
- remove the foreign service exemption (except in the case of foreign service as a seafarer)
- include in the computation of any PILON an estimate of bonuses that might have accrued during the foregone notice period, computed by reference to a statutory formula

The Chancellor made a refinement to those proposals in his statement, dropping the requirement to include in the computation of PILONs any estimate of bonuses, calculating the PILON by reference to basic pay alone.

This is a welcome development as it removes a significant complication from legislation which was badged as a simplification measure.

Personal service companies (PSC)

The Government published a consultation over the summer on Off-payroll working in the public sector: reform of the intermediaries legislation. That consultation proposed that where a PSC provides the services of a worker to a public body, such as a Government department, NHS trust or local authority, it should be that public body that should be responsible for deciding whether the intermediaries legislation (also known as IR35) should apply. If it finds that the rules should apply then it would also have to pay to HMRC the tax and National Insurance on the deemed employment payment, deducting those amounts from the amount it pays to the PSC.

The Chancellor has now settled a question that was left open in that consultation - he has decided that the public body should not be allowed to deduct the normal 5% flat rate deduction from payments for the worker's services in computing the deemed employment payment. The IR35 rules remain unchanged for cases where the worker's services are provided to a private sector business.

Pension investment and flexibility

The pensions reform introduced in 2014 has opened up some additional opportunities to recycle pension investment. It is possible for members of defined contribution (DC) schemes to withdraw income from a flexi-access drawdown fund and re-invest it, thus obtaining tax relief a second time.

If, for example, a member withdraws £40,000 from his uncrystallised fund, 25% is tax free and the balance of £30,000 is transferred to a flexi-access drawdown fund. If income is drawn from that fund, subject to tax, and gradually reinvested as a new pension contribution, the taxed income will attract further tax relief and replace the £30,000 originally withdrawn. 25% of the replaced pension may again be withdrawn tax free. Each pension contribution receives tax relief at 20% or 40%, but when it is withdrawn it is only taxed at an effective rate of 15% or 30% because of the tax free element. Over time, repeated recycling gradually shifts funds from the taxable fund to the tax free fund.

Recognising this unintended advantage of pensions flexibility, a limit of £10,000 per annum was placed on the amount that can be invested in a pension once income has been drawn from the flexi-access fund. This restricted amount is termed the Money Purchase Annual Allowance (MPAA).

The proposal in the Autumn Statement is to reduce the MPAA to £4,000 with effect from April 2017.

A consultation has been published indicating that the government wants to pitch the MPAA at a level which will minimise recycling of pension savings but not prejudice the success of auto-enrolment. At the same time, it is acknowledged that some groups of people may need to access their pension savings in certain circumstances, for example if they are made redundant. They would then re-build the pension fund when they are able.

Statistics quoted in the consultation indicate that only 3% of individuals aged over 55 make DC pension contributions of more than £4,000 a year.

It should be noted that the MPAA, whether at the current level of £10,000 or the proposed lower level of £4,000, is only triggered when a pension scheme member draws income from a flexi-access drawdown fund. It is **not** triggered if:

- the member uses only the tax free lump sum and does not draw income from the taxable portion of the fund
- the member's fund is still held under the former 'capped drawdown' arrangement and his withdrawals of income do not exceed the capped amount. (If the cap is exceeded, the drawdown fund automatically converts to flexi-access in any case)

Provided that members can keep their withdrawals within these limits, the standard annual allowance of £40,000 applies.

Pension scams

The increased freedom to draw on pension savings, whilst welcomed by many, has inevitably led to an increase in people being defrauded of their savings or being persuaded to make unwise investments. The government will shortly launch a consultation inviting comments on options to tackle pension scams.

It had been widely anticipated that cold calling will be banned. Respondents to the consultation will have the opportunity to consider whether such a ban would be effective. Other measures to be considered relate to giving pension scheme administrators greater powers to block suspicious transfers out of the fund. There is a danger though that the increased regulation will fuel pensioners' frustration at dealing with the pension institutions, and indeed it could be seen as an excuse by the firms to limit pension freedom.

Foreign pensions

The Chancellor announced that the tax treatment of foreign pensions is to be more closely aligned with the UK's domestic pension tax regime, by bringing them fully into tax for UK residents. Further explanation was not provided but it is assumed that the rule under which only 90 percent of a foreign pension is subject to income tax will be curtailed.

Specialist schemes for those employed abroad (section 615 schemes) will be closed to new savings. Sundry other measures will be adopted aimed at removing the advantages for a UK resident of investing in a Qualifying Recognised Overseas Pension Scheme (QROPS). At the same time, the criteria for 'recognising' such schemes is to be reviewed possibly resulting in the loss of favourable status of many overseas schemes.

Life insurance bonds

HMRC documents published alongside the Autumn Statement have confirmed that legislation will be introduced to change the taxation of insurance policy gains. Disproportionate tax charges can arise when an investor makes a large partial surrender early in the life of the policy. This is because the taxable gain is based on the cash withdrawn which may not represent the economic gain.

A consultation held over the summer outlined three possible alternative ways of taxing the gain. The options are described in detail in the consultation document. Disappointingly, no announcement was made at Autumn Statement as to the choice of a particular method. The suggestion appears to be that taxpayers will have to apply to have the charge recalculated on a 'just and reasonable basis'.

It will be interesting to find out how this will work in practice. At present, most taxpayers, and indeed many advisers, do not know how the chargeable gain on a particular withdrawal is calculated: they rely on the insurance company's Chargeable Event certificate to provide the necessary details. Any element of choice in the structure of the withdrawal or the calculation of the gain would place a heavy responsibility on the company and the taxpayer.

Other consultations

Over the summer there have been a number of consultations on proposals for tax changes that would affect employers:

- Simplifying the process for PAYE Settlement Agreements
- Date for 'making good' on benefits in kind

The Chancellor did not specifically mention any developments on any of these proposals but we should have more clarity on the details when the draft legislation for Finance Bill 2017 is published on 5 December 2016.

New consultation topics

The Autumn Statement also included advance notice of consultations to be launched at the next Budget:

- a consultation on the valuation of benefits in kind for tax purposes, including living accommodation in particular
- a call for evidence on the use of income tax relief for employee's business expenses, including those not reimbursed by the employer

Capital Taxes

Inheritance tax exemption for political donations

There has been a long-standing exemption from inheritance tax for donations to political parties. A political party qualifies for the exemption if at the last general election before the gift:

- two members of that party were elected to the House of Commons
- one member of that party was elected to the House of Commons and no less than 150,000 votes were given to candidates who were members of that party

The government will now introduce legislation to extend the exemption to parties with representatives in the devolved legislatures of Scotland, Wales and Northern Ireland. In addition parties whose representatives are elected at by-elections (as well as general elections) will qualify.

The exemption will take effect from Royal Assent of Finance Bill 2017/18.

Non-domiciled individuals

Following an original announcement at Summer Budget 2015 and two consultations, the Autumn Statement confirmed that individuals will become deemed UK-domiciled if they have been UK resident for 15 of the past 20 years. For inheritance tax purposes, this is a reduction from 17 out of the past 20 years. In addition, a person who was born in the UK and had forsaken his UK domicile will become deemed domiciled again for IHT purposes on returning to the UK after a year of tax residence.

The proposed legislation has been published in outline as draft legislation for Finance Bill 2017.

The charge on UK residential property held through an offshore company or trust has also been confirmed. Such property will fall within the inheritance tax net from April 2017.

Tax administration

Making Tax Digital

The government has announced that it will publish its response to the Making Tax Digital consultations, and provisions to implement the changes announced, in January 2017.

Tax simplification

The government has requested that the OTS conducts a review on aspects of the VAT system and Stamp Duty on share transactions.

Business Taxation

Non-resident companies' UK income chargeable to corporation tax

The government will consult at Budget 2017 on the case and options for bringing 'taxable income' received by non-resident companies into the UK corporation tax regime. The policy objective is to ensure that resident and non-resident companies are treated equally in the general framework of corporation tax. Specific reference is made to the proposed rules limiting interest deductions and the use of losses which are discussed below.

The intention appears to take companies such as non-resident landlords out of the income tax regime and into the corporation tax system. It is not yet clear whether non-resident companies whose only income comprises interest or royalties will be similarly impacted.

Another unknown is whether non-resident companies newly subject to corporation tax on income will also be taxed on gains on the disposal of the rental properties. Currently, such gains are exempt unless caught by the new transactions in UK land rules which tax trading or development profits under FA 2016, ss 76-77, and apply for disposals on or after 5 July 2016.

Affected companies that are profitable and not highly geared may ultimately benefit from a lower corporation tax charge of 17% from 2020 as opposed to the current 20% income tax charge. On the other hand, loss-making and highly geared companies may suffer from the future restrictions on losses and interest deductions. Potentially, these could significantly increase the UK tax costs for the latter.

Non-resident companies and their advisers will need to monitor developments in 2017 and beyond to assess whether companies with UK source income will have new UK corporation tax filing responsibilities.

Expanding R&D tax relief

In her speech at the CBI annual conference on 21 November 2016, the Prime Minister, Theresa May, outlined the government's commitment to invest an extra £2bn a year in research and development (R&D) tax incentives by the end of this Parliament. Mr Hammond reconfirmed this during the Autumn Statement. In addition, the government announced its intention to review the current tax environment for R&D and "build on the introduction" of the above the line R&D tax credit (also referred to as RDEC). No further detail was provided but it may be an indication that the above the line credit is to be extended to small companies with the existing SME reliefs being phased out (currently a "super-deduction" or surrender of losses for a payable tax credit).

We await further detail and clarification, but in the meantime it may be sensible to review any R&D expenditure with a view to maximising claims under the current SME regime, which operates on a simpler accounting basis than the existing ATL regime for large companies.

Patent box

Specific provisions will be included in Finance Bill 2017 which make changes to the patent box regime with effect for accounting periods beginning on or after 1 April 2017. The new rules will cover the scenario where two or more companies work in collaboration on R&D projects under a cost sharing arrangement. The new provisions will ensure that companies will not be disadvantaged nor will they be able to gain an advantage by working together in this way.

It is expected that further details will be available when the draft legislation is published on 5 December 2016.

Hybrid mismatches

Legislation will be introduced to make minor amendments to the rules in FA 2016, s 66 and Sch 10 to ensure they operate as intended. The amendments will come into effect from 1 January 2017 but further details are not yet available.

Measures previously announced

Several of the items referred to in the documentation published have already been announced, and these are set out below. Mr Hammond also reconfirmed the government's commitment to the Business tax roadmap. This was first published at Budget 2016 and sets out the government's plans for taxing companies for the remainder of this Parliament and beyond.

Reform of loss relief

The government announced at Budget 2016 that restrictions would be introduced from April 2017 to limit the amount of losses that companies can use against their profits. At the same time, it was announced that there would be more flexibility in the types of profit that can be relieved by losses.

Following a period of consultation, the government has confirmed that some of the unintended consequences of the reforms will be addressed and the administrative aspects will be simplified.

Restricting interest deductions

The potential restriction on the deductibility of interest for UK corporation tax purposes has been the subject of an ongoing consultation since the OECD issued its final recommendations on tackling base erosion and profit shifting (BEPS) in October 2015.

The government confirmed that a restriction will be introduced as planned from April 2017.

The announcement confirms that the deduction available for net interest expenses will be restricted to 30% of UK taxable earnings, subject to the ability for multinational groups to deduct net interest expenses up to a higher level, based on the net interest to earnings ratio for the worldwide group. Only groups with net interest expenses of more than £2m annually will be affected.

The proposed exclusion protecting the provision of finance for public infrastructure projects will be widened. The government has also confirmed that banking and insurance groups will be subject to the new restrictions in the same way as groups in other sectors.

Substantial shareholdings exemption (SSE) reform

At Budget 2016 and as part of the Business tax roadmap, the government announced that reforms would be made to the SSE.

Following a period of consultation, it has been confirmed that the changes will apply from April 2017, which will simplify the SSE regime generally, remove the 'investing requirement', and provide a more comprehensive exemption for those companies that are owned by qualifying institutional investors. The removal of the investing requirement means that it will no longer be necessary for the disposing company or group to satisfy a test as to its own trading status. This is a welcome development as under the existing rules, a disposal by the UK subsidiary of a worldwide group requires an analysis of the activities of the entire group.

Corporation tax in Northern Ireland

For a number of years, the government has been working with the Northern Ireland (NI) Executive to pursue the introduction of an NI corporation tax rate of 12.5% from April 2018. This is subject to the government being satisfied that the finances of the NI executive are on a sustainable footing. It was announced that the NI corporation tax regime will be amended in Finance Bill 2017 to give small and medium sized enterprises trading in NI the potential to benefit from the lower rate of corporation tax. Further measures will be introduced to minimise the risk of abuse and to ensure the relevant commencement provisions are in place.

Reform of bank levy regime

It was announced at Summer Budget 2015 that the bank levy regime would be reformed, largely with a view to reducing the main rate of the levy, and restricting its application to UK rather than worldwide operations.

Now that the consultation on the reforms has concluded, the government has confirmed its intention that the relevant legislation will be included in Finance Bill 2017. There will be an exemption for certain UK liabilities relating to the funding of non-UK companies and non-UK branches. More details will also be provided when the government publishes its response to the consultation.

Museums and galleries tax relief

The government first announced that it would introduce tax relief for museums and galleries at Autumn Statement 2015. However, it was announced that the scope of the relief would be extended to include permanent exhibitions so that more institutions could benefit. The rates of relief will be set at 25% for touring exhibitions and 20% for non-touring exhibitions, capped at £500,000 of qualifying expenditure per exhibition. Relief will be available from April 2017 and will expire in April 2022 if it is not renewed.

Grassroots sports

It has been confirmed that companies will be able to receive a corporation tax deduction for contributions made to grassroots sports, as originally announced at Autumn Statement 2015. Legislation will be included in Finance Bill 2017 which will have effect from 1 April 2017.

Electric vehicles

A 100% first-year capital allowance is available for expenditure incurred in the period from 23 November 2016 to 31 March 2019 for corporation tax (5 April 2019 for income tax) on new, unused electric charge-point equipment installed solely for the purpose of charging electric vehicles. This should be a further incentive to businesses to use, or provide to employees, electric vehicles but they should be aware of the short period in which the allowance is available.

Property and trading income

As announced at Budget 2016, a £1,000 allowance will be introduced for both property income and trading income with effect from the 2017/18 tax year. Individuals with property income or trading income below £1,000 will no longer need to declare or pay tax on that income, and those with income above the allowance will be able to calculate their taxable profit either by deducting their expenses in the normal way or by simply deducting the relevant allowance from their gross income. This forms part the business tax roadmap to which the government recommitted in this Autumn Statement.

Partnership taxation

Following consultation, draft legislation will be published which aims to clarify some aspects of partnership taxation, in particular in relation to profit allocations.

The government is aware that some of the existing rules are unclear or produce an inappropriate outcome and wishes to make both the calculation and reporting of profits simpler. This could result in a welcome reduction in compliance time and costs.

Abolition of Class 2 NIC

Clarification has been provided that the self-employed will access contributory benefits through Class 3 and Class 4 NICs following the abolition of Class 2 NICs from April 2018. Those with income below the Small Profits Limit will need to pay Class 3 NICs to access Contributory Employment and Support Allowance, and support will be given to such individuals during the transition. Currently Class 3 weekly rates are much higher than Class 2 rates so this will be an added cost. All self-employed women will still be able to access the standard rate of Maternity Allowance.

Incorporation

The Chancellor noted in his speech that the Office for Budget Responsibility has highlighted the growing cost to the Exchequer of incorporation as tax revenues are eroded. The government will therefore be considering how to ensure that the taxation of different ways of working is fair between different individuals, and sustains the tax-base. They will consult in due course on any proposed changes.

Disguised remuneration schemes

The government announced that the existing disguised remuneration rules are to be extended to tackle schemes entered into by the self-employed. Disguised remuneration schemes are artificial arrangements that usually involve an individual's income being funnelled through a third party, with the money often then being paid to the individual as a 'loan' that is never repaid. There is no further detail provided and indeed no clarification as to whether the new rules will follow those set out in the original consultation document. However the self-employed should review their contracts and documentation to ensure that any genuine commercial transactions may not inadvertently be caught by these rules.

Employers will also be denied tax relief for an employer's contributions to such schemes, unless tax and NICs are paid within a specified period (as yet unspecified), in order to deter them from using disguised remuneration schemes.

VAT

New FRS rate

In order to tackle abuse of the VAT Flat Rate Scheme, a new 16.5% VAT flat rate will apply from 1 April 2017 for businesses with limited costs.

Any business defined as a limited cost trader may not use a different rate beyond 1 April 2017. An easy-to-use online tool will be provided to help businesses determine whether they should use the new rate.

It is likely to apply to many labour-only businesses as the VAT inclusive expenditure on goods must be less than 2% of VAT inclusive turnover in a prescribed accounting period, or greater than that but less than £1,000 per year. Businesses using, or thinking of joining, the Flat Rate Scheme, must determine by 1 April 2017 whether they are a limited cost trader.

Following consultation a new and more effective 30% penalty for VAT fraud will be implemented following Royal Assent of Finance Bill 2017. It will be applied to businesses and company officers when they knew or should have known that their transactions were connected with VAT fraud.

VAT grouping

The government has stated that it intends to consult on VAT grouping but has not provided details at this stage.

Tax avoidance and evasion

Tackling exploitation of the VAT relief on adapted cars for wheelchair users

Currently it is possible for the supply of a specially adapted vehicle to certain individuals to be zero-rated if certain conditions have been satisfied. The government has become aware that this legislation is being abused and have announced that they intend to clarify the application of the VAT zero-rating for adapted motor vehicles to stop the perceived abuse.

Hidden economy and money service businesses

The government announced that it intends to introduce legislation that will extend HMRC's data-gathering powers to money service businesses in order to identify those operating in the hidden economy.

Tackling the hidden economy

The government will, following consultation, consider whether it would be appropriate to make access to licences or services for businesses conditional on the business being registered for tax. It is also intending to develop proposals that will strengthen sanctions for businesses who repeatedly and deliberately participate in the hidden economy. Further details will be included in Budget 2017.

Updating the VAT Avoidance Disclosure Regime

As announced at Budget 2016, following consultation, legislation will be introduced in Finance Bill 2017 to strengthen the regime for disclosure of avoidance of indirect tax. Provision will be made to make scheme promoters primarily responsible for disclosing schemes to HMRC and the scope of the regime will be extended to include all indirect taxes. This will have effect from 1 September 2017.

A penalty for participating in VAT fraud

Previously announced in Budget 2016 and following consultation, the government will introduce legislation in Finance Bill 2017 to implement a new and more effective penalty for participating in VAT fraud. It will be applied to businesses and company officers when they knew or should have known that their transactions were connected with VAT fraud. The penalty is intended to improve the application of penalties to those facilitating organised VAT fraud. The new penalty will be a fixed rate penalty of 30% for participants in VAT fraud. The new legislation will be implemented following Royal Assent of Finance Bill 2017.

Power to examine and take account of goods at any place

The government has stated that legislation will be introduced in Finance Bill 2017 to extend the current customs and excise powers of inspection. This will amend the Customs and Excise Management Act 1979 (subscription sensitive) and enable officers to examine goods away from approved premises such as airports and ports, to search goods liable for forfeiture and open or unpack any container. This will take effect from Royal Assent of Finance Bill 2017.

Personal Taxes

Tax treatment of care home fees paid by a company

Summary – The FTT found that care home fees paid by a family company were a benefit in kind for the appellant's father rather than her personally.

A family company paid the care home fees of Mrs B, whose daughter (the taxpayer) was an employee and husband was majority shareholder and managing director. HMRC said the taxpayer had contracted personally with the care home but the company met her liability to pay the fees, and so a taxable benefit arose on her. The taxpayer said she had contracted as agent for the company and the benefit was taxable on her father.

The questions for the First-tier Tribunal were:

- whether the husband had authorised the company to pay the care home fees;
- whether he had authorised the taxpayer to act as agent; and
- if so, whether she was acting in that capacity when she signed the contract.

Decision:

The tribunal judge said, from the facts, the husband was involved in the company's finances and was 'clearly aware' the payments were made. Further it was 'inconceivable' that the taxpayer would have paid the care home fees from the company without having been told to do so by her father. She knew that he had checked the company cashbook and bank account, but he was in control of the business and she followed his instructions.

On the taxpayer's authority as agent of the company to sign the contract with the care home, the judge said the evidence showed that the care home had known and accepted she was acting in this capacity. Therefore the contract was between the care home and the company. As a result of the company paying the fees, these sums were a benefit provided for a member of the employee's family under s201 ITEPA 2003. The question was, who bore the liability?

Referring to *Vestey v CIR* [1980] STC 10, the judge said it was clear that HMRC did not have a discretion as to which employee to tax. This was a matter for parliament. Neither do employers have that discretion. She accepted the proposition that s701 ITEPA 2003 provided a hierarchy with spouse at the top, followed by parent. It followed, therefore, that the benefit for the care home fees was taxable on the husband, not the taxpayer. The taxpayer's appeal was allowed.

Comments - In the absence of any specific rules for which of two employees was liable for a benefit in kind in this case, the FTT interpreted the definition of 'members of a person's family or household' in s721 ITEPA 2003 as a hierarchy with the 'spouse' at the top and 'guest' at the bottom. As 'spouse' also came before 'parent', the FTT held that the benefit in kind arising from the comapny's payment of care home fees was taxable on Mr Baylis, not on Ms Baylis. This approach does not however entirely resolve the question in all situations: for example where a benefit is provided to a third party whose two children work as employees of the same employer. However, as the FTT concluded 'that is a matter for another day'.

S Baylis v HMRC TC5454

Late application for enhanced protection

Summary – The First-tier Tribunal decided that the taxpayers did not have a reasonable excuse for the late notification of their claims for enhanced protection of their pensions against the lifetime allowance charge

The taxpayers were trustees of the RY pension fund. They made late applications for enhanced protection of their pensions against the lifetime allowance. The deadline had been 5 April 2009. HMRC refused. They appealed, saying they had a reasonable excuse because they had relied on a pensions adviser who was expected to make the application on their behalf.

Decision:

The First-tier Tribunal said it had been reasonable for the taxpayers to rely on their adviser because the pension issues were complicated and the application for enhanced protection required technical computations on the valuations of pensions. However, given that they were concerned about the service supplied, they had done too little to ensure the matter was being dealt with.

Further, they sacked the adviser because they were unhappy with the service but, even though they were aware of the April 2009 deadline, they did nothing about the application for ten months 'on an unfounded assumption' it had been made.

The taxpayers did not have a reasonable excuse for the late application. Their appeal was dismissed.

Comments - The taxpayers in this case attempted to rely on the FTT case of *Irby* in 2012 (TC1979), in which Mr Irby successfully appealed against HMRC's refusal to consider a late application for enhanced protection. But the FTT found that the crucial distinction between this case and *Irby* was that Mr Radley and Mr Gibbs were aware of the deadline for applications of 5 April 2009.

C Radley and A Gibbs v HMRC TC5417

Discretionary bonus and SMP

Summary - The FTT found that it was correct to include a discretionary bonus paid to a pregnant employee when determining her 'earnings related rate' of SMP.

Ms Sexton became pregnant whilst employed by Campus Living. Her employment ended on 26 December 2014 and her baby was born on 5 February 2015. The stated reason for the termination of Ms Sexton's employment was redundancy. Ms Sexton commenced a claim against Campus Living for unfair dismissal and pregnancy discrimination and the claim was compromised, without admission of liability.

Campus Living contended that the amount of SMP had been wrongly calculated, in that a discretionary bonus paid to Ms Sexton in October 2014 should not have been taken into account in calculating the 'earnings related rate' of SMP payable for the first six weeks. It argued that this was an annual payment relating to the previous year and so could not be part of Ms Sexton's 'normal weekly earnings'. Campus Living also considered that Ms Sexton's right to SMP was taken into account in arriving at the payment made under the settlement agreement, so that she had already received a payment in respect of SMP and had no further entitlement.

Decision:

The FTT held that the SMP calculation was 'purely arithmetical': 'One takes the earnings in the relevant period (which in this case includes the bonus) and then calculates the weekly equivalent of that amount.' There was no requirement for the pay during the relevant period to be 'normal' in the sense of the usual amount.

Finally, the FTT found that Ms Sexton could not contract out of her entitlement to SMP. Consequently, and although the settlement agreement purported to be in full and final settlement of all her claims, Ms Sexton was still entitled to SMP.

Comments: It is crucial that the correct computation of SMP is performed. This case has confirmed that the payment of a bonus, although discretionary, during the relevant period may have the effect of significantly increasing the amount of SMP due in the first six weeks of a maternity leave.

Campus Living Villages UK v HMRC TC5466

Was the taxpayer a self-employed partner or an employee?

Summary –First-tier Tribunal found that the appellant was an employee and not a self-employed partner.

The proprietor of Karate World set up the business as a partnership with several employees as partners, of whom the taxpayer was one. From 2003, the partnership submitted partnership returns showing the taxpayer as a partner and he submitted self-assessment returns as a partner and claimed overlap relief. He did not complete the employment pages.

After an enquiry, HMRC amended his 2010-11 return because the profit share declared in it did not match that in the partnership return.

The taxpayer appealed, saying he was an employee rather than a partner. He had not entered into a partnership agreement and was paid a wage and bonus according to the performance of the business.

Decision:

The First-tier Tribunal accepted the taxpayer's claim. There was 'substantial control' over when and how the taxpayer worked. The business provided the general equipment for classes, although he had to provide his own uniform and weapons. This, though, did not indicate employment or self-employment. However, he received holiday pay and sick pay, neither of which were consistent with self-employment.

The tribunal found there was no change in the relationship between the taxpayer and the business in 2003 and accepted the taxpayer's assertion that it had not been the parties' intention that he would become self-employed. The judge concluded the taxpayer was an employee and allowed his appeal.

Comments - This is an interesting reversal of the normal position where a person tries to argue that they are self-employed, said Andrew Hubbard. 'Here the taxpayer wanted to be treated as an employee. Presumably the issue concerned who had to pay the tax; by persuading the tribunal that he was an employee the taxpayer seems to have shifted the liability to his employer. HMRC may want to appeal this decision because if other people ran a similar argument there could be significant pressure on the tax base.'

R Ashton v HMRC TC5456

Creating a loan account for pension contributions? (Lecture P987 – 6.41 minutes)

A 0% starting rate applies for interest income, but only where taxable non-savings income is less than £5,000. Non-savings income includes employment income, trading income, property income and trust income.

In 2016/17 we also have the introduction of the personal savings allowance which creates a 0% rate of tax on interest up to £1,000 for basic rate taxpayers or £500 for higher rate taxpayers. Any interest income thereafter is taxed at 20%, 40% or 45% as normal.

It is therefore possible for a basic rate taxpayer to draw £11,000 salary, £6,000 director's loan interest and £5,000 dividend and pay no income tax at all. Further dividends up to the basic rate band would only attract a 7.5% rate of tax.

Given that £6,000 of interest can be extracted tax free from an OMB corporate could we lend personal money to fund pension contributions? And then charge interest on the loan to the company.

Illustration

Max draws salary of £11,000 and dividends of £32,000 from his trading company. Max also has £75,000 of personal savings in a deposit account bearing interest at < 1%.

Max decides to lend his company £25,000 at 8% over each of the next three years to enable the company to make an annual pension contribution of £25,000. The company has reasonable levels of retained profit but is not cash rich. The loan is required to pay the £25,000 pension contribution.

In year one Max now has £2,000 (£25,000 x 8%) of tax free interest from the company so he reduces his dividends by the same amount. He now draws a salary of £11,000, loan interest of £2,000 and dividends of £30,000. This gives him £43,000 of income and as a consequence is a base rate taxpayer.

Each year the interest will increase by £2,000 until it is at a level of £6,000 pa after three years. Dividends are reduced to accommodate the interest so as to remain a basic rate taxpayer. Max has restructured his income so as to reduce the effective rate of extraction

HMRC are unlikely to challenge the remuneration levels of Max i.e. salary of £11,000, pension contributions £25,000.

The £25,000 annual pension contributions secures CT relief at 20%.

After three years Max will have £75,000 invested in his pension fund plus the company owes him the £75,000. The loan of £75,000 is accruing £6,000 tax free interest at 8% every year. This is a far better return than his current 1% on his £75,000.

High income taper for pension relief (Lecture P988 – 9.49 minutes)

From 6 April 2016, the annual allowance is tapered for high income individuals. The annual allowance is reduced by £1 for every £2 of 'adjusted income' in excess of £150,000. The reduction is rounded down to the nearest £.

However, the annual allowance cannot be reduced to below £10,000, giving a maximum restriction for 2016/17 of £30,000. The maximum restriction will apply to taxpayers with adjusted income of £210,000 and above in 2016/17, giving them the minimum annual allowance of £10,000.

Illustration – Basic Taper

Bill is a high income individual with adjusted income of £180,000. His annual allowance will be tapered to £25,000 as follows:

	£
Adjusted income	180,000
Less:	(150,000)
Excess Income	30,000
Restriction (30,000/2)	15,000
Annual allowance	40,000
Less: Restriction	(15,000)
Tapered annual allowance	25,000

An individual is a 'high income individual' for 2016/17 if they have 'threshold income' over £110,000 and 'adjusted income' of over £150,000. The limit for threshold income is arrived at by taking £150,000 and deducting the amount of the normal annual allowance.

'Threshold income' is net income for tax purposes less the gross amount of any pension contributions for which basic rate tax relief has been given at source.

If the individual's income has been reduced by any salary sacrifice arrangements or flexible remuneration arrangements designed to swap employment income for pension provision, then the amount of the reduction must be added back in arriving at threshold income. This applies where the arrangement was entered into after 8 July 2015.

So, where an individual's taxable income before personal allowances but after deducting the gross amount of personal pension contributions paid does not exceed £110,000, the tapering provisions will not apply and there is no need to calculate the individual's adjusted income.

If threshold income does exceed £110,000, the tapering provisions will only apply where 'adjusted income' exceeds £150,000.

The starting point for calculating 'adjusted income' is also net income for tax purposes.

We then need to add the amount of any pension contributions for which the employee has received relief as a deduction in arriving at employment income.

This would be the case where the employee had made contributions to an occupational scheme under the net pay arrangements.

We also need to add the amount of any pension contributions paid by the employer.

Illustration

Mary receives a gross salary of £125,000 and has a company car with a benefit value of £5,000. She makes a personal pension contribution of £11,200 net per annum and her employer contributes £16,000 to her personal pension scheme.

Mary also receives property income (after allowable expenses) of £15,000 per annum.

In order to determine whether the tapering provisions apply, we firstly need to calculate Mary's threshold income:

	£
Employment Income (125,000 + 5,000)	130,000
Property Income	15,000
Net Income	145,000
Less: Gross personal pension contributions (11,200 x 100/80)	(14,000)
Threshold income	131,000

We deduct the gross amount of the personal pension contributions as these contributions will have received basic rate relief at source.

Mary's threshold income exceeds £110,000 therefore we need to calculate her adjusted income to see if the tapering provisions apply.

	£
Employment Income (125,000 + 5,000)	130,000
Property Income	15,000
Net Income	145,000
Add: Employer pension contribution	16,000
Adjusted income	161,000

No adjustment is needed in respect of Mary's pension contribution when calculating adjusted income as this amount has not been deducted in arriving at net income. However, we do need to add the amount of the employer contribution. As adjusted income exceeds £150,000, the tapering provisions apply.

	£
Adjusted income	161,000
Less:	(150,000)
Excess Income	11,000
Restriction (11,000/2)	5,500
Annual allowance	40,000
Less: Restriction	(5,500)
Tapered annual allowance	34,500

Anti-avoidance provisions prevent an individual from entering into an arrangement to reduce or eliminate the effect of the tapering provisions by reducing threshold or adjusted income in one year but then increasing it in another. The annual allowance is calculated as if the arrangements had not been made.

If the individual is carrying forward any unused annual allowance from a tax year prior to 2016/17, this is still available for relief in full. Taper will only apply to 2016/17 allowances onwards.

For example, if an individual has unused annual allowance of £30,000 from 2015/16 and a tapered annual allowance of £35,000 for 2016/17, his total available annual allowance for 2016/17 is £65,000.

When calculating the amount of any unused allowance to carry forward in respect of 2016/17 and later years, only the unused amounts of the tapered annual allowance can be carried forward. In other words, if the individual's annual allowance for 2016/17 is calculated as £34,000 and the individual makes a pension contribution of this amount, there is no unused annual allowance to carry forward.

Capital Taxes

CGT and a forfeited deposit (Lecture P989 – 12.23 minutes)

The Upper Tribunal decision in *Hardy v HMRC (2016)* is one which is simultaneously unsurprising to most tax practitioners but astonishing to the layman. The facts were simple. Mr Hardy had contracted to buy a flat in Roehampton off-plan, paying a 10% deposit of £72,000. When the time came to complete the purchase, he was unable to do so and, under the terms of the contract, he lost his deposit. Mr Hardy claimed that, for CGT purposes, he had made an allowable loss of £72,000 which he sought to offset against other capital gains which arose in the same tax year.

Mr Hardy had argued before the First-Tier Tribunal last year that, on entering into the contract with the developers, he had acquired beneficial ownership of the flat (which was undoubtedly an asset) and that, when the vendor rescinded the contract, he had disposed of that asset at a loss. However, in the light of the observations of two of the House of Lords judges in *Jerome v Kelly (2004)*, the First-Tier Tribunal reached the opposite conclusion with the following words:

> 'The consequence for the present appeal is clear: neither the exchange of contracts, nor the satisfaction of the condition as to construction of the houses, marked the acquisition of assets by Mr Hardy, or anybody else, because the transactions intended never took place; and, accordingly, the rescission of the contracts did not mark a disposal of assets on which either a gain or a loss could be realised. On any view of the matter therefore, the loss of the deposits cannot have been a loss capable of being allowed against chargeable gains in the same year.'

Mr Hardy was initially refused permission to appeal against this decision, but, having instructed counsel (he had previously represented himself), he advanced a new argument which he was then permitted to take forward to the Upper Tribunal.

Here the argument was subtly different: on entering into his contract, Mr Hardy had acquired valuable contractual rights (principally the right to require the flat to be transferred on payment of the purchase price). Unfortunately for Mr Hardy, this latest argument was rejected by the Upper Tribunal. The 'valuable contractual rights' and the 'beneficial interest in the property' were really no more than two ways of describing the same thing. The Upper Tribunal, too, relied heavily on the reasoning in *Jerome v Kelly (2004)* and the detailed analysis of S28 TCGA 1992 by the House of Lords. They concluded that, 'when a seller and a buyer enter into a contract for the sale of land, the seller does not dispose of an asset and the buyer does not acquire an asset'. Of course, if and when the contract is completed, the disposal is normally treated by S28 TCGA 1992 as taking place on the date of the contract. However, if the contract is never completed (as was the case with Mr Hardy), there is simply no disposal and no acquisition.

A layman who came across this case would probably be bemused. He might vaguely recall having heard it said that CGT is supposed to be a tax on real gains which makes allowance for real losses – see, for example, the words of Lord Wilberforce in *Aberdeen Construction Group Ltd v CIR (1978)*.

He might wonder whether the denial of relief to a man who manifestly made a genuine loss of £72,000 in real money sits well with the pronouncements of HMRC and the Government about the desirability of everyone paying 'the right amount of tax'.

On the other hand, a tax professional will be less concerned: the law is what it is and it is well known that this sometimes leads to odd results. He might then reflect on what would have happened if Mr Hardy had assigned his rights under the contract (assuming that they were assignable – which, in this case, they were not). We know that such rights are not assets for CGT purposes, given that HMRC and two Tribunals have just told us so. It must necessarily follow that any profit on an assignment of such rights would not arise from the disposal of an asset and would not be chargeable to CGT. Granted that, in some circumstances, a profit on the assignment of rights may be subject to income tax as arising from an adventure in the nature of trade; but this will not always be the case. And, where it is not, the logic – to invoke a familiar phrase – which cooked Mr Hardy's goose will also be fatal to HMRC's gander.

Contributed by Robert Jamieson

SDLT – Sum of lower proportions (Lecture P990 – 18.12 minutes)

From 6 April 2017, tax deductions for residential buy to let finance charges are being phased out and are being replaced by a tax reduction for such costs at the basic rate of income tax. The restriction on deductibility of interest and the replacement tax reducer will be phased in over four tax years as follows:

1. 75% deduction against rental income, 25% tax reducer for 2017/18,
2. 50% deduction against rental income, 50% tax reducer for 2018/19,
3. 25% deduction against rental income, 75% tax reducer for 2019/20, and
4. 0% deduction against rental income, 100% tax reducer for 2020/21 and following years.

This will not apply to companies with residential letting businesses and so clients with high profits are considering incorporation as a way to minimise the impact of these new rules.

Illustration

Gordon and Mavis are married and together run a large residential rental property business. They have no other taxable income. They each spend 35 hour each week managing the business.

They have not run this through a limited company due to the historical difficulty in obtaining finance for buying the rental properties through this trading medium.

They generate gross rental income of £500,000 with non-finance cost expenses of £150,000 and finance costs on fixed interest, interest-only loans of £300,000.

2016/17

Rental business profits are £50,000, apportioned £25,000 each. They can both use their personal allowances of £11,000 so each has taxable income of £14,000.

Their income tax liabilities for 2016/17 are (20%) £2,800 each a total of **£5,600**.

2020/21

Rental business profits are £350,000 (the interest is now a tax reducer), apportioned £175,000 each. They lose their personal allowances at this income level.

Assuming the Government sticks to its pledge to raise the basic rate band to £50,000 and that the additional rate of 45% still applies to income above £150,000, each will have an income tax liability of:

£37,500 @ 20%	£7,500
£112,500 @ 40%	£45,000
£25,000 @ 45%	£11,250
£175,000	£63,750
Less tax reduction: £150,000 x 20%	(£30,000)
	£33,750

The total tax liability for them both will be **£67,500**. This is on a rental profit net of the interest cost of £50,000 giving an effective rate of 135%.

The unincorporated structure of their business is not going to be effective going forward, to protect themselves from the new regime, they should consider incorporating the business.

Incorporation of a property letting business

Further tax will of course be payable on any profits extracted from the corporate structure, with the recently announced changes to dividend taxation making this more costly than before. However, where clients wish to reinvest some, or all, of their property letting profits back into the growth of the business, incorporation will nearly always be significantly more advantageous than personal ownership.

There are a number of factors that need careful analysis when contemplating a possible incorporation, eg. the administrative burden of a company and the effect which the corporate structure may have on borrowings, with banks typically charging higher rates of interest to a company. However, the tax charges that can arise on incorporation (in particular, CGT and SDLT), and the possibility of avoiding them, will often be the deciding factor.

CGT

Transferring a property portfolio to a connected company will normally give rise to a CGT charge on a deemed disposal at market value that can be an expensive exercise. However, where the rental properties have been actively managed, case law has shown that the activities can be treated as a business for CGT purposes, giving scope for reliance on the rollover relief available under S162 TCGA 1992. This requires that the business and all the business assets (other than cash) must be transferred as a going concern to the company wholly in return for shares. In this circumstance, the aggregate net gains on the properties are automatically rolled over against the base cost of the new shares. No claim is needed for relief under S162 TCGA 1992. It should be noted that this procedure gives the properties a tax uplift in the company, in view of the fact that they go into the company at current market value.

The question of whether property letting constitutes a business for CGT purposes is not entirely clear-cut but the decision in *Ramsay v HMRC (2013)* provides a pretty robust authority for treating substantive property letting activities as a business for the purposes of S162 TCGA 1992 incorporation relief. In that case, the Upper Tribunal ruled that activities ordinarily associated with the management of investment properties can be regarded as the running of a business. Furthermore, the activities must be significant, with a reasonable amount of time being devoted to property-related work. In the *Ramsay* case, the taxpayer spent, on average, 20 hours a week managing and maintaining the properties. This case shows that it is the quantity, and not the quality, of the activity that is important. It also helped that the property owner did not have any other employment or trade.

SDLT

As a general rule, there is no SDLT charge when properties are transferred to a company for no consideration. However, there is an important exception to this principle in that S53 FA 2003 imposes a market value charge if:

(i) property is transferred to a company; and

(ii) the transferor is connected with the company (S1122 CTA 2010 for the meaning of 'connected').

Given that several rental properties will often be put into the company at the same time, this is likely to involve an unacceptably high SDLT charge since they will constitute 'linked' transactions (see S108 FA 2003). At present, the maximum rate is 12% on the top slice of the value acquired by the company.

Partnerships and sum or lower proportions (SLP)

Where a partnership, or better still an LLP, exists to transfer the properties, it may be possible to eliminate the SDLT charge completely. The relevant legislation is set out in Sch 15 FA 2003 and these provisions take priority over the market value rule in S53 FA 2003 – see Para SDLTM34160 of the Stamp Duty Land Tax Manual for confirmation of this statement. The salient measure is found in Para 18 Sch 15 FA 2003 and uses the 'SLP' to determine the consideration for SDLT purposes and is calculated as:

MV x (100 – SLP)%

where:

- MV = market value of the properties transferred; and
- SLP = 'sum of the lower proportions'

The SLP definition is provided in Para 20 Sch 15 FA 2003 and involves a three-step procedure:

Step One

Identify the <u>partners</u> who are <u>connected persons</u> and who have an <u>interest in the properties after</u> the transaction (ie. through their shareholdings) – they are known as 'relevant owners'.

Step Two

For each relevant owner, find their percentage interest in the properties after the transaction.

Step Three

Add together all these percentage interests – this produces the SLP percentage.

Note that the SLP will be 100 where these partners (eg. husband and wife or mother and daughter) become the only shareholders in the new company. In these circumstances, the application of the above formula will always produce a tax rate of 0%. This is the case even if the aggregate market value of the properties transferred into the company is, say, £5,000,000.

Illustration

A husband and wife partnership is considering incorporating. The partnership ratios are husband 60%, wife 40% and this percentage is maintained in the company.

The company is connected to the husband as the husband controls the company. The connected person post incorporation owns 100% of the property i.e. the company owns 100%.

Pre incorporation the husband owns 60%. We then add the % owned by his wife pre incorporation i.e. 40%. So the pre incorporation % is increased to 100%. The lower of the pre and post %'s is 100% which will then set the SDLT consideration at £nil.

MV x (100 – 100)% = Nil

Illustration

George and Frank incorporate their partnership. George has a 60% interest and Frank has 40% and this % is maintained in the company.

The company is connected to George as he controls the company. The connected person post incorporation owns 100% of the property i.e. the company.

Pre incorporation George owns 60%. If Frank is not connected to George the pre-incorporation ownership % is 60%.

The lower of the pre and post %'s is 60% which will then set the SDLT consideration at 40% of MV.

MV x (100 – 60)%

In order for the SDLT advantage using the sum of lower proportions, the transfer must be from a partnership (or LLP). This is *not* the same as joint ownership. One key factor is likely to be whether the partners have submitted their relevant tax details on the partnership pages of a self-assessment tax return. In other words, is there a proper partnership? Although, in the past, the courts have considered a number of aspects when they have been called upon to determine whether or not a partnership exists, the three main requirements to establish the reality of such an arrangement are that:

1. there is a written partnership agreement in place;
2. there is a separate partnership bank account; and
3. the partners genuinely share both profits and losses.

It is important to realise that there is anti-avoidance legislation in S75A FA 2003 which prevents an individual who is running a property letting business on his own from forming a partnership with, say, a spouse or a brother and then incorporating that partnership in order to enjoy the SDLT benefit.

Whichever route is being considered it is important to seek professional advice.

What if incorporation is too complex/ expensive?

One option is to consider reducing the amount borrowed by selling off a property/ properties where rental yields have been low. The proceeds can be used to reduce the gearing. Paying a small amount of CGT might be cheaper than incorporation.

Another option might be to ensure that some of the properties qualify as furnished holiday lets where tax relief for finance charges will still be available and entrepreneurs' relief should be available on any eventual sale.

Administration

Does the UK government have the power to trigger article 50?

Summary - The High Court found that the secretary of state for exiting the European Union does not have power to give notice, under Article 50 of the Treaty on European Union, for the UK to withdraw from the EU.

Following the referendum of 23 June 2016 in which a majority of the UK population had voted in favour of leaving the European Union (EU), the key question was whether, the Crown, acting through the government, is entitled to give notice to the European Council, under art 50, for the UK to cease to be a member of the EU.

Decision:

The High Court stated that the most fundamental rule of UK constitutional law is that parliament is sovereign. There is no superior form of law than primary legislation, except only when Parliament has enabled this to happen. The European Communities Act (ECA) 1972, which conferred precedence on EU law, is the only example. However, even then, parliament remained sovereign, so that it retained power to repeal the ECA 1972.

The court added that the subordination of the executive government to law is the foundation of the rule of law in the UK.

The court accepted that 'another settled feature of constitutional law' is that the conduct of international relations (including the making and unmaking of treaties) is a matter for the government. The court explained, however, that this prerogative does not extend to changes to domestic law. This case is very unusual; a direct link exists between the UK's membership of the EU and the contents of domestic law, as a result of a combination of EU law principles and the terms of the ECA 1972.

The court concluded that if the UK does withdraw from the EU, directly enforceable EU rights enjoyed by UK citizens will cease to exist.

The secretary of state accepted that some EU law rights would be affected but his main argument was that Parliament had intended that a continuing condition for the existence of these EU rights on the domestic plane was the UK's membership of the EU, which depended solely upon the action of the government on the plane of international law. The court considered, however, that this contention 'was flawed' at a 'basic level', as it ignored the constitutional principle that, unless parliament legislates to the contrary, the government does not have power to vary the law of the land.

Comments – Following in the wake of the Referendum vote this case is of course high profile as it goes to the root of who can deal with Brexit and of course will have significant tax effects. The court stated: "The ECA 1972 could not be regarded as silent on the question of what happens to EU rights in domestic law if the Crown (by its government) seeks to take action to undo them on the international plane. This decision confirms that Parliament has to be involved in the Brexit process." The Government's appeal to the Supreme Court is scheduled for 5 December

The Queen oao G Miller & D Tozetti Dos Santos v The Secretary of State for exiting the European Union

Permission to appeal against a construction industry scheme penalty

Summary – The FTT refused permission for a taxpayer to appeal late against a penalty for negligently delivering returns under the CIS. Although the FTT found that the taxpayer had a good explanation for four years of the delay it found that even if the delay without good explanation was eight months it was still significant.

The taxpayer ran a property maintenance business. In October 2009, HMRC imposed a penalty of £9,254 because he had submitted incorrect construction industry scheme returns for the years 2002-03 to 2007-08. The maximum penalty was £61,698 but this was reduced initially by 80% and then, on review in May 2010, by a further 5%.

There was contact between the taxpayer and HMRC after that and, in December 2010, he was told he had nothing further to pay which he understood to mean that he was no longer liable for the penalty. That was not the case and, in November 2011, he received a demand for the penalty. Various letters followed and eventually, in May 2015, he applied to the First-tier Tribunal to make a late appeal.

Decision:

The tribunal concluded that the merits of the taxpayer's case were 'neither very strong nor conversely very weak'. On the taxpayer's argument that the penalty was unfair and disproportionate, the tribunal referred to *CRC v Hok* in 2013, in which it was ruled that it could not discharge a penalty on the ground of unfairness.

Even given the taxpayer's belief that he had nothing to pay, the delay of five years before appealing had to be considered 'in that the ability of the tribunal to administer justice is hampered when dealing with old disputes where such evidence as there is becomes increasingly stale'.

It would be prejudicial to HMRC for the tribunal to accept a late appeal when it assumed, several years ago, that the matter was closed.

The taxpayer's application for a late appeal was refused.

Comments - The FTT reached its decision on whether or not to allow the appeal out of time by considering the overriding objective and the questions set out by Morgan J in Data Select Ltd v R v& C Commrs in 2012.

R Gawthrop v HMRC TC5418

Late filing of stamp duty land tax form – Christmas post

Summary – The Tribunal found there was no reasonable excuse for the delay in filing the form

The taxpayer was late submitting a land transaction return SDLT1, as a result of which HMRC imposed a penalty. He appealed saying he had not received his solicitor's letter enclosing a copy of the form for him to sign.

He was working in Cornwall and was out of contact because he had left his phone at his mother's house in Bristol. Further, the transaction had taken place in early December and the taxpayer thought more time should be allowed given the possibility of postal delays.

Decision:

The First-tier Tribunal had the 'utmost sympathy' for the taxpayer but said he did not have a reasonable excuse for the late form. His solicitor should have been aware of the need to comply with the deadline for submission, but the primary responsibility was the taxpayer's. He could not rely on the busy Christmas period as an excuse.

The taxpayer's appeal was dismissed.

Comments – Although the First-tier Tribunal had the 'utmost sympathy' for the taxpayer but said he did not have a reasonable excuse for the late form. Deadlines are important and there are penalties for missing them.

AP Brown v HMRC TC5423

Penalty for not filing RTI return

Summary – The taxpayer did not have a reasonable excuse for not filing its return.

The taxpayer failed to file a final electronic return under real time information (RTI) for 2013-14. HMRC issued a penalty. The taxpayer appealed. Its grounds were that it employed only four people and, according to HMRC's instructions on PAYE in RTI, it did not have to submit a return online unless it had more than nine staff. It said it had asked HMRC for a paper form but did not receive one.

After it had been told about the taxpayer's appeal to the First-tier Tribunal, the Revenue wrote to the taxpayer explaining that, even though it was a business with fewer than nine employees, it had to report PAYE in real time and that a paper P35 no longer applied. HMRC added that, if the taxpayer sent the form within 30 days, it would review the penalties with a view to cancelling them.

Decision:

The First-tier Tribunal said the taxpayer's failure to submit the form had arisen because it had misunderstood the legislation on the relaxation for employers with fewer than nine employees when it read the terms on HMRC's website. However, the judge found the wording clear, saying 'there was sufficient guidance available … for [the taxpayer] to have established that the terms of the relaxation were limited'. The mistake was honest but not reasonable.

Further, HMRC had given the taxpayer the chance to rectify its mistake but it had not taken advantage of this.

The taxpayer did not have a reasonable excuse for not filing its return. Its appeal was dismissed.

Comments – Although HMRC did not need to they applied a generous regime to the taxpayer allowing extra time to deal with matters. The case demonstrates that where mistakes are made and extra time is given that must be taken advantage of or the penalties will be inevitable.

Elite Hand Car Wash v HMRC TC5431

Reliance on professional advice

Summary – The First-tier Tribunal set aside penalties for inaccuracies because the taxpayers had taken reasonable care by relying on professional advice, albeit that the advice was wrong.

The first taxpayer (AC) inherited a house from her late mother in 1988. It was let from 1998 to 2010 and was sold on 23 July 2010. For three weeks before completion, the taxpayers moved into the house. They claimed only or main residence relief for the property but HMRC refused it. When the matter came to the First-tier Tribunal the taxpayers accepted the only or main residence elections were wrong, but continued their appeal against the penalties imposed by HMRC for inaccurate returns.

They did not dispute that their returns were incorrect but said the carelessness was on the part of their adviser and therefore fell within Sch 24 para 18 FA 2007. AC said she was undergoing medical treatment when the time came to complete her return and had relied on her tax adviser to do 'a good job'. She added that she had sought advice about the capital gain on the property because she took other professional advice about claiming only or main residence relief on the disposal.

Decision:

The First-tier Tribunal was satisfied that the taxpayers were truthful witnesses and had sought advice at least twice on the capital gains liability on the sale of the house.

Referring to the decision in *Mariner* (TC3039), the judge said: 'When a person seeks appropriate professional advice from somebody who is a professed expert in the applicable discipline, it will almost always be reasonable for the person who has sought out such advice to rely upon that advice provided only that that person has selected a seemingly competent professional adviser.'

The taxpayers had taken reasonable care to avoid the inaccuracy and their appeal was allowed.

Comments - In this case HMRC suggested that one of the taxpayers had not taken reasonable care because he had not spoken directly to the professional adviser. The FTT rejected this contention, finding that it was entirely appropriate for the taxpayer to have relied upon what was reported to him by the other taxpayer, his wife, as she was the person dealing directly with the professional tax advisers. As the FTT put it '[t]hat is the reality of family life'. The FTT commented that 'the average man in the street cannot reasonably be expected to have a working knowledge of tax legislation, notwithstanding the artificial legal presumption that individuals are presumed to know the law'. Consequently reliance on professional advisers is therefore reasonable

A Carrasco and J Carrasco v HMRC TC5460

Opting out of cost-shifting regime

Summary – The FTT concluded that although it had the power to extend the time limit for serving an opt out from the costs-shifting regime it decided not to do so.

The taxpayer had several appeals waiting to be heard at the First-tier Tribunal. The 2011 and 2015 appeals had been classified as standard but the 2013 ones as complex. A cost-shifting regime applied to complex hearings and the taxpayer could apply to opt out of it.

Decision:

The tribunal confirmed to the taxpayer that it had not. The 2011 and 2015 appeals were later reclassified as complex so the taxpayer wrote to the tribunal to opt out of the cost-shifting regime in relation to those appeals and also to the ones in 2013.

The judge accepted that the letter was a valid notice to opt out for the 2011 and 2015 appeals. However, the taxpayer had put forward no good reason why it had not opted out in time for the 2013 appeals. On the taxpayer's argument that it would be difficult apportioning costs between the various appeals, the judge accepted that this may cause some difficulty but he did not see why this should preclude the taxpayer or HMRC recovering their costs from those hearings.

The judge concluded it would be 'unjust to deprive HMRC of their ability to recover costs that are yet to be incurred should they be successful in the 2013 appeals'. The time limit to opt out would not be extended.

Comments - The decision provides a useful summary of the difference between a direction ‘consolidating’ appeals and a direction that appeals be ‘heard together’, per the r.5(3)(b) Tribunal Rules. When two appeals are consolidated, they become a single appeal with a single appeal reference and lose their identity as separate appeals. This means that appeals made by different taxpayers cannot be consolidated since appeals made by different taxpayers could never be regarded as a single appeal. By contrast when appeals are directed to be heard together, they retain their identity as separate appeals even though they may be case-managed together and heard together at the same time and by the same tribunal panel. In this case, the tribunal directions referred to appeals being ‘combined, case managed and heard together by the same Tribunal’. Judge Richard’s noted that while at first sight, the use of the word ‘combined’ could appear to be suggesting that the appeals were to be consolidated, in context, it was clear that the appeals had not been consolidated.

The Aquarius Film Company LLP (in liquidation), A Cade, R Barnett v HMRC TC5434

Validity of a discovery assessment

Summary - The FTT allowed a taxpayer’s appeal against a discovery assessment in relation to a failed tax avoidance scheme because although HMRC made a discovery of an insufficiency of income tax, the insufficiency was not brought about deliberately.

Mr Tooth appealed against a discovery assessment issued by HMRC in relation to his participation in a failed avoidance scheme, the 'Romangate' tax avoidance scheme. This was on the understanding that this would lead to employment related losses being generated in 2008–09 which could then be set off against his 2007–08 income, thus reducing his tax liability for that year.

The first issue was whether, when the assessment was made on 24 October 2014, the discovery was 'stale', so that the right to make an assessment was lost.

The second issue was whether the insufficiency of tax had been brought about deliberately.

Decision:

On the first issue, the FTT noted that the threshold for a discovery was low, following *Charlton* in 2013, and included a 'change of view, change of opinion or correction of an oversight'. It added that an HMRC officer had reviewed Mr Tooth's file in the light of the decision in *Cotter* in October 2014, and had come to the conclusion that a discovery assessment should be issued. The discovery had therefore not been stale at the time of the assessment.

With regard to the second issue because of IT problems when filing his return online, Mr Tooth had entered an employment loss on the partnership pages of his return, explaining this in the white box. HMRC contended that the fact that an employment loss had been deliberately entered on the partnership pages of the return was sufficient not only for a discovery assessment to be issued but for the time limit to make such an assessment to be extended to 20 years, on the basis that the insufficiency of tax had been deliberate. The FTT robustly rejected HMRC's contention, noting that the required causal link between the insufficiency of tax and the deliberate action was missing.

Comments - The FTT noted that 'a causal link between the insufficiency of tax and the deliberate action is required and it is necessary to ask what a taxpayer has done, deliberately, to bring about that insufficiency'. Because in this case the FTT found that neither Mr Tooth, nor his advisers, were aware of the consequences of completing the tax return in the manner they did, instead of in the way they were instructed to complete it, the FTT found that there was nothing that Mr Tooth, nor his advisers, did that deliberately brought about the insufficiency of tax.

R Tooth v HMRC TC5452

Statutory records

Summary - The FTT found that due diligence material and transportation documents were statutory records for the purpose of the VAT Regulations.

This was an appeal against penalties and the issue was whether two categories of documents, due diligence material and transportation documents, required by HMRC under Sch 36 FA 2008 information notices constituted statutory records.

Decision:

The FTT observed that the term 'business and accounting records' is widely drafted in reg 31(1)(a).

It is entirely within the control of a business whether it keeps such records. It is a question of fact whether a business does in fact keep records. The FTT found that the due diligence and transportation documents, if kept by the appellant, would be kept for its business purposes (and almost certainly exclusively so), rather than for any private or personal purpose of its directors or employees. They were therefore business records.

The FTT added that records kept 'for the purpose of accounting for VAT' were not simply those that evidenced the basis of the numerical calculation to input and output tax; and they may, for instance, include documents used to defend a claim to entitlement to input tax.

The FTT also noted that the appellant had been on notice that HMRC had concerns that it had been trading in supply chains involving MTIC fraud and had been advised to keep due diligence and transportation documents to mitigate the risk of a denial of input tax. Those documents were therefore statutory records and had been reasonably required under the information notices.

Comments – We do not get many cases dealing with what are statutory records so it is useful to get judicial guidance. The FTT highlighted that the reasonableness of HMRC's request for documents should be assessed by reference to all the relevant facts.

Drinks Stop Cash & Carry v HMRC TC5459

Partner payment notices

Summary - The FTT decided that penalties issued for the late payment of partner payment notices were valid, in the absence of a reasonable excuse.

Mr O'Donnell was a member of both Ingenious Film Partners LLP and Ingenious Film Partners 2 LLP. HMRC had issued him with two PPNs. He had then written to HMRC to make representations in relation to both of them.

Mr O'Donnell was seeking to 'carry back' losses that he said had arisen from his participation in the two LLPs against taxable income in the 2001/02 and 2002/03 tax years. He contended that, because HMRC only had an enquiry open in relation to Mr Donnell's tax returns for 2004/05 and 2005/06 (and had not opened an enquiry under Sch 1A TMA 1970 into the claim to carry back the losses), it was out of time to assess him in relation to the 2001/02 and 2002/03 tax years.

In June 2015, HMRC confirmed the two PPNs by letter. Mr O'Donnell replied to HMRC in July 2015 but his letter did not reach them; and, in September 2015, HMRC issued him with penalties for the non-payment of the PPNs within the deadline.

Decision:

Did Mr O'Donnell have a reasonable excuse for the late payment of the PPNs and the validity of the penalties issued by HMRC? The FTT accepted that the *De Silva* case, which the Supreme Court was scheduled to hear, was relevant to the 'underlying assessment'. However, parliament had given HMRC power to issue PPNs precisely in 'cases such as this'.

Furthermore, parliament had also made it clear that a challenge to a PPN should be made by way of judicial review. Mr O'Donnell, having chosen not to make such a challenge, could therefore not argue his belief that the underlying assessment was invalid was a reasonable excuse not to pay the PPNs.

The FTT also accepted that Mr O'Donnell has experienced financial difficulties in making the accelerated partner payments. However, he had not suggested that the insufficiency of funds was attributable to events beyond his control. Therefore, the FTT was not satisfied that his financial difficulties amounted to a reasonable excuse.

Comments:. The FTT noted in particular that he had been dealt fairly and promptly with HMRC. The nature of these cases means that they are likely to be contested. However it is clear what the objective of Parliament was in creating the relevant legislation. This case is another example of an unsuccessful challenge in relation to advance payment notices**.**

O'Donnell v HMRC [2016] UKFTT 743K

HMRC's change of policy and costs

Summary - The FTT found that HMRC had not been unreasonable in not applying for a stay of proceedings while it conducted a policy review of the relevant issue. Therefore the appellant's application for costs was denied.

Football Mundial supplied the use of pitches and league management services for small competitive football matches. It had been accounting for VAT on the basis that the supplies were standard rated. Following *Goals Soccer Centres* in 2012, Football Mundial had requested a repayment which had been denied by HMRC. It had appealed against the decision.

Meanwhile, HMRC started a policy review of the VAT treatment of supplies of pitches and league management services, which led to the issue of a Revenue & Customs Brief in February 2014 and the settlement of the appeal. Football Mundial contended that HMRC should have applied for a stay of its appeal as soon as it was lodged, on the basis that it was carrying out a review. Alternatively, HMRC should have informed Football Mundial about the review and it would have applied for a stay. Football Mundial therefore applied for an award of costs.

Decision:

In October 2013, HMRC had written to Football Mundial, explaining its policy following the *Goals* decision; and the FTT considered that the policy set out in the Brief published in February 2014 was not different to that set out in the October letter. Furthermore, *Goals* had involved two separate contracts, whereas Football Mundial had a single contract; and its appeal was on the basis of a single exempt supply, or a single supply that was partly exempt and partly standard rated. The extent to which it operated in the same way as Goals therefore remained to be negotiated.

The FTT also noted that the October letter ought to have been viewed as an invitation to enter into negotiations with HMRC about multiple supplies and apportionment and it was unfortunate that the appellants had not seen it as such — although they had eventually put the multiple supply argument forward when amending their statement of claim.

Comments - FTT found that HMRC had not been unreasonable in not applying for a stay of proceedings.

Football Mundial v HMRC TC5464

Same evidence may serve more than one purpose

Summary - Unanimously, the court allowed HMRC's appeal in relation to the admission of some of the evidence, but left the question of whether they were entitled to resist a claim for zero-rating in a case of this kind without alleging relevant fraud or misconduct by the taxpayer to be determined at the final hearing, when all the relevant evidence had been deployed.

This was an appeal against a case management decision of the UT which related to a group of conjoined appeals. The first group ('the Invalid Invoice Appeals') arose from HMRC's refusal to allow Infinity to deduct VAT allegedly paid by it in relation to taxable supplies to it of mobile phones, on the ground that the relevant VAT invoices did not comply with the VAT Regulations, SI 1995/2518 reg 14(1)(g)(h). In particular, the invoices did not contain a sufficient description of the goods and of the quantities. HMRC contended that none of the alleged supplies had occurred because, at the relevant time, either none, or an insufficient number of, those types of phone had been manufactured and put onto the market.

The second group ('the Zero Rated Appeals') arose from the refusal of HMRC to allow Infinity to zero rate its own supplies of mobile phones, on the basis that they were exported to another member state, on the ground that there had actually been no such export. Again, HMRC's case and evidence was that the export documents were unreliable, as they had been issued by a notoriously fraudulent freight forwarding agent called Magic Transport.

Decision:

In relation to the Invalid Invoice Appeals, HMRC had served a witness statement from one of its case officers which sought to prove criminal convictions of various named individuals for conspiracy and cheating the public revenue in connection with the supply of mobile phones. Some of these individuals were said to be beneficially interested in, or involved in the management of, one of Infinity's suppliers of mobile phones. The court found that this statement was 'manifestly irrelevant; it sought to prove certain convictions of fraud without any connection with the transactions at issue and did not advance HMRC's case that mobile phones of the types identified in the relevant invoices could not have been available in the market in sufficient quantities for there to have been genuine supplies to which the invoices related'. This part of the appeal was therefore dismissed.

As for the Zero Rated Appeals, the court noted that HMRC's evidence relating to Magic Transport did not, on its own, expressly or by any necessary implication contain any allegation of participation in or knowledge of fraud, bad faith or failure to take reasonable steps by Infinity. The court therefore rejected the argument that HMRC was also trying to prove a case of misconduct by Infinity.

The FTT had struck out the Magic Transport evidence because it regarded it as being deployed not for the purpose of challenging the reliability of consignment documents issued by Magic Transport, but for the purpose of proving a positive case that Infinity had not acted in good faith, which HMRC had declined to plead.

The court found, however, that it could not be an objection to the deployment of evidence in support of a positive case that did not allege fraud or misconduct against a party to proceedings, that the same evidence was supportive of such a case, merely because that additional case was not being pursued. The Magic Transport evidence was plainly supportive of a positive case that no real reliance could be placed on consignment documents issued by Magic Transport as evidence of export. It should therefore be admitted.

Comments - In this hearing, the Court of Appeal prepared the ground for the substantive appeal on the issue of zero-rating of the taxpayer's exports by ruling on the admissibility of evidence and considering the decision of the FTT to refuse to allow the deployment of evidence by HMRC.

HMRC v Infinity Distribution 2016 EWCA Civ 1014

HMRC Deadline Dates

1 December 2016

- Payment of corporation tax liabilities for accounting periods ended 29 February 2016 for small and medium-sized companies not liable to pay by instalments is due by this date.
- Check HMRC website to ascertain whether advisory fuel rates have been increased by this date.

7 December 2016

- Due date for filing VAT returns and payment for 31 October 2016 quarter (electronic payment).

14 December 2016

- Due date for payment of quarterly corporation tax instalment for large companies (depending on accounting year-end).
- Monthly EC sales list to be filed by this date if paper return used.

19 December 2016

- Pay PAYE, NIC, CIS and student loan liabilities for month ended 5 December 2016 if not paying electronically by this date.
- File monthly CIS return by this date.

21 December 2016

- File online monthly EC sales list by this date.
- Submit supplementary intrastat declarations for October 2016 by this date.

22 December 2016

- PAYE, NIC, CIS, student loan liabilities should have cleared into HMRC bank account by this date.

30 December 2016

- Deadline for submission of online self-assessment tax returns if underpayments are to be collected by a PAYE coding adjustment.

31 December 2016

- Companies House should have received accounts for private companies with 31 March 2016 year ends and public limited companies with 30 June 2016 year ends by this date.
- HMRC should have received corporation tax self-assessment returns for companies with accounting periods ended 31 December 2015 by this date.
- End of CT61 quarterly reporting period.
- Year end for taxable distance supplies to UK for VAT registration.
- Non-EC traders claim recoverable UK VAT in year ended 30 June 2016 by this date.
- End of relevant year for cross-border acquisitions of taxable goods in the UK for VAT registration.

HMRC News

Eclipse may cost its investors dear

Many celebrities could face 'financial ruin' as the taxman has ordered them to repay up to 20 times of what they invested in a massive avoidance scheme.

Former Manchester United manager Sir Alex Ferguson and ex-England boss Sven Goran Eriksson are among the 780 investors spread across 39 partnerships. Businessmen invested £2.2 billion into the film investment schemes, with HMRC informing advisers it would be demanding sums far in excess of those invested.

The scheme enabled investors to avoid paying tax to the government through buying and renting back Hollywood blockbuster movies to film studios.

Nick Wood, an adviser for hundreds of investors in the Eclipse 35 partnership, told The Times:
'I think there will be people potentially jumping off bridges. My expectation is, out the 780 people involved, I'd think it highly likely that up to 600-700 would go bankrupt.'

An investor to the scheme who put in £200,000, for example, could be expected to pay back somewhere between £2million and £4million.

Eclipse 35, one of the 39 partnerships, was deemed to be a tax avoidance scheme by the Supreme Court back in April 2016. HMRC are expected to issue demands to those involved in the next two months, with recipients given 90 days to pay.

Other celebrities to invest in the schemes include former England footballer Glenn Hoddle and Sir Peter Davis, who served as chairman of Sainsbury's.

In order to boost investment in the British film industry, tax breaks were introduced in 1997, leading to £500million investment in UK-based productions by 2000. However the tax reliefs have been exploited by big money investors who were advised they could shelter their income by pouring money into the industry. There was no suggestion that the schemes were illegal.

Updated code of conduct will discourage number of avoidance schemes

Seven leading tax and accountancy bodies have responded to the government's avoidance challenge by updating their code of conduct.

The government is committed to reducing tax avoidance and the revised Professional Conduct in Relation to Tax (PCRT), published by the seven bodies, makes clear that members should not engage or encourage tax avoidance activity. HMRC has endorsed the code.

The new PCRT will come into effect during March 2017 and includes five new standards that will prevent the creation, promotion or encouragement of tax avoidance schemes.

In a letter to the seven professional bodies, the Financial Secretary to the Treasury, Jane Ellison MP, thanked them for their commitment to good tax compliance and responsible tax planning by responding to the government's Budget 2015 challenge.

HMRC, as a key stakeholder, was consulted during the development of the new code and welcomes the fact that the regulatory bodies have taken up this challenge put to them in the March 2015 Budget.

The seven professional bodies are:

1. Chartered Institute of Taxation
2. Association of Taxation Technicians
3. Association of Accounting Technicians
4. Association of Chartered Certified Accountants
5. Institute of Chartered Accountants in England and Wales
6. Institute of Chartered Accountants of Scotland
7. Society of Trust and Estate Practitioners

Taskforce launches criminal and civil investigations into Panama Papers

The Chancellor of the Exchequer and the Home Secretary have updated the House on the Panama Taskforce.

More than 30 individuals and companies are under active investigation for criminal or serious civil offences linked to tax fraud and financial wrongdoing uncovered by the Panama Papers Taskforce partners, with hundreds more under detailed review.

The Chancellor of the Exchequer and the Home Secretary have on 8 November published an update on the work of the Panama Papers Taskforce. The cross-agency taskforce was created in April 2016 to analyse all the information that had been made available from the International Consortium of Investigative Journalists (ICIJ)'s Panama Papers data leak.

In a written ministerial update to the House, the Chancellor of the Exchequer and the Home Secretary reported that the Taskforce has:

- opened civil and criminal investigations into 22 individuals for suspected tax evasion
- led the international acquisition of high-quality, significant and credible data on offshore activity in Panama – ensuring the important work of the Taskforce was not delayed by the ICIJ's refusal to release all of the information that it holds to any tax authority or law enforcement agency
- identified a number of leads relevant to a major insider-trading operation led by the Financial Conduct Authority and supported by the National Crime Agency
- identified nine potential professional enablers of economic crime – all of whom have links with known criminals
- placed 43 high net worth individuals under special review while their links to Panama are further investigated

- identified two new UK properties and a number of companies relevant to a National Crime Agency financial sanctions enquiry
- established links to eight active Serious Fraud Office investigations
- identified 26 offshore companies whose beneficial ownership of UK property was previously concealed, and whose financial activity has been identified to the National Crime Agency as potentially suspicious
- contacted 64 firms to determine their links with Mossack Fonseca to establish potential further avenues for investigation by the Taskforce
- seen individuals coming forward to settle their affairs in advance of Taskforce partners taking action.

In addition, the Taskforce has established a Joint Financial Analysis Centre (JFAC). Using the data and intelligence gathered from across the Taskforce, the JFAC has developed cutting-edge software tools and techniques, ensuring the Taskforce has access to the very best information from which to work.

HMRC's Director General for Customer Compliance, Jennie Granger said:

> The net is closing in on tax evasion and economic crime and there are no safe havens for hiding money offshore. The vast majority of individuals and businesses pay their fair share and it's on their behalf that the Taskforce has made so much progress on so many fronts.
>
> The Taskforce is leading the world on the acquisition and analysis of data that has enabled us to uncover and take swift action on evidence of wrongdoing – regardless of how deeply hidden the arrangements are. It will also enable us to identify those jurisdictions where regulatory oversight requires improvement.

These developments by the Taskforce build on strong action already taken by the government since 2010, which include:

- summer 2015 Budget investment of an additional £800 million for HMRC to expand their compliance and tax evasion work. This is expected to recover £7.2 billion in tax by the end of 2020/21, and will triple the number of criminal investigations for serious and complex tax crime. The aim is to increase prosecutions in this area to 100 a year, by the end of this Parliament.
- increasing global financial transparency among more than 100 countries, including British Overseas Territories and Crown Dependencies, by automatically sharing offshore account data. This additional data will help identify and pursue the tiny minority of tax cheats still hiding their money offshore.
- publishing the National Risk Assessment for Money Laundering and Terrorist Financing to better understand the risks and vulnerabilities for the UK. The Action Plan, published in April 2016, and the Criminal Finances Bill, introduced to Parliament in September, will significantly improve its capabilities to tackle money laundering and recover the proceeds of crime, including proceeds of corruption.

Making Tax Digital

The CIOT and LITRG submitted their responses to the six Making Tax Digital consultation documents with the CIOT including the following key messages in each of its responses:

- Whilst MTD will bring benefits to HMRC, the likely impact on most businesses and taxpayers will be an increased workload and / or increased costs. It is not at all clear that there will be commercial benefits to offset such costs, particularly for smaller businesses.
- The timetable for mandation of MTD is far too optimistic and must be pushed back. The proposed deferral of MTD for certain small businesses over the proposed exemption threshold is insufficient. Effective software is not yet available and fully tested, so the substantial number of businesses that currently do not use software will inevitably have difficulties both selecting the appropriate software and getting to grips with its functionality. Businesses that currently do use software will be prejudiced if their provider cannot keep up with the demanding timescales.
- Deferral of MTD will allow a smoother and more effective transition. The continued widespread use of spreadsheets, and an upload facility onto an HMRC portal, will assist businesses get used to updating HMRC more regularly, in a more digitised fashion, whilst ensuring that transition time and costs can be better managed.
- The thresholds for mandation need to be increased. The £10,000 threshold for exemption is far too low. It could place the obligation on non-taxpayers and landlords with a single buy-to-let residential property.
- That said, the case for mandating larger businesses into MTD has not been made out. These businesses are already likely to have comprehensive record-keeping systems, already in a digital format, and many corporates will be subject to independent external audit. Mandation of a particular method of digital record keeping, and quarterly reporting, will create significant administrative costs and burdens. The figures being submitted quarterly would still need to be adjusted at the end of the year for tax purposes, and the submission of unadjusted figures will be of little or no benefit to HMRC or to the business.
- Real simplification of the tax system, particularly for small businesses, will help MTD work. For example, a simple income-minus-business expenses model would be easier for taxpayers to understand and report. The simplification proposed is inadequate and potentially detrimental to taxpayers. In any event, simplification should take place BEFORE introducing mandatory digital record keeping and reporting.
- Agents will be an integral part of MTD, yet the consultations are worrying devoid of much mention of agents, and seemingly imply that businesses will wish to ‘do it themselves’. Agent access and functionality needs to keep progress with taxpayer access, and consideration needs to be given to the different types of agent and the various functions that they carry out.

- Communication of MTD, direct to businesses and individuals, is vital. There is much work to be done to educate and inform the public about these very significant proposals, and how they change the interaction they will have with HMRC. In our view, HMRC will need to step-up its promotion of MTD. Digital communications such as YouTube and Twitter will not reach businesses that currently do not use digital tools. Television, radio and newsprint should be considered.

LITRG included the following key messages in each of its responses:

- We generally support the HMRC digital strategy and recognise that many benefits may be possible in the digital world. We are though hugely concerned that much of the detail of the MTD programme is still to be considered and finalised, and as a result implementation of MTD for unincorporated businesses from April 2018 is totally unrealistic and unachievable in the timescale.
- The current timetable does not allow sufficient time for:
  – HMRC to properly publicise and educate the public about MTD;
  – businesses to prepare for these changes, both the practical impacts and additional costs which;
  – the software, which is crucial to the success of MTD, to be fully developed and tested.
- We strongly urge HMRC to delay the commencement of MTD until the design has been completed and fully tested. This should substantially reduce the massive risk of the project going seriously wrong with the damage done to HMRC reputation but also the inevitable 'teething problems' that will without doubt occur. A more relaxed introduction will lessen the chances of the public quickly losing faith in the system, reduce the chance of naturally compliant taxpayers making mistakes due to having to rush into unfamiliar territory, and protect HMRC from reputational damage.
- We do not support the principle of mandating MTD and are wholly opposed to this approach. If we compare it to self assessment (SA) online filing which has been very successful without being mandatory, we can see that if a product is good and beneficial, taxpayers will naturally migrate to it. Mandation is very likely to have the opposite effect to that which it is intended to foster: instead of increasing tax receipts, it may act as a disincentive to businesses to trade legitimately and encourage some into the hidden economy.
- Many businesses with low incomes will find it extremely difficult to comply with the requirements of MTD for a number of reasons, being cost, extra administrative time, lack of IT knowledge, and lack of financial literacy. To make the system work as smoothly as possible, we would strongly recommend that the exemption level is raised very substantially above the proposed limit of £10,000 annual turnover. In our view we consider that the exemption limit should initially be set at an amount equivalent to the current VAT registration threshold. This should at least mean that MTD for business will be more successful from the outset as potentially problematic traders will be below the exemption limit. In turn, fewer resources will be required to provide digital and perhaps financial support to those who will need assistance. This should result in a much smaller group than would otherwise be the case. But if MTD is as good as HMRC promise, traders will almost certainly wish to join it voluntarily.

- The success of the MTD programme depends heavily on the use of good software. It is the responsibility of Government to provide free software where it is a requirement to have software to be able to comply with legal obligations. In respect of MTD HMRC should ideally provide good, free software to small businesses. Relying on commercial businesses to make free software available is, in our view, fraught with very significant problems and is wholly unsatisfactory. Free software provided from commercial sources will have only limited functionality, thus those unable to afford upgraded packages could be excluded from many of the purported benefits of MTD and free software providers will constantly be bombarding their customers with update requests.
- Finally, there will always be some taxpayers who are digitally excluded for a variety of reasons such as lack of broadband due to remote location, or age, or disability. The service and support available to this group must be of at least the same level as that available to digitally enabled taxpayers. Regretfully, the detail of what this support will likely be has not yet been made clear.

Digital tax should not be a burden to businesses

Jim Harra wrote the below letter to the Financial Times published on 10 November 2016

> HM Revenue & Customs will not be asking anyone to file accounts five times a year, nor will we be introducing in-year quarterly payments. Businesses will simply send in-year updates to HMRC using information collated automatically by the same software used to record day-to-day transactions. This will help businesses pay the right amount of tax, taking away the need to put things right at a later date.
>
> Businesses already keeping their records digitally should see no additional costs at all. Free software will be there for businesses with the most straightforward affairs, and we are looking at additional assistance with transitional costs.
>
> We fully recognise that this is a significant change for some businesses, which is why we're introducing it gradually as well as exempting some of our smallest businesses, but at the heart of digital transformation is a simpler, more efficient tax system that frees business people from red tape and form-filling.

Tax-Free Childcare: Top things childcare providers should know

Overview

Tax-Free Childcare is a new government scheme to help working parents with the cost of childcare.

Parents will be able to open an online account, which they can use to pay for childcare from a registered provider.

For every £8 a parent pays in, the government will pay in an extra £2. Parents can receive up to £2,000 per child, per year, towards their childcare costs, or £4,000 for disabled children.

The scheme will be available for children up to the age of 12, or 17 for children with disabilities.

To qualify, parents will have to be in work, and each expecting to earn at least £115 a week. Each parent must not have income over £100,000 per year.

Tax-Free Childcare scheme launch to parents

Tax-Free Childcare will be launched from early 2017. The scheme will be rolled out gradually to families, with parents of the youngest children able to apply first.

Parents will be able to apply for all their children at the same time, when their youngest child becomes eligible. All eligible parents will be able to join the scheme by the end of 2017.

Childcare Providers

Use the information below to get ready to sign up to Tax-Free Childcare.

You'll need to sign up to receive payments from parents

Throughout September and October 2016, letters were sent to regulated and approved childcare providers across the UK, asking you to sign up online for Tax-Free Childcare.

You can sign up online now.

You must be a regulated or approved childcare provider to receive Tax-Free Childcare

Only childcare providers registered with a regulator can receive Tax-Free Childcare payments.

To register with a regulator can take up to 12 weeks. If you aren't, do so now, so that your customers can pay you using Tax-Free Childcare. For registration timelines, please check the appropriate regulators website.

Check that your regulator has your current address

You'll only receive an invitation to sign up for Tax-Free Childcare if your regulator has your current address, so check that this is up to date.

Please also make sure your regulator has your current email address as this will help us if we need to contact you.

If your regulator does have your current address but you haven't received your invitation, you can call the childcare service helpline on 0300 123 4097.

Parents will be able to see if you've signed up for Tax-Free Childcare

Once you've signed up, you'll appear on our new digital tool which lets parents search for childcare providers who can be paid using Tax-Free Childcare.

Be ready for Tax-Free Childcare

If you're running a business, you'll need your 10-digit Unique Tax Reference (UTR) number to sign up for Tax-Free Childcare. This is the number that HM Revenue and Customs (HMRC) gave you when you first told HMRC that you were working for yourself.

You can find your UTR on any HMRC communications, for example, your tax statement or payment reminder, or by logging onto your Personal Tax Account.

If you can't find your UTR number, HMRC can send this number to your address. For more information, call the childcare service helpline on 0300 123 4097.

If you're a nanny, you'll need your National Insurance number to sign up for Tax-Free Childcare. You can find this on your payslip, P60, or letters from HMRC about tax, pensions and benefits.

Making Tax-Free Childcare payments will be easy

When you signup, you'll need to give us your bank details. Parents will then be able to send you payments directly from their Tax-Free Childcare accounts to your bank account (via BACS).

Each child will have a Tax-Free Childcare reference number. Parents can let you know their reference number to help you identify their payments.

Looking forward

More information about Tax-Free Childcare will be available ahead of its launch.

Consultations

Simplifying the Gift Aid donor benefits rules: response to the consultation and further consultation

At Autumn Statement 2014 the government announced a comprehensive review of the rules governing the benefits that charitable donors can receive as a consequence of a Gift Aid-eligible donation – the donor benefit rules.

Following a call for evidence, a consultation ran from 18 February to 12 May 2016, which set out some simplification options. The government is grateful to all those organisations and individuals that provided a response.

This publication summarises the responses to the first consultation and invites stakeholders' views on specific reform options. This second consultation will remain open until 3 February 2017, after which the government will consider responses received and publish its response.

Employment allowance: restricting the allowance from employers of "illegal workers"

At Budget 2016 the Chancellor announced that: 'Employers who hire an illegal worker face civil penalties from the Home Office. The government will build on this deterrent by removing a year's Employment Allowance from those receiving civil penalties, starting in 2018.'

This consultation seeks comments on the draft regulations to restrict this allowance.

Business Taxation

Relevance of an application to rectify a deed of trust

Summary – The FTT directed a taxpayer company to provide details of any application for rectification of a Trust Deed or any decision not to make such an application. This was because of the potential implications on the substantive appeal concerning HMRC's disallowance of EBT contributions

The taxpayer made contributions to an employee benefit trust it had set up in 1997 in three accounting periods to 31 March 1998, 2001 and 2003. In September 2005, it executed a deed of variation to rectify the trust deed preventing the trustees having power to pay emoluments.

After enquiries into the taxpayer's corporation tax returns for the same periods, HMRC said the contributions were not allowable tax deductions. The taxpayer appealed, but the case was stayed behind three others. In the meantime, the taxpayer had accepted that rectification of the trust deed could be awarded only by a court of equity and therefore an application to the High Court was necessary.

In February 2016, HMRC wrote to the taxpayer asking to be informed about the rectification application. The taxpayer objected saying HMRC had 'no legitimate interest' in these proceedings and, were it not for the corporation tax appeal, the department would know nothing about it.

Decision:

The First-tier Tribunal said the question of whether the taxpayer applied to the High Court for rectification of the trust deed was 'highly material' to the appeal. As a result, it should inform the tribunal and HMRC within seven days of making the application.

Comments - The FTT was very clear that it had no jurisdiction to deal with any issues concerning possible rectification proceedings as these were properly questions for the High Court. But as the implications of whether the taxpayer company did or did not make an application for rectification of the trust deed was highly material to the FTT appeal proceedings, it decided that it should make directions concerning any possible application.

Yelkar Ltd v HMRC TC5389

Employer pension contributions (Lecture B987 – 11.51 minutes)

Where employee and employer pension contributions fall within the annual allowance (plus any unused allowance from the three years before), there is no income tax liability for the employee. Creating pension pots of up to £1,000,000 are a very good tax investment as:

- Employer contributions can be tax deductible when made;
- The funds within the pot is tax privileged;
- 25% of the fund can be withdrawn tax free;
- Any pot remaining on death pass IHT free to beneficiaries.

As we know, controlling directors of small companies can draw a mix of a salary equal to the personal allowance, dividends and pension contributions. With higher taxes being applied to dividend income and IHT free pension pots passing to the next generation, we are seeing a surge in pension contributions being made by employers.

Employer contributions

Where a corporate employer, past or present, makes pension contributions to an employee's pension fund, these contributions are tax deductible in the period paid and for corporation tax relief, can be made without limit provided that the wholly and exclusively test is satisfied. As tax advisor we would need to check that the director's role in business has been sufficient such that the contribution is justifiable as part of their overall remuneration package. Remember that the level of dividends that have been extracted is not relevant when considering this package. For HMRC to accept this they would consider third party equivalent amounts and would refer to BIM 46035.

Example

Mr and Mrs Black are directors of their company that currently generates £100,000 profits per annum after having deducted annual salaries of £11,000 each. Mr Black works full time in the business while Mrs Black plays a much smaller role, working on part time basis only.

Given that Mr Black works full time, the company could make pension contributions of £40,000 (plus any unused annual allowance brought forward from the three years before) and up to the annual profits of the business without HMRC questioning the level of contributions.

We would need to look more closely at what would be considered reasonable for Mrs Black as she is only working part time.

What is reasonable?

To establish what is reasonable we will need to consider the number of hours worked, the hourly rate for the type of work that is performed plus an element for being a director. A contribution in the region of £1,000 as a director who does some work in the company is unlikely to be considered unreasonable; the more skilled the work, the higher the contribution that can be justified.

Contributions pre sale or retirement

Large pension contributions running up to either the sale of the company or retirement might trigger HMRC to look more closely at the 'wholly and exclusively' rule. They could argue that the contribution is paid in respect of the individual leaving the company rather than wholly and exclusively for the purposes for the trade.

It is worth considering creating an on-going contract of employment for three years requiring a set package to paid each year, without mentioning a possible sale or retirement. If that contract is not honoured then there is a contractual liability to pay that package when the cash is available. These amounts should be paid before completion as relief is only due if the amount is paid in the accounting period while trading.

Spreading of significant contributions

Ordinarily, the company gets tax relief in the accounting period in which the contribution is paid. However, if there is a significant increase over the contribution paid in the prior period then relief will need to be spread over two, three or four accounting periods depending on just how significant the increase is.

If the current year's contributions are more than 210% of last year's contributions and the excess over 110% of the previous year's contributions is more than £500,000 then spreading is required.

Excess over 100% of previous year	Number of years
£500,000 but < £1,000,000	Spread over 2 years Current + following year
£1,000,000 but < £2,000,000	Spread over 3 years Current and following two years
£2,000,000 +	Spread over 4 years Current and following three years

Donations by a subsidiary to its parent charity **(Lecture B988 – 13.20 minutes)**

Charities with trading income have historically set up wholly-owned subsidiaries to carry on their trading activities. The subsidiary is of course liable to corporation tax on its trading profits, but this liability will normally be extinguished by the subsidiary making a Gift Aid donation of all its profits to the charity, thereby reducing its taxable profits to nil. Given that this payment is tax-free in the hands of the charity, the trading profits have been received without incurring a liability to tax. This practice was endorsed by the Charities Commission in section D5 of Guidance Note CC35 to the effect that the Gift Aid donation did not constitute a distribution.

However, the opinion expressed in CC35 has recently been questioned and, given the importance of the issue to charities and their advisers, the ICAEW sought a legal opinion on the matter. Counsel's advice confirmed that such payments were indeed distributions and therefore, to the extent that any payment by the subsidiary exceeded its profits available for distribution, that payment (ie. the excess amount) was unlawful.

Following discussions between the ICAEW and HMRC, HMRC issued guidance to the effect that this new interpretation should be noted by all charities and their subsidiaries for accounting periods commencing on or after 1 April 2015. As a result, subsidiaries are no longer entitled to claim a Gift Aid deduction for any donations made in excess of their distributable reserves. In the event of a subsidiary receiving a repayment by the charity of an unlawful distribution, the amount received will be free of tax in the hands of the subsidiary.

By way of illustration, the following example shows the potential effect for charity clients:

Old guidance (donations not treated as distributions)

		£
Subsidiary's accounting profit before tax		1,000,000
Add:	Depreciation and other disallowable expenditure	40,000
Taxable profit		1,040,000
Less:	Gift Aid donation	1,040,000
PCTCT		£Nil
Corporation tax payable		£Nil
Amount received by charity		£1,040,000

Revised guidance (donations treated as distributions)

		£
Subsidiary's accounting profit before tax		1,000,000
Add:	Depreciation and other disallowable expenditure	40,000
Taxable profit		1,040,000
Less:	Gift Aid donation (see working below)	990,000
PCTCT		£50,000
Corporation tax payable @ 20%		£10,000
Amount received by charity		£990,000

The subsidiary's Gift Aid donation is calculated as follows:

		£
Subsidiary's distributable reserves		1,000,000
Less:	Corporation tax	10,000
		£990,000

Contributed by Robert Jamieson

Corporation tax loss relief reform (Lecture B989 – 20.49 minutes)

In his Budget on 16 March 2016, the then Chancellor announced that there is to be a reform of the corporation tax rules governing the carry-forward of trading losses and certain other items with effect from 1 April 2017. This reform is of considerable significance to all single companies and to groups.

The losses included in this reform cover:

- trading losses;
- non-trading loan relationship deficits;
- management expenses of investment companies;
- UK property losses; and
- non-trading losses on intangible fixed assets.

These notes, which provide an outline summary of the Government's proposals, focus largely on trading losses. The relevant legislation is expected to be included in FB 2017.

The details of the Government's thinking are set out in a consultation document which was published in May 2016 and is entitled 'Reforms To Corporation Tax Loss Relief: Consultation On Delivery'.

The Government say that this reform is in line with one of their key policy objectives, namely the 'modernising' of the tax system, in view of the fact that the existing rules on the carry-forward of company losses are 'not consistent with international best practice, overly restrictive and not reflective of the way in which businesses operate'.

At the same time, the Government state that the absence of any restriction on the profits which can be relieved by carried forward losses can also have 'undesirable outcomes' for the Exchequer, in that businesses making substantial UK profits may not pay any corporation tax due to losses incurred from earlier activities. In response, one might argue that, however 'undesirable' this may be for the Exchequer, such a consequence is still a perfectly logical one. The Government counter this line by pointing out that the majority of G7 countries now have various forms of restriction in place for the carry-forward of losses.

Of the two main reform proposals, the first one will be beneficial to the taxpayer, given that the new regime will allow greater flexibility in the way in which loss carry-forwards can be used. That is to say, trading losses will no longer have to be carried forward against future profits from the same trade – they will be able to be offset against other sources as well.

On the other hand, the second one will give a cash flow advantage to the Government, in that the amount of losses being carried forward which can be utilised each year will, in some cases, be the subject of a restriction.

Elaborating on the position in rather more detail, the consultative document proposes that:

1. when corporate losses arise on or after 1 April 2017, they can be carried forward and set against other profits such as income from interest or property or alternatively they can be surrendered to other group companies and set against their trading and non-trading profits; and
2. with effect from 1 April 2017, the amount of a company's profits which can be relieved by losses carried forward will be limited to a figure of 50%, subject to an annual allowance of £5,000,000 which will apply per company or per group (as the case may be).

The vast majority of businesses will be unaffected by the 50% restriction, given that it will be the very largest companies or groups which have loss carry-forwards of more than £5,000,000.

Two other points should be noted:

1. capital losses will be ring-fenced so that they can still only be relieved against chargeable gains; and
2. the existing legislation restricting the use of losses where there has been a major change in the nature or conduct of the trade will remain in place.

The consultation document goes on to provide a comprehensive pro forma for the calculation of a company's loss position. The basic model works as follows:

- Calculate company's taxable profits after reliefs, including in-year losses / group relief and excluding
    - carried forward losses;
    - carried back reliefs; and
    - post-31 March 2017 carried forward losses to be claimed from other group companies;
- Allow up to £5,000,000 of these profits to be relieved in full by carried forward losses;
- Allow up to 50% of the remaining profits to be relieved by the remaining carried forward losses (with pre-1 April 2017 losses to be used in priority to later ones); and
- If there are still profits which can be relieved within the 50% limit, allow them to be relieved by post-31 March 2017 carried forward losses which have been claimed from other group companies.

Carried back losses are not taken into account in calculating the amount of profits to which the 50% restriction applies. Instead, carry-back relief will be allowed and set against any profits which remain after this restriction has been applied.

There are three further matters which should be mentioned.

1. Where a company's profits include both trading and non-trading sources, in-year losses and group relief are split and relieved proportionately against those profits. Thus, if the ratio of trading to non-trading profits is 3 : 1, three-quarters of the in-year losses and group relief will be applied against trading profits and one quarter against non-trading profits.
2. In the case of a group of companies, the group will have absolute discretion as to how it should allocate its £5,000,000 limit between its members (and then within the chosen company or companies, between the different categories of profit).

3. Pre-1 April 2017 losses which are carried forward are always subject to the existing streaming rules, ie. they can only be carried forward against profits of the same trade.

Illustration

May plc has total profits of £8,000,000 for the year ended 31 March 2019. This figure is made up of:

- trading profits amounting to £6,000,000; and
- non-trading profits amounting to £2,000,000.

The company has an in-year non-trading loan relationship deficit of £800,000.

May plc also has the following carry-forwards:

- pre-1 April 2017 trading losses of £10,000,000;
- a pre-1 April 2017 non-trading loan relationship deficit of £900,000; and
- a post-31 March 2017 UK property loss of £750,000.

Step 1

To begin with, calculate the amount of May plc's profit to which the 50% restriction will apply:

The company's total profits for the accounting period, excluding any restricted loss carry-forwards, are £8,000,000.

The trading profits are £6,000,000 and the non-trading profits are £2,000,000. This gives a trading proportion of three-quarters and a non-trading proportion of one quarter.

The first relief is for the in-year non-trading loan relationship deficit of £800,000. Applying this proportionately, £600,000 is set against the trading profits and £200,000 against the non-trading profits.

May plc's trading profits become £6,000,000 – £600,000 = £5,400,000 and the non-trading profits become £2,000,000 – £200,000 = £1,800,000.

May plc, as a standalone company, is entitled to the full £5,000,000 allowance. It decides to allocate this entirely to its trading profits, meaning that, of the £10,000,000 trading loss carry-forward, one half has not been absorbed.

The company's trading profits stand at £5,400,000 – £5,000,000 = £400,000. The non-trading profits of £1,800,000 are not allocated any of the allowance.

Step 2

Allow up to 50% of the remaining profit to be relieved by losses carried forward, subject to the existing streaming rules:

May plc's existing trading profits after Step 1 are £400,000. 50% of this comes to £200,000 and so the company can use a further £200,000 of its pre-1 April 2017 trading losses, reducing the loss carry-forward figure to £5,000,000 – £200,000 = £4,800,000. Remember that these losses, which predate 1 April 2017, cannot be set against any other sources of profit.

The company's non-trading profits after Step 1 stand at £1,800,000. 50% of this comes to £900,000. However, this is sufficient to absorb the pre-1 April 2017 non-trading loan relationship deficit of £900,000.

The company has no capacity left within the 50% restriction to use any further losses. Thus no part of the post-31 March 2017 UK property loss of £750,000 can be utilised.

May plc's remaining profits of £1,100,000 (£200,000 trading and £900,000 non-trading) will be subject to corporation tax at 19%.

The company will carry forward the remaining pre-1 April 2017 trading losses of £4,800,000 and the post-31 March 2017 UK property loss of £750,000.

In addition to the in-year £800,000, the company has used £5,200,000 of its pre-1 April 2017 trading losses and all of its pre-1 April 2017 non-trading loan relationship deficit of £900,000.

Contributed by Robert Jamieson

VAT

Lack of export documents

Summary – The assessment and penalties stood in respect of the lack of export documents.

The taxpayer traded as a wholesaler of tyres in Northern Ireland. The bulk of sales were zero rated as exports to the Republic of Ireland, although the customers usually collected their purchases. The business raised invoices recording the Irish VAT numbers and addresses of the customers but failed to obtain any commercial documents that the goods had left the UK. HMRC assessed output tax on the basis of a lack of export evidence, concluding the goods had been sold in the UK.

The taxpayer suggested HMRC should first check with customers if it was concerned about loss of revenue.

HMRC's view was that the onus was on the taxpayer to retain the relevant proof to comply with the legislation.

Decision:

The First-tier Tribunal disagreed with the taxpayer that HMRC should contact the customers to verify the exports. It was for the taxpayer to prove it was entitled to zero rate the supplies. The assessment and penalties stood.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, commented: 'The business owner's main argument was that she was unaware of the need to keep proof of export but ignorance of the law is no defence. This case is probably a timely reminder for advisers to ensure that clients who export goods are keeping proper evidence to prove the goods have left the UK. When the customer collects the goods and ships them abroad, it is sensible to take a deposit to cover the potential VAT liability if the customer does not forward the relevant documents. The time limit for obtaining the relevant proof is three months after the supply took place.'

Transactions concerned with VAT fraud

Summary – The Upper Tribunal dismissed the company's appeal against the decision of the First-tier Tribunal in 2014 that the appellant knew, or ought to have known, that certain transactions were connected with fraud.

Prizeflex made 16 purchases of mobile phones from suppliers in the UK and immediately sold them to customers in other EU countries. It claimed input tax of £1,326,470 on the purchases. HMRC refused this because each deal traced back to a trader that had charged VAT but disappeared without accounting for it.

The First-tier Tribunal found for HMRC. It concluded that the taxpayer had known of the connection in 15 of the 16 transactions and it should have known of it in the remaining one.

Prizeflex appealed to the Upper Tribunal, saying the First-tier Tribunal had misunderstood HMRC's case against it and failed to appreciate that dishonesty was alleged. These errors impaired the fact-finding process and led to further mistakes.

Decision:

The Upper Tribunal disagreed that the First-tier Tribunal had failed to understand HMRC's case against the taxpayer, saying it had set this out clearly. Further, HMRC was not required specifically to allege 'dishonesty' as long as the taxpayer's conduct was clearly described in the pleadings and evidence, which it was.

On the taxpayer's assertion that the First-tier Tribunal should have admitted evidence about the director's good character, the Upper Tribunal said: 'The established authorities state that there are good reasons for the long-established practice of not admitting evidence of good character in civil proceedings and the First-tier Tribunal should not lightly cast that practice aside.' If it had decided in this case not to exercise a discretion to admit the evidence of good character, that would not involve any error of law.

Finally, the Upper Tribunal disagreed with the taxpayer's criticism that the findings of fact did not support the First-tier Tribunal's conclusions and said it had set out the correct test when considering whether the taxpayer should have known about fraud.

The taxpayer's appeal was dismissed.

Comments - This is the usual victory for HMRC in their difficult fight against MTIC fraud. Mr Surana was unable to provide a convincing commercial explanation, or any written evidence, of why certain deals were entered into, how they were negotiated, how particular buyers were found for particular sellers or vice-versa or why it was that no deals failed, were only partially fulfilled or were fulfilled by more than one supplier, This was compelling evidence that Prizeflex knew that the transactions were fraudulent when it entered into them.

Prizeflex Ltd v CRC, Upper Tribunal

Liability to register for VAT

Summary –The taxpayer failed to convince the Tribunal that there was more than one business

The taxpayer traded as a decorator, project manager and carpenter. He maintained that the project management activity was carried out as a partnership with his wife. HMRC said the taxpayer carried out all three activities. Further, they should be aggregated, as a result of which he should have registered for VAT on 1 June 2008; without the project management turnover, there would have been no liability to register. HMRC backdated the registration and issued a late registration penalty for £10,750, before reducing it to £3,247.

The taxpayer appealed.

HMRC claimed that a partnership had never existed because the taxpayer had not claimed the project management was a partnership until after the Revenue had identified a late registration problem. He had declared it on his individual self-assessment tax returns as sole trader turnover.

The taxpayer said his wife was the key player in the project management business, mainly because of her academic skills, and that he was the junior partner. He also said an HMRC officer at a help centre had advised him that each of the three businesses was independent as regards the registration threshold.

Decision:

The First-tier Tribunal agreed with HMRC that the project management work was an extension of his sole trader activities and there was no separate partnership in place. There were no practical indicators of a partnership, such as reporting of some profits on the wife's tax returns, separate bank account, or sales invoices raised in its name. HMRC was correct that the taxpayer should have been registered for VAT.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, noted: 'If the potential VAT problem had been considered in advance, there would have been scope to create a separate legal entity for the project management work, especially since the activity is very different from decorating and carpentry work, and the driving force behind the project management business appeared to be the taxpayer's wife. But the horse had definitely bolted by the time the taxpayer tried to back-pedal his way out of a late registration problem.'

DJ Butler v HMRC TC5392

Was internet provider of hotel accommodation acting as agent or principal?

Summary - The FTT considered the single question of whether the appellant was acting as principal or as agent in respect of supplies to travellers of hotel accommodation and other services and found that the appellant acted as agent in respect of standard contracts, but it was not satisfied that the company had discharged the burden of proving agency status in respect of missing contracts and those governed by foreign law.

The issue was whether Hotels4U.com Ltd (H4U) was supplying travel services to travellers as the agent of a disclosed principal or the alternative that it was selling those services as principal. If Hotels4U was acting as agent, its supplies were not liable to VAT in the UK. If it was acting as principal, it should account for VAT under TOMS.

H4U entered into contracts with suppliers of hotel rooms and displayed details of the hotels on its website. Travellers or travel agents would choose a hotel on the website; and a contract would be entered into either between a traveller and H4U or between a travel agent, on behalf of a traveller, and H4U.

Decision:

The FTT referred to *Secret Hotels2* in 2014 in the Supreme Court (*SH2*) as authority for the principle that the FTT's task was to start with the agreements themselves and identify the rights and obligations of the parties, in order to characterise the nature of their relationship. They should then check whether this characterisation was in accordance with the economic reality.

The FTT noted that the wording of the key provisions in the contracts were virtually identical to the equivalent provisions in *SH2*, which the Supreme Court ultimately had held established a contract of agency. On the face of the documents and taking account of the commercial context, the FTT found that, prima facie, H4U was the disclosed agent of the accommodation provider.

The FTT observed that the agent's obligations towards the principal were limited (to dealing accurately with bookings and remitting to the principal all monies due to it). It also observed that although the principal's obligations to the agent were more onerous, that did not, of itself, prevent the contract from being one of agency. It simply represented the commercial reality that the balance of power was with H4U, which dealt with many single hotels and small chains which were anxious to obtain access to a large part of the UK market through H4U's website. H4U was therefore able to impose obligations on the hotels in order to protect its reputation and goodwill. Similarly, the fact that the traveller may not always know the correct legal entity with which he was contacting did not mean that H4U was acting as principal.

The FTT therefore allowed the appeal in relation to the categories of contracts submitted. It was, however, not able to reach a decision in relation to missing contracts and contracts governed by foreign law and left it to the parties to negotiate the quantum of the claims in relation to those other contracts.

Comments - The decision in this appeal follows a seven years long dispute in *R & C Commrs v Secret Hotels2 Ltd* leading to the Supreme Court judgment in favour of the appellant company. Both cases concerned the question of whether the company was acting as a principal in dealing with customers in its own name or as an intermediary and in both cases the decisions were based on the wording of the written agreements. In view of the facts in this appeal being materially identical to those considered by the Supreme Court it was inevitable that the outcome would be similar. Not resolved in this appeal, however, was the categorisation of the appellant as agent or principal in respect of contracts governed by foreign law. It is now likely that a referral to the ECJ will be required to determine the meaning of ‘acting solely as an intermediary’ in art. 306 of the 2006 VAT directive and whether that is different from ‘agent’ in English law.

Hotels4U.com v HMRC TC 5447

Are subsidiaries of a non-profit making entity eligible bodies?

Summary – The UT found that the companies that were fully owned subsidiaries of a non-profit making body were not 'eligible bodies'.

The taxpayer was the representative member of a VAT group which included two wholly owned subsidiaries, Bradfield College Developments Ltd and Bradfield College Enterprises Ltd.

They made supplies of sports services which were treated as made by the taxpayer as representative member of the group.

It later claimed these were exempt under s 31 and Sch 9 Group 10 item 3 VATA 1994 as supplies by an eligible body of services closely linked with and essential to sport or physical education. HMRC refused the claim.

It was common ground that the taxpayer, as an educational charity, was an eligible body. The issue was whether the organisations (Developments Ltd and Enterprises Ltd) that physically made the supplies were exempt.

The First-tier Tribunal held that neither was an eligible body within the meaning of Sch 9 Group 10 notes (2A) to (2C) because their constitutions did not have restrictions on distributions of profits. The taxpayer appealed.

It said that, under UK law, a wholly owned subsidiary of a non-profit making body could also be a non-profit making body as long as it met the requirements of note (2A)(a), (b) and (c). Developments Ltd and Enterprises Ltd were permitted to distribute profits only to the taxpayer, which was a non-profit making body. They were therefore eligible bodies within note (2A). Further, the terms of the constitution of a corporation did not determine conclusively whether the body had the aim of achieving profits for its members.

Decision:

The Upper Tribunal said the constitutions of Developments Ltd and Enterprises Ltd had not restricted their ability to distribute profits to non-profit making bodies only. So they failed the test in the second part of note (2A)(a). The fact that the taxpayer had been the only shareholder and that profits had been covenanted to Developments Ltd and Enterprises Ltd did not cause the exemption to be available.

The taxpayer’s appeal was dismissed.

Comments – Both companies were wholly owned by the charitable College and apparently the College had no intention of disposing of its shares in them, but the UT still held that it was necessary for the constitutions of both companies to restrict distributions of any profits. In the relevant periods, the Memorandum of Association and Articles of Association of Enterprises and Developments contained no specific prohibition on distributing profits, which was sufficient to dismiss the College’s appeal.

St Andrew's College Bradfield v HMRC UT

Hire purchase supplies and bad debt relief

Summary - The Court of Appeal heard an appeal by HMRC against a decision of the Upper Tribunal (UT) concerning VAT bad debt relief in relation to debts which GMAC incurred in connection with its supplies of motor cars between 1978 and 1997. HMRC challenged the decision that VAT could be reclaimed, but succeeded only to the extent that claims prior to April 1989 were held to be time-barred. The court dismissed HMRC’s appeal against findings of the UT that the conditions requiring debtors to be insolvent and title in the goods to pass to the debtor were incompatible with EU law.

GMAC was a finance company which purchased motor vehicles from dealers and sold them on to customers on hire purchase terms.

GMAC would account for VAT on the full sale price charged to the customer (excluding credit charges) under Sch 4 para 1 VATA 1994. In the relevant periods, VAT bad debt relief provisions imposed two alternative conditions for bad debt relief: the property had to have passed ('the property condition'); and the debtor must be formally insolvent ('the insolvency condition').

These conditions were difficult to satisfy in the context of hire purchase agreements. First, if the customer defaulted on the payments under the hire purchase agreement, property would not have passed. Second, where the finance company did not take insolvency proceedings, for example because the amount outstanding was less than the relevant bankruptcy or insolvency limit, or where the costs associated with such proceedings were not commercially justified, it could not satisfy the insolvency condition. GMAC therefore contended that both the property condition and the insolvency condition were incompatible with the Principal VAT Directive. Both the FTT and the UT had found in favour of GMAC and held that the conditions fell to be disapplied.

Decision:

The Court of Appeal observed that the property condition did not only have the effect of excluding from relief all bad debts incurred in connection with hire purchase agreements. It also excluded relief in the case of any contract for the supply of goods which contains a *Romalpa* (retention of title) clause. The question was therefore whether the exclusion of all supplies of goods where title is retained could be justified. The Court of Appeal considered that such an exclusion was neither appropriate nor necessary.

In relation to the insolvency condition, the Court of Appeal noted the evidence that in 90–95% of repossessions by GMAC, there was no bankruptcy or insolvency. This was because, in the vast majority of cases, customers were individuals so that formal insolvency proceedings were not commercially sensible. The result was that entire classes of bad debt claims were excluded from relief. The Court of Appeal therefore confirmed that both conditions should be disapplied.

The Court of Appeal found, however, that the exercise of GMAC's EU law rights was not rendered 'excessively difficult or virtually impossible' by s39(5) FA 1997. Therefore, GMAC's claim for supplies which had taken place before 1 April 1989 was barred, as GMAC had adequate time to exercise its EU law rights.

Finally, the Court of Appeal found that the time limits applied to GMAC's claims to assert its EU law rights through the mechanism of the domestic machinery were disapplied because they set the time by reference to the invalid insolvency condition. The domestic legislation should therefore be read as not imposing any time condition and GMAC's claim was not out of time.

Comments - The Court of Appeal confirmed that the pre-1997 bad debt relief regime did not comply with EU law. The latest decision in this long-running dispute came as no surprise in view of the previous judgment of the Appeal Court in the case of *British Telecommunications plc*, in which the facts were materially consistent with those in the present case. Unless HMRC seek leave to appeal the decision to the Supreme Court, the decision opens the way for similarly affected taxpayers with stayed appeals to enforce their post 1989 claims.

HMRC v GMAC (UK) [2016] EWCA Civ 1015

Was a car available for private use?

Summary –The taxpayer's appeal was dismissed as the car could be used privately

The taxpayer claimed input tax on a car it had bought in 2015. HMRC refused the claim on the ground it was available for private use. The company director kept the car at his residential address over the Christmas period because there was no secure place to park it at the business premises.

Decision:

The First-tier Tribunal said it was clear that the vehicle was not intended for private use, but the issue was whether the taxpayer had made the car available for use. The judge found there were no legal or physical restrictions to prevent private use by the director or employees of the company.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, commented: 'This case again highlights the two separate tests that need to be passed for input tax to be claimed on the purchase of a new car. First, it must be used exclusively for business purposes and, second, it must not be available for private use. It is the second test about availability that causes the biggest challenges. There have been four First-tier Tribunal cases on this issue in the past six months – this win for HMRC means the score is now 2-2.'

Ireland Generator and Spare Parts Ltd v *HMRC TC5415*

Change to pre-registration input tax

Revenue and Customs Brief 16 (2016) sets out HMRC policy on deduction of VAT relating to assets used by the business prior to its VAT registration. It clarifies when, and to what extent, VAT is deductible and what to do if the correct treatment has not been applied.

Background

UK law allows a business registering for VAT to recover tax they have incurred on goods and services before their effective date of registration (EDR). This allows the recovery of VAT against goods and services as long as they're used by the taxable person to make taxable supplies once registered.

Services must have been received less than 6 months before the EDR for VAT to be deductible. This time limit simplifies the rules and means you don't need detailed calculations of the use before and after your EDR. This excludes services that have been supplied onwards. VAT on services received within the relevant time limit can be recovered in full.

We also have a simplified rule for goods. Goods have a 4 year time limit for deduction that is consistent with the general 'capping' provisions. This excludes goods that have been supplied onwards or consumed before EDR. However, VAT on fixed assets purchased within 4 years can be recovered in full. The word 'consumed' has been interpreted inconsistently over time, particularly in relation to business assets. This brief clarifies the policy position.

HMRC policy

HMRC policy hasn't changed and is as set out below. This brief has been issued because VAT on assets held prior to EDR hasn't always been treated consistently.

Subject to the normal rules on VAT deduction:

- VAT on services received within 6 months of EDR and used in the business is recoverable in full
- VAT on stock is deductible to the extent that the goods are still on hand at EDR (for example apportionment may be required)
- VAT on fixed assets purchased within 4 years of EDR is recoverable in full, providing the assets are still in use by the business at EDR

Full recovery only applies if your business is fully-taxable. If you're partly-exempt, have non-business activities, or need to restrict VAT deduction for any other reason, you'll need to take that into account when calculating your deductible VAT.

There are different rules for capital items under the Capital Goods Scheme. Please see VAT Notice 706/2 for details.

Correcting errors

HMRC will accept corrections for overpayment of VAT in the following circumstances:

- the business has reduced the VAT it deducted on fixed assets, to account for pre-EDR use
- HMRC has raised an assessment of tax to account for pre-EDR use of fixed assets
- HMRC has reduced a repayment claim to account for pre-EDR use of fixed assets

HMRC will consider claims for repayment of penalties and interest charged as a result of assessments.

Time limits for error correction in relevant cases:

- 4 years from the due date of the relevant VAT return where VAT deduction has been restricted in error by the business, or HMRC has incorrectly reduced a repayment
- 4 years from the date the assessment was paid where HMRC have raised an assessment that incorrectly restricts VAT deduction

Corrections of errors, other than assessments, should be dealt with as per the guidance in section 6 of VAT Notice 700/45.

Claims relating to VAT paid on assessments raised in error should be made on an Error Correction Notice (form VAT652) as per the guidance in section 4.4 of VAT Notice 700/45.

Guidance in the VAT Input Tax manual and Section 10 and 11 of VAT Notice 700: the VAT guide will be amended to ensure the policy position is clear.

Development in phases and the capital goods scheme

Summary - The FTT allowed the appeal against HMRC's decision to aggregate the cost of the purchase of a property and the cost of refurbishing it for the purposes of the £250,000 threshold for the capital goods scheme.

Water Property had acquired a building, subject to planning permission to convert the ground floor into a children's day care nursery and the upper floor into flats. It had then granted a lease of the ground floor and entered into two building contracts: one for the alterations to form a nursery; and the other for the development of three flats. Works on the flats had begun once works on the nursery was completed.

Under the VAT Regulations, SI1995/2518, para 113(4), an item is only a capital item where the value of the expenditure is £250,000 or more. However, the FTT observed that the regulations contain no express indication of how the £250,000 threshold is to be applied where expenditure is of more than one of the specified types. The issue was therefore whether the amount of more than one type of expenditure can be aggregated for the purposes of para 13; and, if so, in what circumstances.

Decision:

The FTT found that the separation in time between the acquisition and the commencement of the building works and the uncertainties as to the availability of finance, and therefore whether the works would be carried out, meant that there was no capital item to which para 13 could apply. Therefore, the option to tax made by the company was valid and it could recover input tax incurred in relation to the acquisition and refurbishment of the ground floor.

Comments - The main question in this appeal was whether the amount of more than one type of expenditure can be aggregated for the purposes of the £250,000 threshold for capital goods and, if so, in what circumstances. The FTT decided not to aggregate the expenditure. The lease of the nursery was at a market rent and VAT was chargeable on that rent. These arrangements were commercial. They involved no evasion or avoidance. The same result in terms of ability to deduct input tax would arise if the developer and nursery were not in common ownership, because the transactions were on commercial terms. As all of the steps and the overall transactions were commercial, there was no abuse.

Water Property v HMRC TC5450

DIY building scheme and occupation restrictions

Summary - The FTT found that a bungalow subject to an occupation condition did not qualify as a dwelling for the purpose of the DIY builders refund scheme.

Mr Heckingbottom appealed against HMRC's refusal of his claim for a VAT refund under the DIY scheme in relation to a bungalow. HMRC considered that the erection of the bungalow was not a 'building designed as a dwelling' because of a restriction on its use contained in the planning permission. The planning permission limited the occupation of the bungalow to persons employed in the fishing business on the site. The appeal had been stayed behind *R Burton* [2016] UKUT 20, in which the UT had held that an occupation restriction was sufficiently mandatory and clear to amount to a prohibition.

Decision:

The FTT confirmed that, as a result of the restriction in the planning consent, the bungalow was not a dwelling within the DIY scheme. It added that the claims also failed to meet the requirement of s 35(1)(b), as the works had been carried out in furtherance of the appellant's business.

Comments – In line with *Burton*, this case confirms that an occupation restriction will prevent a building from qualifying as a dwelling for the purpose of the DIY scheme.

T Heckingbottom v HMRC TC5462

Input tax claims on new cars (Lecture B990 – 10.32 minutes)

Introduction

There is no problem claiming input tax on the purchase of a new motor car if it is a tool of the trader of the business:

- taxi driver
- car hire business
- driving school
- motor dealer buying the car for resale

There is also no problem making a claim if it is a genuine pool car but HMRC will need convincing on the 'pool' status of the vehicle eg by considering who uses it and where it is kept overnight. But if a new car is purchased outside of the above categories and is not used exclusively for business use and is also available for private use, then input tax cannot be claimed.

In this article, I will share four recent First-tier Tribunal (FTT) cases, two of which were won by the taxpayers. The cases might provide an opportunity for input tax to be claimed on new cars in certain situations.

The law

The relevant legislation about input tax and cars is shown in Box 1. There are two key issues:

1. The intention must be to use the vehicle wholly for business purposes; and
2. It should not be available for private use.

What is the difference between those two conditions?

To give a simple example, if I am an employee of ABC Ltd, and must sign a contract of employment that says I must never use a company vehicle for private purposes, the vehicle is not 'available' for my private use.

So if I breach this condition by doing detours to theatres and football grounds, this does not affect the requirement of Article 7. In other words, my 'actual use' is a different test to 'available use'.

Article 7 of the Value Added Tax (Input Tax) Order 1992 - ("the Order") provides:

(1) subject to paragraph (2) to (2H) below tax charged on (a) the supply … to a taxable person … of a motor car shall be excluded from any credit under section 25 of the Act.

(2) Paragraph 1 above does not apply where:

(a) the motor car is:

(i) a qualifying motor car

(ii) supplied … to … a taxable person; and

(iii) the relevant condition is satisfied.

(2E) For the purposes of paragraph (2)(a) above the relevant condition is that the … supply … is to a taxable person who intends to use the motor car … (a) exclusively for the purposes of a business carried on by him, but this is subject to paragraph (2G) below…

(2G) A taxable person shall not be taken to intend to use a motor car exclusively for the purposes of a business carried on by him if he intends to …(b) make it available … to any person … for private use, whether or not for a consideration …

Zone Contractors Ltd – taxpayer victory

This issue of employment contracts was the important factor in the case involving a groundworks company Zone Contractors Ltd (TC533). the relevant paragraph from the contract stated:

"Company vehicles – the use of Company vehicles is strictly for the purpose of performing the Employers trade or business by the Employee. It is hereby strictly forbidden for the Employee to use the Company vehicle for any personal use inside/outside their employment hours. Any Employee found to be contravening this will be subject to Disciplinary Procedures. The Company vehicle must be returned to the nominated address after use as instructed by the Director"

So the question you might be thinking is: "Does this mean that a paragraph like this in our clients' employment contracts means they can all claim input tax when they buy new cars?"

The answer is 'no' because the commercial reality must always reflect the terms of the contract. This was the argument of HMRC, namely that the directors of Zone had failed to show that the contractual restriction was carried out in practice.

But the tribunal noted that the disputed vehicles were always kept overnight at the company offices or, alternatively, were left on site ie there was both a legal and physical restriction on the availability of the vehicles for private use. A total input claim of £27,151 was allowed on six cars.

Jane Borton (TC5224) – another taxpayer win

There was also good news for Jane Borton (TC5224) who overturned an HMRC assessment for £4,913 concerning a Land Rover Freelander (classed as a car) and also a careless error penalty of £736.

She maintained that the vehicle was ‘exclusively used for the purpose of her business’ (para 9) and that it was ‘so dirty from business use that it was entirely unsuitable for private use’.

A key issue was that the vehicle was only insured for business purposes, therefore giving a legal restriction that prevented private use. The appeal was allowed and to quote from the report (para 22):

“We are satisfied on the basis of the evidence as a whole that the appellant had no intention, at the time she acquired the Freelander, to make it available to herself or any other person for private use.”

The insurance issue is interesting because the cover in the Zone case included use for ‘social domestic and pleasure’ (SDP) but the tribunal was convinced that SDP use was the starting point for this particular policy, with ‘business use’ added as an extra. In other words, the SDP cover was a fait accompli, even if there was no intended use.

Venda Valet Ltd (TC5321) – HMRC win

What was different in the case of Venda Valet Ltd (TC5321) that produced a failed appeal about the purchase of a Mercedes car in April 2013 and an input tax claim of £7,833?

The relevant arrangements were as follows:

- The car was locked at the company premises when not being used;
- The two directors were the only people authorised to use it;
- The car keys were kept in a safe when the vehicle was not being used;
- A tracker was fitted to the vehicle to monitor its use; and
- There was no insurance policy in place that prevented private use

Both directors confirmed the vehicle was never used for private motoring but the court agreed with HMRC that input tax could not be claimed: “In our view the agreement between Mr Bradley and Ms Eckersall was simply a non-binding informal agreement as to use of the Vehicle. It was not a legal restriction on private use enforceable by the Appellant.” (para 45)

Ireland Generator and Spare Parts Ltd (TC5415) – HMRC win

The vehicle in question was purchased in the VAT period 10/15 and HMRC disallowed input tax of £2,424.

HMRC highlighted that the company director kept the car at his home over the Christmas period and the tribunal noted that there was no legal or physical restriction in place to prevent private use by the director or employees of the company. This was the key issue that means that the tribunal supported HMRC’s assessment. To quote from para 22:

“The appellant cannot show that the car was out of the reach of anyone who could potentially undertake a private journey.”

Conclusion

The reality is that a clear legal or physical restriction must be in place that prevents private use, such as an insurance policy that only allows business use or a strongly worded contract of employment that can be enforced.

Advisers must always focus on the intended use of the car at the time it is purchased and verify if it is intended to be made available for private use. A subsequent change in the intention is not relevant which is why the tribunal in the Zone case was not interested in reviewing mileage logs. Viewers might also want to review the historical case of Elm Milk Ltd ([2006] EWCA Civ 164), which produced a successful outcome for a one-person company because of a 'board resolution' that prevented private use.

An interesting twist in the Zone case was that HMRC put forward an argument that private use of the cars would include detours to buy 'cigarettes or lunch while out on a business journey or even going off site to collect lunch' (para 56). But the tribunal concluded that such use could be ignored as de minimis and added that if it was relevant, it would be virtually impossible for any car to qualify for deduction under Article 7. This is a reasonable conclusion. As a further twist, the tribunal allowed the Zone appeal despite having "concerns regarding the credibility" of some of the taxpayer's evidence.

So overall, the Zone and Borton cases have created a glimmer of hope for business owners who buy motor cars in certain circumstances but the dice still heavily stacked in favour of HMRC.

Contributed by Neil Warren