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Autumn Budget 2017 (Lectures P1046/ B1046 – 17.20/ 13.01 minutes)

Personal Tax

Rates and allowances

For 2018/19, the personal allowance is increased to £11,850 and the basic rate limit to £34,500, so that the level of income at which an individual comes within the charge to income tax is extended from £45,000 in 2017/18 to £46,350 in 2018/19. The higher rate limit and the personal allowance income limit remain unchanged at £150,000 and £100,000 respectively.

The basic, higher and additional rates are all unchanged, as are the rates on dividends and savings income.

The personal savings allowance, starting rate for savings and starting rate limit all stay at their 2017/18 levels but the dividend allowance is reduced from £5,000 to £2,000 for 2018/19 onwards as legislated for in Finance (No 2) Act 2017.

Other income tax personal reliefs are increased in line with inflation, as is the capital gains tax annual exempt amount that becomes £11,700 from 6 April 2018.

Rates of capital gains tax are unchanged, as are income tax rates for trustees.

The increase in the personal allowance means that the transferable tax allowance for married persons (aka the marriage allowance) becomes £1,185 for 2018/19. The legislation does not currently allow transfers on behalf of deceased spouses or from a surviving spouse to a deceased spouse. With effect on and after 29 November 2017, regardless of when death occurred, an individual will be able to elect to transfer to a deceased spouse, and a deceased individual's personal representatives will be able to make any transferable tax allowance election that the deceased could have made. Any such elections can be made at any time within the four years after the end of the tax year to which they relate, so this change is effectively backdated to 2015/16 when the transferable tax allowance was introduced. References above to married persons and spouses include civil partners.

Car and Van Benefits

The amount to which the appropriate percentage is applied in determining the taxable benefit of company car fuel is £23,400 for 2018/19 (£22,600 for 2017/18). The cash equivalent of the benefit of a company van for 2018/19 is £3,350 (£3,230 for 2017/18). The cash equivalent of the benefit of van fuel for 2018/19 is £633 (£610 for 2017/18).

The diesel supplement for company cars will increase from 3% to 4% for 2018/19 onwards. The maximum appropriate percentage for cars (including any diesel supplement) will, however, remain at 37%.

Electricity provided at workplace charging points for electric or hybrid cars owned by employees will be exempted from taxation as a benefit-in-kind from 6 April 2018.

SAYE option schemes

Employees on maternity and parental leave will be able to take a pause of up to 12 months from saving into a Save As You Earn employee share scheme. This will take effect on 6 April 2018.

Scale rates for accommodation and subsistence

HMRC publish benchmark scale rates for accommodation and subsistence for employees' qualifying overseas travel. These will be placed on a statutory basis on and after 6 April 2019.

Also for 2019/20 onwards, employers will no longer be required to check receipts when making payments to employees for subsistence using benchmark scale rates. This will apply to scale rates for day subsistence and also to the newly legislated overseas scale rates. Employers will be required only to ensure that the employees are undertaking qualifying travel. It will not apply to amounts agreed under bespoke scale rates or industry wide rates.

Termination payments — foreign service relief

Foreign service relief is to be abolished for termination payments and benefits to employees who are UK resident in the tax year in which the employment is terminated. This will apply where the date of the termination is on or after 6 April 2018 and the termination payment, or other benefit, is received after 13 September 2017. Foreign service relief will continue in termination cases where the employee is non-UK resident in the year of termination, and will continue for UK residents where the payment or benefit is in connection with a change of duties or earnings rather than with termination of the employment. Reductions for foreign service will also be retained for seafarers.

Disguised remuneration

Draft legislation published on 13 September 2017 covered the new close companies gateway intended to put beyond doubt, with effect on and after 6 April 2018, when the disguised remuneration provisions apply to remuneration of employees and directors who have a connection to a close company. Additional legislation will require all employees and self-employed individuals who have received a disguised remuneration loan to provide information to HMRC by 1 October 2019 to ensure the charge on disguised remuneration loans outstanding on 5 April 2019 is complied with.

Off-payroll working reform — extension to the private sector

The Government will consult in 2018 on how to tackle non-compliance with the intermediaries legislation (IR35) in the private sector. They state that a possible next step would be to extend the public sector reforms made by Finance Act 2017 to the private sector.

Pensions Lifetime and annual allowances

A decision had already been taken to link the lifetime allowance to inflation, which means that it becomes £1,030,000 for 2018/19. The annual allowance, money purchase annual allowance and taper limit all remain unchanged.

ISAs and Child Trust Funds

The ISA annual subscription limit will remain at £20,000 for 2018/19. The annual subscription limits for Junior ISAs and Child Trust Funds are increased in line with inflation to £4,260 from 6 April 2018.

Venture capital schemes

A Budget would hardly be a Budget if it did not include changes to the tax-efficient venture capital schemes (Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCTs)). This applies in abundance this time, and the principal changes are summarised below.

Relief under all three schemes is to be focused on cases where there is genuine risk to capital invested, and is to exclude companies and arrangements intended to provide "capital preservation". With this in mind a new qualifying condition will introduce a principles-based test to determine if, at the time of investment, the investee company is a genuine entrepreneurial company. It requires a conclusion to be reached as to whether the company has objectives to grow and develop and whether there is significant risk of loss of capital that could exceed the net return to the investor. The changes will have effect for investments made on or after 6 April 2018.

To ensure that tax-advantaged VCTs continue to focus on long-term investment in higher risk companies that intend to grow and develop:

- 'grandfathering' provisions, that enable VCTs to invest in companies under rules in place at the time funds were raised, will be removed from 6 April 2018;
- with effect on and after 6 April 2018, 30% of funds raised by a VCT in an accounting period will have to be invested in qualifying holdings no later than 12 months after the end of that period;
- the proportion of VCT funds that must be held in qualifying holdings will increase from 70% to 80% with effect for accounting periods beginning on and after 6 April 2019; and
- a new anti-abuse rule will be introduced, with effect on and after Royal Assent to Finance Act 2018, to prevent loans being used to preserve and return equity capital to investors.

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

- the limit on the amount an individual may invest under the EIS in a tax year will be doubled to £2 million, provided any amount over £1 million is invested in one or more knowledge-intensive companies;
- the annual investment limit for knowledge-intensive companies receiving investments under the EIS and from VCTs will be doubled to £10 million (but the lifetime limit will remain at £20 million); and
- greater flexibility will be provided when determining whether a knowledge-intensive company meets the permitted maximum age requirement.

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

There is currently a rule that restricts relief for investors who sell shares in a VCT and subscribe for new shares in another VCT within a six-month period (regardless of which event occurs first) and those VCTs merge. This rule will no longer apply if the merger occurs more than two years after the subscription or is for commercial reasons only. This will have backdated effect for VCT shares issued to subscribers on or after 6 April 2014.

Gains made by non-UK residents on immovable property

A consultation will be issued on taxing non-UK residents' gains on immovable property. This will extend the existing rules on residential property to include disposals of UK commercial property by non-residents, both directly and indirectly, and will bring all companies into charge on disposals of residential property, and all persons into charge on indirect disposals of residential property. The changes will have effect on and after 1 April 2019 for companies, and on and after 6 April 2019 for those within the charge to capital gains tax. However, there is an anti-forestalling rule that will apply to arrangements entered into on or after 22 November 2017 that seek to avoid the changes through treaty shopping.

Gift Aid — donor benefit rules

Currently there is a mix of monetary and percentage limits that charities have to consider when determining the value of any benefit they can give to donors without causing the donation to be disqualified from Gift Aid.

Where the gift is £100 or less, the value of any benefit must not exceed 25% of the amount of the gift. This rule will be retained but, as a replacement for existing rules for larger gifts, charities will be able to give donors an additional benefit of up to 5% of the amount in excess of £100. The lifetime limit on the value that a donor can receive from any charity will remain at £2,500.

Business Tax

Property businesses — mileage rates

Since 2013/14 individuals (and partnerships of individuals) carrying on a trade, profession or vocation have had the option of claiming statutory mileage rates as an alternative to claiming actual motor expenses and capital allowances. These can cover one or more cars, motor cycles and/or goods vehicles.

This option was not previously made available to those carrying on a property business but for 2017/18 onwards landlords are given the option as well. Mileage rates will not normally be available in respect of vehicles for which capital allowances have already been claimed, but transitional arrangements will make this possible in relation to a vehicle on which capital allowances were claimed at any time from 2013/14 to 2016/17 inclusive. No further capital allowances will be available once the mileage rates are brought into use for that vehicle.

Capital allowances

100% first-year allowances are available on zero-emission goods vehicles and on gas refuelling equipment but only for expenditure incurred up to April 2018. This will be extended for a further three years so as to apply to expenditure incurred at any time before 6 April 2021 for zero-emission goods vehicles and 1 April 2021 for gas refuelling equipment. This applies equally for corporation tax purposes but by reference to 1 April 2021 for both types of expenditure.

Partnership taxation

On 13 September 2017, it was announced that legislation would be included in the December 2017 Finance Bill to provide additional clarity on certain aspects of the taxation of partnerships. For example, it will be made clear that partnership profits for tax purposes must be allocated between partners in the same ratio as the commercial profits and that the allocation of partnership profits shown on the partnership return is the allocation that applies for tax purposes for the partners. Following consultation, this legislation will be revised to be more compatible with commercial arrangements for allocating profit shares and to reduce extra administrative burdens. The changes will have effect for 2018/19 onwards.

Class 2 NIC

Class 2 NIC was due to be scrapped from April 2018 but, as expected, has been delayed by a year.

There was concern where businesses had profits that fell below the Class 4 limits. In order to secure their state pension, such individuals could pay Class 3 NIC at £14.25 week but that is five times more than they were paying under Class 2. It has been decided that proper consultation is needed to ensure that such individuals are fairly treated.

Research and development expenditure credit (RDEC)

Large companies and in some cases small and medium sized companies, can currently claim a taxable credit of 11% of their qualifying research and development expenditure. For expenditure incurred on or after 1 January 2018, this credit will increase to 12%. The Government will also introduce a new Advanced Clearance service for RDEC which will provide a pre-filing agreement for three years.

Indexation allowance

The treatment of capital gains for companies will be aligned with individuals and non-incorporated businesses by removing the indexation allowance for disposals by companies on or after 1 January 2018. For all disposals on or after this date the indexation allowance will be calculated up to December 2017.

Withholding tax (WHT) on royalties

It is proposed that from April 2019, withholding tax will be extended to include payments of royalties and payments for certain other rights where the payment is to no or low-tax jurisdictions. WHT will apply where the payments are in connection with sales to UK customers. These changes seek to tax profits that have been transferred to a low-tax

country by the transfer of the ownership of intangible assets. The proposals are subject to consultation.

Non-resident companies' UK property income and gains

Currently non-UK resident companies that receive income from UK property are charged to income tax rather than corporation tax. In addition, some non-UK resident companies with chargeable gains on the disposal of UK residential property are currently charged to capital gains tax. Following consultation in March 2017, the Government will bring both UK property income and certain UK residential property gains for non-UK resident companies into charge under corporation tax.

Draft legislation will be published for consultation in 2018 with proposals taking effect from 6 April 2020. This will allow the recent changes in corporate interest restrictions and loss relief to apply to non-UK resident companies with UK real property income.

Disincorporation relief

Disincorporation relief is only available for disincorporations that take place from 1 April 2013 to 31 March 2018. The relief applies to smaller companies and the Office for Tax Simplification noted that uptake had been very low. This relief will not be extended.

Reorganisations of share capital and incorporation of foreign branch

Where the trade and assets of a UK company's foreign branch are transferred to an overseas company in exchange for shares in that company, existing legislation allows the tax on any capital gains on the disposal of assets to be postponed. Legislation will be introduced to ensure that a corporate reconstruction involving an exchange of shares in this overseas company does not end the postponement of this tax liability.

Intangible fixed asset related party step-up schemes

With immediate effect, a company making a disposal of a licence to a related party will not be able to recognise any less than the market value of that licence. In addition, the licensee receiving the licence from a related party cannot recognise a value higher than the market value. This would include the market value of any non-cash consideration for all disposals of intangible fixed assets and licensing arrangements.

Intangible fixed assets regime

The tax treatment of intangible fixed assets for companies was originally introduced in 2002. The Government introduced changes to the tax relief available for certain intangible assets acquired on or after 8 July 2015. There will now be further consultation in 2018 of the tax treatment of intangible fixed assets.

Double tax relief and permanent establishment (PE) losses

With immediate effect, there will be a restriction on the amount of double tax relief available for a company with an overseas PE where the losses of the PE have been set off against profits, other than those of the PE, in the foreign jurisdiction.

Plant and machinery leasing

As noted at the Spring 2017 Budget, the introduction of a new accounting standard for leasing, IFRS 16, creates the need for changes to the legislation. The Government will publish two consultations in December 2017 firstly to review the legislative changes to ensure that the rules for leased plant and machinery continue to work as they do currently and secondly to look at the options for the treatment of lease payments under the new corporate interest restrictions.

Capital gains depreciatory transactions

A depreciatory transaction is one that takes value out of shares of a company, which might be by transferring the assets of a company to another company within a group for no or little cost.

When the shares are ultimately disposed of, a loss on disposal is adjusted by any depreciatory transactions within the previous six years. For disposals of shares or securities made on or after 22 November 2017 this six-year time limit is removed. For negligible value claims the commencement rule will apply to the date the claim is made.

Corporate interest restriction

Certain technical amendments are to be made to legislation to ensure the corporate interest restriction will work as intended.

Stamp Duty Land Tax

Relief for first time buyers

For completions on or after 22 November 2017, first time buyers of residential property in England, Wales and Northern Ireland will not pay SDLT when buying a property for £300,000 or less. The current SDLT threshold is £125,000 for residential properties. The measure does not apply to properties in Scotland and will apply to properties in Wales only until 1 April 2018 when SDLT will be devolved to Wales.

First time buyers paying between £300,000 and £500,000 will pay SDLT at 5% on the amount of the purchase price above £300,000, a reduction of £5,000 on a property costing £500,000. No relief is available for properties above £500,000.

Higher rates of SDLT

Higher rates of SDLT currently apply to purchases of additional residential properties such as second homes and buy-to-let properties. The December 2017 Finance Bill will introduce changes to provide relief in certain cases when someone gets divorced, exchanges a property with a spouse, adds to an existing interest in their main residence or is a child whose affairs are subject to the Court of Protection. A new rule to prevent abuse of relief for replacement of a purchaser’s only or main residence will be introduced requiring the purchaser to dispose of the whole of their interest in their former main residence and to do so to someone who is not their spouse. All the changes will have effect on and after 22 November 2017.

Filing and payment process

At Spring Budget 2017, the Government announced that the reduction in the SDLT filing and payment window from 30 days to 14 days would be delayed until after April 2018. The Government now confirms that the 14 day filing and payment window will apply to land transactions with an effective date on and after 1 March 2019.

VAT

VAT registration and deregistration thresholds

The current VAT registration threshold of £85,000 will not change for 2 years from 1 April 2018. There are no plans to amend the deregistration threshold, which currently stands at £83,000.

Online marketplaces - extending joint and several liability

The government intends to extend the rules on joint and several liability for online marketplaces, which were initially introduced by Finance Act 2016, so that it will be able to put online marketplaces on notice even where a non-compliant seller is based in the UK. In addition, new legislation will be introduced so that online marketplaces could be made liable for VAT unpaid by overseas traders through their websites where they 'knew or should have known' that the overseas business was required to be registered for UK VAT.

Split payment model

Following the 'call for evidence' on the problem of VAT not declared by certain overseas businesses selling goods in the UK via the internet, the Government will publish a response in December 2017. Under consideration is a 'split payment method', whereby a supplier would receive the net amount and VAT will be remitted directly to HMRC.

Vouchers

There will be consultation on legislation ensuring that when customers pay with vouchers businesses will account for the same amount of VAT as when other means of payment are used.

VAT fraud in labour provision in the construction sector

The Government announced that it will publish a technical consultation on draft legislation for a VAT reverse charge in spring 2018. The measure shifts responsibility for paying the VAT along the supply chain to remove the opportunity for it to be stolen.

Personal tax

Actor using personal service company

Summary - Although an actor had provided his services via a personal service company, this did not prevent him from being employed by his clients for NICs purposes.

This appeal is a test case with a number of other appeals, particularly concerning actors, awaiting its outcome.

Mr Robert Glenister, a well-known actor, owned a personal service company, Big Bad Wolff Ltd, with his wife. He was a director of the company and received employment income and dividends in respect of his acting services. Mr Glenister had provided his services directly to clients during the relevant periods, the contract between Mr Glenister and the clients would have been, as a matter of general law, a contract for services and not a contract of employment. It was also common ground that, had Mr Glenister's services been supplied directly to clients and the contracts under which those services were supplied provided for the payment of salary, Mr Glenister would have been, as a result of Categorisation Regulations, treated as being in employed earner's employment for the NICs purposes with the effect that primary and secondary Class 1 contributions would be payable in respect of his earnings.

The appeal by Big Bad Wolff Limited relates to HMRC's decision that the company was liable to pay primary and secondary Class 1 National Insurance Contributions of £147,547 for the period from 6 April 2004 to 5 April 2014 in respect of Robert Glenister's earnings.

The issue was the correct statutory construction of Social Security Contributions and Benefits Act (SSCBA) 1992 s 4A and the Intermediaries Regulations, SI 2000/727, reg 6, and the application of the Social Security (Categorisation of Earners) Regulations, SI 1978/1689.

Decision

The First Tier Tribunal said that the reason that s4A had been enacted was to prevent NIC being avoided through the use of personal service companies. Prior to the introduction of s4A, a worker, who would otherwise be in employment, would avoid NICs by using an intermediary company to supply his services to the client. Mr Glenister would, as a matter of general law, be a self-employed actor. However, if he contracted directly with a client and was paid a salary (with the result that he was not within the Categorisation Regulations 1978 exclusion in Sch 1 Part 1 Column (B)), he would be treated as being in employed earner's employment for NICs purposes. Therefore, although Mr Glenister would be a self-employed person as a matter of general law, he would be treated as being in employment by the Categorisation Regulations.

This was therefore a case where someone who would otherwise be treated as being in employment had sought, by using an intermediary company, to reduce his liability to NICs. This was the type of mischief s 4A aimed to avoid.

The case was dismissed.

Big Bad Wolff Ltd v HMRC (TC06143)

EIS or SEIS – wrong form

Summary – As with other similar cases, once granted HMRC had no lawful means to withdraw the original EIS application and replace it with an SEIS application.

On 26 June 2014, the company sought advance assurance from HMRC in connection with a Seed Enterprise Investment Scheme proposal. HMRC replied that it would authorise the company to issue compliance certificates when they received form SEIS1.

On 20 July 2015, Innovate Commissioning Services Limited submitted a form EIS1. HMRC confirmed receipt but checked that the company had intended to provide the EIS1. The company had moved so it did not receive the letter. In September HMRC gave authority for the company to issue compliance certificates.

In April 2016, the company submitted an SEIS1 and asked that the EIS1 be withdrawn. HMRC refused.

Decision

The First Tier Tribunal noted that the case was similar to X-Wind (TC5086) and GDR (TC5219). Consequently to succeed, the company's appeal in this case needed to present new information so that it was distinguishable from these cases.

Innovate Commissioning Services Limited said there were differences because it had sought advance assurance and HMRC was aware that it had SEIS in mind.

However, HMRC had written to confirm the company had intended to submit the EIS1 but received no reply. Further, once granted, HMRC had no lawful means to withdraw the original application and replace it with another.

The taxpayer's appeal was dismissed.

Innovate Commissioning Services Ltd v HMRC (TC06152)

Resident in the UK

Anthony and Sally Peck are British and lived in the UK. In 1986 they moved from Hertfordshire to East Sussex to be near Sally Peck's mother, who died in 2002.

The couple had never made close friends in the East Sussex area and after the death of Sally Peck's mother had very little to tie them to the area. They decided to move somewhere warmer and sunnier and by 2005 had settled in the South of France. From 1 March 2006, they rented a property in Monaco and finally bought a property to live in in 2008, where they currently live. They moved all of their important personal possessions to Monaco. They regarded their old home in the UK as their holiday home. They also owned two other properties, one was rented out as they could not sell it and the other, inherited from Sally Peck's mother, was never let but sold in 2016.

The couple had read the document 'IR20' and were aware that they were likely to be considered UK resident if their visits in any tax year exceeded 90 days.

The couple own a group of property investment companies (‘the Hale Group’) from which they derive the majority of their income. Sally Peck is the majority shareholder as the group was inherited from her father. The couple are both directors. In late 2005, to simplify the administration and to reduce further the work done by Mr Peck, the Hale Group disposed of a significant number of the freehold reversions that they owned. This process started in October 2005 and continued until 2008.

Shortly after starting to live in Monaco, the couple filled in form P85 to tell HMRC of their departure from the UK, stating that their departure date was 20 March 2006. They returned their NHS medical cards, removed themselves from their GP practice in the UK. However, Anthony Peck had an operation performed in a private London hospital in November 2010. They surrendered their UK driving licences and sold their PEPs and ISAs. They obtained Monaco driving licences and registered with a doctor, dentist and cardiologist in Monaco. The dates of these vary but were all between April 2006 and December 2007. The couple continued to own cars kept in the UK until 2010, when, due to the difficulties of insuring the cars when they were not UK resident, the cars were taken off the road. Since 2007 they have owned a car in Monaco. They have Monaco bank accounts and credit cards. They have UK bank accounts and UK credit cards.

They kept their visits to the UK to fewer than 90 days. At first, their visits back to the UK were generally one a month, for around a week at a time but became once every two months, for around 10 – 14 days at a time. Extensive analysis provided by HMRC showed regular trips to UK supermarkets, main high street retailers such as Boots and John Lewis, and occasional trips to restaurants and hotels for meals with friends.

Decision

The Tribunal stated that case law makes it clear that in order to be considered not UK resident, having previously been UK resident, a distinct break must be effected in the pattern of the taxpayer’s life in the UK. The taxpayer must not have a ‘settled abode’ in the UK if they are to be considered not UK resident. Regularity of visits is likely to mean that a taxpayer is considered resident.

When considering the issue of ‘a distinct break’, the Tribunal said that when looking at the pattern of their lives in the UK both before and after their departure for Monaco, they found it difficult to see a distinct change in the nature of their life in the UK. When Anthony Peck was asked ‘A typical week in the UK in 2005 was similar to a typical week in the UK in 2007?’ he answered ‘yes’. They continued to use their old home, had UK bank accounts and went out with friends. The Tribunal held that there was not a distinct break in the pattern of the life of the couple the UK.

Anthony and Sally Peck continued to be UK resident in 2006/07, 2007/08, 2008/09, 2010/11 and 2011/12.

Anthony and Sally Peck (TC06179)

Are the new ‘Remittances’ rules flawed? (Lecture P1050 – 16.44 minutes)

The latest Finance Bill (F(No2)B 2017) was published on 8 September 2017. It contains nearly all the measures – some slightly modified – that were dropped from the spring Finance Bill after the Prime Minister called the General Election earlier this year.

The provisions in F(No2)B 2017 are expected to become law shortly before the date of the Autumn Budget which has been announced as taking place on 22 November 2017. This article looks at some of the aspects of the non-UK domiciled legislation.

In order to encourage non-UK domiciliaries to bring funds into the UK (and therefore benefit the UK economy), all such individuals – other than what are now known as formerly domiciled residents – have a window of opportunity running up to 5 April 2019 in which to separate out their income, gains and capital which have hitherto been mixed in a single overseas account.

On the face of it, this is a very helpful mechanism as it will allow these people to segregate their original 'clean' capital investments from any gains on the sale of an asset or to segregate their gains from income so that, for example, it is the gains which are remitted to the UK at a tax cost of 20% rather than the remittance being income for which the charge could be as high as 45%.

There are, however, going to be individuals who will find it difficult to identify precisely the quantum of income, gains and capital contained in a mixed account. For instance, the individual may have held a portfolio of investments for many years with regular payments going in and out of the portfolio. The good news is that it is not necessary to be able to identify all the constituent parts of the mixed fund. As long as the taxpayer can show that the account contains a particular amount of capital, gains or income, that amount can be transferred out of the mixed account into a new account. This leaves the remainder of the funds (whatever they may represent) in the mixed account.

There is no formal procedure for nominating the income, gains or capital that move from the old account to the new account. The taxpayer merely has to keep a record of how the calculations were made so that they can be shown to HMRC, if requested.

One somewhat odd provision is that HMRC have specified that all the transfers out of the mixed account must take place on the same day and that, once this has been done, subsequent transfers out of the same account will not be effective in achieving the desired segregation. So if, for example, Jean-Pierre, a UK-resident non-UK domiciliary, has £60,000 – this is the sterling equivalent – in his mixed account and has identified that £12,000 represents capital and £6,000 represents a capital gain (but does not know how the rest is made up), he can transfer £12,000 to a new clean capital account and £6,000 to a new capital gains account on the same day. However, if he subsequently discovers that there is a further £8,400 of clean capital, he cannot make a second transfer to his new clean capital account. Instead, he would need to transfer the remaining £42,000 to a new mixed account and he could then make a transfer of £8,400 out of this latest account into his clean capital account. This would effectively segregate the additional £8,400 of clean capital.

HMRC also take the view that, if a transfer out of a mixed fund exceeds the amount of income, gains or capital in that account, there will be no segregation. In other words, the money in the new account will be treated as representing the same 'mix' of funds as was held in the old account. It follows that taxpayers should therefore be cautious when estimating the amount of their clean capital.

Unfortunately, some tax experts feel that the complexity of this legislation defeats its purpose of persuading wealthy non-UK domiciliaries to remit significant funds to the UK for expenditure or investment. They feel that the rules, as they stand, will actively discourage taxpayers from cleansing their 'tainted' funds, leaving the money trapped offshore.

The problem is that the 'offshore transfer' provisions are not in point if the money that is paid out of the mixed fund is expected to be remitted to the UK. This is likely to be precisely the reason for the cleansing, but the F(No2)B 2017 rules do not disapply the ITA 2007 legislation which could treat the segregation as ineffective if that was the intention. Thus the cleansing regime will not work as it was meant to.

In order to avoid this result, Para 44 Sch 8 F(No2)B 2017 needs to make it clear that the relevant nomination treatment will apply, whether or not the cleansing transfer is an 'offshore transfer'.

It is understood that HMRC have offered assurance in correspondence that taxpayers will be able to cleanse a mixed fund provided that the income, gains or capital 'belong' to them. They promise that further clarification will be available in a set of guidance notes (still to be published), but, at present, many commentators believe that the legislation cannot produce such an outcome with its current wording.

The position has been summed up by STEP's Technical Committee with these words:

> 'We think that Para 44 Sch 8 F(No2)B 2017 in any event needs to take account of the fact that the "offshore transfer" provisions do not apply if it is anticipated that the money which is paid out of the mixed fund will be remitted to the UK. Where an account is being cleansed by a transfer of what is thought to be clean capital to a new offshore account, it may of course very well be the case that the taxpayer intends to remit the clean capital to the UK in the foreseeable future so that S809R(6)(b) ITA 2007 will apply with the result that a subsequent remittance would still fall within S809Q ITA 2007 and the cleansing would not have worked as intended. As the purpose of the provisions is precisely to encourage remittances to the UK, taxpayers must be given certainty that the law will work as intended.
>
> In order to avoid any uncertainty, the legislation needs to make it clear that the nomination treatment will apply, whether or not the cleansing transfer is an "offshore transfer".'

Contributed by Robert Jamieson

Tax relief for loan interest denied

HMRC guidance on income from property used to state that:

> 'If you increase your mortgage loan on your buy-to-let property you can also treat interest on the additional loan as a revenue expense but only up to the capital value of the property when it was brought into your letting business.'

> 'Interest on any additional borrowing above the capital value of the property when it was brought into your letting business is not tax deductible.'

An example taken from HMRC's guidance clarified how this works.

- A buy-to-let property is purchased for £120,000 with a mortgage of £90,000 and let out. Interest was available for relief on a loan of up to £120,000, the capital value of the property when it was first brought into the letting business.

- If, three years later, the property is valued at £150,000 and the mortgage is increased to £115,000, interest on the full mortgage can still be claimed as a revenue expense as the loan doesn't exceed the initial £120,000 value of the property.

- However, if the mortgage is subsequently increased to £125,000, only the interest on £120,000 of the loan is tax deductible; the additional £5,000 is not tax deductible.

But we have a problem

Let's say that a taxpayer looked to release capital from his buy to let business by taking out a loan. He used the money to help fund the purchase of his home. In accordance with the guidance above, he claimed the interest charged on the loan as a deduction against his rental income.

In November 2015 HMRC opened an enquiry into taxpayer's tax return seeking to disallow the interest on the basis that the loan was not for a qualifying purpose because it was used to buy a private home. They argued that s34 ITTOIA 2005 has an overriding 'wholly and exclusively' requirement and that the purpose of the loan was not qualifying.

In a letter to HMRC, the taxpayer's advisers quoted verbatim from BIM45700 and the guidance above. HMRC replied March 2017, reiterating that it would not allow the interest deduction. The advisers requested a review by another officer but, in May 2017, they agreed with the first.

Guidance changed in April 2017

In April 2017, the exact same piece of HMRC guidance noted above had been rewritten and now reads:

> 'If you increase your mortgage loan on your buy-to-let property you may be able to treat interest on the additional loan as a revenue expense, as long as the additional loan is wholly and exclusively for the purposes of the letting business.
>
> 'Interest on any additional borrowing above the capital value of the property when it was brought into your letting business isn't tax deductible.'

The example of the £120,000 property that is later re-mortgaged has been removed.

The advisers suggested that to change guidance that had been cited in an enquiry case during that investigation amounted to an 'abuse of power'. They wrote to HMRC saying:

- taxpayers are entitled to rely on HMRC guidance, as long as it is 'clear, unambiguous and devoid of relevant qualification' (R v CIR, ex parte MFK Underwriting Agencies Ltd [1989] STC 873);
- in further guidance following the Mansworth v Jelley case, HMRC had concluded that, even if current understanding of the law changed, previous guidance would stand if the taxpayer could show that they had acted reasonably in reliance on it and would suffer detriment from the correct application of the statute;
- Specifically, they cited HMRC Brief 60/09, which states:

> 'We will normally be bound by our previous guidance where the taxpayer can demonstrate that he or she:
>
> - reasonably acted in reliance on the previous guidance; and
> - would suffer detriment from the correct application of the statute'

HMRC's view

HMRC's argument is that 'the change of wording does not signal a change of policy or interpretation ...The purpose of the change was to make that expressly clear in that piece of guidance.'

It seems that even judicial review may not protect the taxpayer. In the Mansworth v Jelley judicial review case R (Hely-Hutchinson) v HMRC [2017] EWCA Civ 1075, the Court of Appeal found that the taxpayer had no 'legitimate expectation' to rely on the guidance because the department had opened earlier enquiries before changing the guidance.

So having acted in accordance with the original guidance that has changed (but has not changed), the remortgage is now not allowed even though it was at the time. Should other property owners be concerned? Are HMRC looking at all similar taxpayers to see if they can now generate additional tax revenues by disallowing interest deductions?

Adapted from an article in Taxation (19th October 2017)

Capital Taxes

Securities of negligible value

Where the value of shares has become negligible, an allowable loss may be established by the owner claiming that they are treated as being sold and re-acquired, either on the date of the claim or at a specified time within the two tax years prior to the year of claim.

In October 2016, HMRC accepted that shares in London Mining plc as having negligible value for the purposes of a claim under TCGA 1992, s 24(2).

The complete list of negligible value securities is available at:

www.hmrc.gov.uk/cgt/negvalist.htm.

Failure to report share disposal

Summary – Failing to report a share disposal that included cash, loan notes and shares was considered careless, prompted and could not be suspended.

Stephen Merrie was the sole shareholder in Primary Fluid Holdings Ltd. On 4 August 2014 he sold his entire shareholding to Flowtech Fluidpower Plc for just under £10 million. He had been with the business since 1987 and it was agreed that he would remain as Managing Director and join Flowtech's operational Board.

The consideration consisted of:

Cash	4,766,071
Loan notes (repayable in 2015-16)	1,620,000
Shares in Flowtech Fluidpower PLC (subject to a 12 month lock in condition)	3,500,000
	9,886,071

Stephen Merrie failed to report the gain in his 2014/15 self-assessment return. He believed that he did not need to report these gains until the loan notes were repaid and the shares sold. Following a stroke, in December 2015 he ceased working for Flowtech.

HMRC opened an enquiry into his 2014/15 return on 28 January 2016 explaining that:

- any cash paid on completion fell to be chargeable in the year of disposal;
- the same principle applied to the loan notes ;
- the consideration relating to the shares fell under s127 TCGA 1992. Any gain would be chargeable when the Flowtech shares were eventually sold.

Entrepreneurs' relief was available on the gains relating to the cash and loan note consideration but the share disposal was treated as a separate disposal (share – for – share) and therefore the conditions for Entrepreneurs' Relief must be considered at the date of disposal. Unfortunately by that date, Stephen Merrie was no longer an officer or employee of the company.

It was explained that he could make an election under S169Q TCGA 1992 to disapply s127 TCGA 1992. The share for share exchange would be ignored and the value of the shares received brought in as consideration so that the £3.5 million value of the consideration shares would be brought into the computation and Entrepreneurs' Relief would then wholly allowable.

Stephen Merrie duly made an election under s 169Q TCGA 1992 which resulted in the shares in Flowtech Fluidpower PLC also being included as consideration in 2014/15.

Stephen Merrie appealed against an HMRC's decision to impose a penalty of £95,112.79 under Sch. 24 FA 2007 in respect of an inaccuracy in his 2014-15 self-assessment income tax return. The assessment of tax that gave rise to the penalty was not in dispute. The points at issue were whether:

1. Stephen Merrie was careless in submitting the inaccurate tax return;
2. the disclosure to HMRC was prompted;
3. the amount of the penalty was excessive;
4. the penalty could be suspended.

Decision

The First Tier Tribunal concluded that Stephen Merrie did not take reasonable care. He assumed that the gain would be chargeable in the year the loan was to be repaid and the shares disposed of. The First Tier Tribunal said that:

> "although he may have spoken to HMRC when checking his entitlement to Entrepreneurs' Relief, it is inherently improbable that the advice he received was not to declare the cash and loan elements of the share sale in the year of disposal."

The Tribunal said that he did not alert HMRC to the inaccuracies in his returns before HMRC discovered the inaccuracy and for that reason his disclosure must be regarded as prompted.

The penalty range for a careless error is 15% - 30% of the Potential Lost Revenue for a prompted disclosure. The investigating officer considered that 'the Appellant could not have been more helpful' and therefore reduced the penalty to the minimum 15%

Although Stephen Merrie proposed to appoint an agent to submit his future tax returns, the Tribunal agreed with HMRC. This error did not occur as a result of a system error.

There was very little likelihood of a similar type of inaccuracy occurring again, as although Stephen Merrie may at some time hold and dispose of shares which could give rise to capital gains, it is highly improbable that there would be any involving loan notes, shares as consideration and Entrepreneurs' Relief. The penalty should not be suspended.

The appeal was dismissed and the £95,112.79 penalty confirmed.

Stephen Merrie v HMRC (TC06103)

Non-resident CGT return on sale of property

Summary – The taxpayer had a reasonable excuse for not filing a Non-resident CGT return by 30 days after the disposal of her UK property.

Patsy-Anne Saunders had previously been resident in the UK but in 2012 she moved to Saudi Arabia. She rented out her former UK home and continued to file an individual self-assessment tax return.

On 15 November 2015 she sold the property.

On 6 April 2016 she received a notice to file her individual self-assessment return for the year ending 5 April 2016. She did this within time, on 15 August 2016 and in the return's capital gains tax summary pages, she inserted a capital loss of £6,395.

Box 37 on page CG2 in SA108 asks the taxpayer to tick the box if they have 'submitted a non-resident capital gains tax (NRCGT) return for the disposal of a UK residential property or properties during 2015'. This may have been what prompted her to make further enquiries of HMRC. She claimed that until speaking to HMRC she was unaware of the provisions of s 12ZB TMA 1970. Under these provisions, she was required to deliver a NRCGT return for the year ending 5th April 2016, 30 days after the date of disposal of a property held by her. Her NRCGT return was therefore required no later than 15 December 2015. On 16 September 2016, upon receipt of her return, HMRC issued notices of penalty assessments of £100, £900 and £300 in respect of her late NRCGT return.

She appealed arguing that she had a reasonable excuse for failing to file her return on time.

HMRC say that, although the need to file a NRCGT return within 30 days of the completion date was new legislation, she had no reasonable excuse saying that:

- she had an obligation to stay up to date with legislation affecting her activities within the United Kingdom.
- ignorance of the law is no excuse; that she should have been aware of the changes effected by s 12ZB TMA 1970
- the obligation to file a NRCGT return within 30 days of a disposal cannot be regarded as obscure or complex law.

Decision

The First Tier Tribunal stated that on a strict reading of ss12ZA and 12ZB TMA 1970, Patsy-Anne Saunders had no obligation to file a NRCGT return since she had made a loss.

The Tribunal rejected HMRC's argument that there had been ample publicity about the new rules in both the chancellor's 2014 Autumn Statement and HMRC's website before April 2015. They noted that it would only have been reasonable to expect Patsy-Anne Saunders to read the guidance if she had been alerted to the changes.

The Tribunal's view was that the subject matter was arcane, difficult to find and counter-intuitive. They said that it was clear that the taxpayer had a genuine and honest belief that the gain could be declared in her 2015-16 tax return, in January 2017. They concluded that the taxpayer had a reasonable excuse.

The appeal was allowed and the late filing penalties discharged.

Patsy-Anne Saunders v HMRC (TC06173)

Trusts: Relief For Property Finance Costs (Lecture P1047 – 10.31 minutes)

This article will discuss how relief for finance costs is obtained by trusts which have a UK property business in the light of the finance cost restrictions introduced with effect from the tax year 2017/18.

Introduction

UK property is historically a good investment for Trustees. Trustees are responsible for investing the settled funds so as to preserve the value of the trust on behalf of the beneficiaries. UK property tends to hold its value and is generally less exposed to value fluctuation than equity-based products thereby making real-estate a suitable investment for many Trustees. Acquiring UK residential property also gives the beneficiaries a place to live should this be required.

Settled funds are often invested into UK property in order to generate both annual rental income for the income beneficiaries and longer-term capital growth for reversionary beneficiaries with an interest in the trust capital. This is important in trusts where beneficiaries have competing income and capital interests as the Trustees need to be seen to be acting fairly and not to favour one class over the other.

Trustees pay income tax on their annual net property income. Net property income means income receivable less allowable expenses payable. The rules for deducting letting expenses against rental receipts are broadly the same as those which apply for individuals. This means that Trustees who have borrowed to fund the UK property investment and who subsequently incur finance costs will be affected by the restrictions brought in by Finance (No 2) Act 2015 which take effect from the tax year 2017/18.

Discretionary Trusts

Discretionary trusts can accumulate income and can distribute income at the discretion of the Trustees. Discretionary trusts pay income tax on their income at the “rates applicable to trusts” which are 38.1% for dividend income and 45% for other income. Discretionary trusts have a starting rate band of £1,000 within which income is taxed at the basic rate or dividend ordinary rate.

Trust income that has been used to meet ongoing management expenses is only taxed at the basic rate or the dividend ordinary rate. Trust expenses are paid out of dividends in priority to other income.

The profits of a property letting business within a trust are computed in the same way as for individuals, so the restrictions for finance costs within ITTOIA 2005, s.272A will also apply. From 2017/18, finance costs incurred by Trustees will be disallowed when computing the taxable profits of the property business but relief will instead be given as a reduction in the tax payable in the bottom half of the tax computation.

This change is being phased in as below:

	% of finance costs allowable as an expense	**% of finance costs given as an income tax reduction**
2016/17	100%	NIL
2017/18	75%	25%
2018/19	50%	50%
2019/20	25%	75%
2020/21	NIL	100%

Discretionary trusts receive the income tax reduction by virtue of ITTOIA 2005 s.274B. The income tax reduction is the “relievable amount” multiplied by the basic rate (20%). The “relievable amount” is the lower of the:

- finance costs disallowed as an expense; and
- taxable profits for the property business for the year (net of any allowable losses brought forward).

Illustration

A discretionary trust has income and expenses for 2017/18 as follows:

	£
Rental income on a residential investment property	10,000
Bank interest	1,500
Dividends	9,000

Expenses:	£
Letting expenses	4,000
General management expenses	925

The letting expenses include £2,000 of interest on a loan taken out to partially fund the acquisition of the investment property.

The income tax payable by the Trustees in 2017/18 is as follows:

	£	£
Rental income	10,000	
Less: Letting expenses	(4,000)	
	6,000	
Add: Disallowed interest (£2,000 x 25%)	500	
Net property income		6,500
Bank interest		1,500
Dividends		9,000
		17,000
Less: Trust expenses met from dividends (£925 x 100/92.5)		(1,000)
Liable at rates applicable to trust		16,000

Tax:	
£1,000 @ 20%	200
£5,500 @ 45%	2,475
£1,500 @ 45%	675
£(9,000 – 1,000) @ 38.1%	3,048
£1,000 @ 7.5%	75
	6,473
Less: Tax reduction for disallowed interest (£500 @ 20%)	(100)
Income tax payable	6,373

Note: The relievable amount is £500 as this is lower than the net property income for the year.

Where the disallowed finance costs are not fully relieved in the year (for example where the Trustees have brought forward property business losses), the unrelieved finance costs are carried forward and are eligible for a tax reduction in a later year.

The construction of the tax pool is affected by the finance cost disallowance only in so far as the credits to the pool are 45% of the amount of taxable property income (being 45% of the property business profits after the disallowance of finance costs). There is no further adjustment to remove the 20% tax reducer from the tax pool.

In the above illustration, the tax pool for 2017/18 would be as follows:

	£
B/fwd at 6 April 2017 (say)	500
Add:	
Tax paid at basic rate	200
Tax paid at trust rate (£2,475 + £675)	3,150
Tax paid at dividend trust rate	3,048
Pool balance (available to frank income distributions to beneficiaries)	6,898

The effect of the finance cost disallowance is that taxable property business profits will increase from 2017/18 onwards which will in turn lead to larger amounts of tax entering the tax pool. Trustees will accordingly be less exposed to overdrawn tax pool charges under ITA 2007, s.496.

Beneficiaries of discretionary trusts are unaffected and income distributions (even when made directly from property business profits) will continue to be treated as generic "trust income" and will carry a 45% tax credit.

Interest-In-Possession Trusts

The tax treatment of finance costs is different where the UK property business is within an interest-in-possession (IIP) trust.

In a typical IIP arrangement, a beneficiary (the "life tenant") has a right to the annual net income of the trust after deducting income related expenses and income tax. The net income is certified to him on form R185. Income tax is paid by the Trustees at the basic and dividend ordinary rates only - the rates applicable to trusts do not apply to IIP trusts as income cannot be accumulated or paid at the discretion of the Trustees. Any tax paid by the Trustees is allowed as a tax credit in the hands of the beneficiary (and is certified as such on the R185).

If an IIP trust has a UK property business, the property business profits for the tax year are calculated as for a discretionary trust. ITTOIA 2005, s.272A applies and finance costs are subject to the phased-in restriction as outlined above. The resulting profit is then taxed in the hands of the Trustees at the basic rate (20%).

However the IIP Trustees are not entitled to a 20% tax reducer on the disallowed interest as ITTOIA 2005 S.274B which gives such relief to discretionary trusts only applies to "accumulated or discretionary income". Instead the reduction in income tax is given at beneficiary level.

The IIP Trustees will therefore:

- Furnish the life tenant with a form R185 which reflects the amount of property income which has been taxed in their hands - ie, the property income profit as adjusted for disallowable finance costs. The R185 will certify the income tax paid at the basic rate on those profits with this credit being available to the beneficiary. Note that the net distributable income as certified on the R185 is likely to be different to the net income to which the beneficiary is actually entitled since the beneficiary is only entitled in law to the economic property business profits (which may be less that those chargeable to income tax). There is therefore likely to be a mismatch between the trust accounts and the R185;

- Notify the life tenant of the amount of the amount of finance costs which have been disallowed. This is then the "relievable amount" for the beneficiary. The beneficiary will then be able to claim a tax reduction under the normal rules for individuals (ITTOIA 2005 s.274A) which is equal to 20% of the lower of either the:
  - Relievable amount (as notified by the Trustees);
  - Taxable property business profit as certified on the R185 (the gross amount before the deduction of basic rate tax); and
  - Beneficiary's adjusted total income (broadly being non-savings income after personal allowance).

Bearing in mind that the beneficiary is receiving both a 20% tax reducer on the disallowed interest and a credit for the basic rate tax paid by the Trustees, this would leave a basic rate taxpaying beneficiary in a repayment situation in respect of his trust income.

Article prepared by Steve Sanders, Tolley Tax Training

More on furnished holiday lettings **(Lecture P1048 – 22.09 minutes)**

It is common knowledge that 100% business relief under S105 IHTA 1984 provides an effective exemption from IHT. There are of course conditions which must be met in order for the relief to be available and, in particular, the relief will not apply if the business 'consists wholly or mainly of one or more of the following, that is to say, dealing in securities, stocks or shares, land or buildings or making or holding investments' (per S105(3) IHTA 1984).

From the property owner's perspective, things have not been looking good – as far as IHT is concerned – when it comes to the business of letting out property. In recent years, the Tribunals have consistently decided that the letting of property is a business which consists wholly or mainly in the making or holding of investments, no matter how extensive the landlord's ancillary services turn out to be. There will be many taxpayers (and advisers) who take the perfectly reasonable view that they are carrying on a bona fide business and are not merely involved with the making or holding of investments. However, it is now a seriously uphill struggle to convince the judicial authorities of this.

The First-Tier Tribunal case of Ross v HMRC (2017) seems almost to have concluded the issue. The late Mrs Ross was a two-thirds partner in a substantial partnership (the Green Door Cottages Partnership) that managed eight holiday cottages and two staff flats at Port Gaverne in Cornwall along with another property in Weymouth. The cottages were very fully let and an impressive list of services was provided for the tenants. The case report records the provision of the following facilities:

- central heating and double glazing;
- wood burning stoves;
- television, direct dial telephone and CD/DVD player;
- fully equipped kitchen and dishwasher;
- laundry facilities on site;
- cots and high chairs;
- car parking;
- disabled access;
- dogs welcome;
- free wifi;
- handyman on site;
- children's sandpit, fishing nets and croquet set;
- OS maps of the local area;
- newspaper and milk delivery;
- change of bed linen during stay;
- recycling facilities;
- barbecue;
- sun loungers and garden furniture;
- kayak and surf boards; and
- feather pillows in the bedrooms.

The Tribunal acknowledged that a high level of services was being provided to the holidaymakers and that these services were more extensive than those considered in any previous decision. This sounds encouraging. Unfortunately, it was irrelevant because, in the Tribunal's view, the relief would not be available 'however high the standard of services which were provided and whatever the level of expenditure incurred on those services'. In the end, relief was denied on the ground that the business of the partnership consisted mainly of an investment in property. The fact that this business was run on sound commercial lines and with much effort did not matter.

The stumbling block appears to have been the words of Henderson J in HMRC v Pawson (2013):

> 'I take as my starting point the proposition that the owning and holding of land in order to obtain an income from it is generally to be characterised as an investment activity. Further, it is clear from the authorities that such an investment may be actively managed without losing its essential character as an investment.'

However, even Henderson J acknowledged that there may be some situations where the provision of additional services or facilities of a non-investment nature (eg. cleaning the property, the provision of heating, the provision of a welcome pack and being on hand to deal with queries and emergencies) will predominate, although this possibility seems to have been rejected by the latest case.

It should be noted that HMRC's current practice in this regard, which is set out in Para IHTM25278 of the Inheritance Tax Manual, has recently been significantly rewritten, presumably as a result of the decisions in the Pawson and Green cases. The Green case was heard in 2015.

Contributed by Robert Jamieson

Mandated trust income and tax returns **(Lecture P1049 – 12.58 minutes)**

In the case of an interest in possession trust in respect of which income has been mandated to the life tenant and any remaining income not so mandated is all taxed at source, the wording on page 2 of SA900 (the Trust and Estate Tax Return) makes it clear that there is no need to complete all the trust's income details and that the beneficiary can instead simply report the mandated income on his personal tax return. In such circumstances, it is open to the trustees then to ask to be taken out of self-assessment for future years.

Essentially, this is an administrative shortcut. The tax paid remains the same, but there are time and cost savings for both the trustees and HMRC.

Para TSEM3763 of the Trusts, Settlements and Estates Manual says:

> 'Sometimes the trustees mandate trust income to a beneficiary. If the trustees mandate income to a beneficiary, it means that the beneficiary receives it and the trustees do not. So, in such a case, there is no statutory basis . . . for taxing the trustees as being in receipt of the income. The beneficiary both receives the income and is entitled to it.
>
> The trustees exclude the income from the Trust and Estate Tax Return, even if it is untaxed.'

Under the regimes applying since 6 April 2016, dividends and interest will nearly always be received gross, with the trustees being primarily liable for the appropriate tax rates of 7.5% and 20% respectively – remember that the dividend tax allowance and the personal savings allowance are not in point for trustees. However, if such income is mandated to the life tenant, the liability passes to him. If the beneficiary does not declare the relevant income and pay the tax on it, the liability cannot fall back on the trustees.

In response to questions raised by their members the CIOT and ICAEW, sought HMRC's views on exactly what constitutes 'mandated trust income'. The professional bodies' opinion is that, until it is revoked, any standing instruction given by trustees as to the payment of income before it falls entirely under their control will constitute a mandate.

HMRC were asked to consider the position of eight possible scenarios:

1. The registrar of a company is given a mandate to pay any dividends directly into the beneficiary's bank account.
2. The bank or building society is instructed to pay any interest as it arises into the beneficiary's bank account.
3. Investments are held by an investment manager in nominee accounts and the manager is instructed to pay the income as it arises into the beneficiary's bank account.
4. Investments are held by an investment manager and the manager has a standing instruction to pay the income periodically (eg. quarterly) into the beneficiary's bank account.
5. The registrar of a company is given a mandate to pay the dividends directly into the trustees' bank account, with the trustees then forwarding the income to the beneficiary.
6. The bank or building society is instructed to pay any interest as it arises into the trustees' bank account, with the trustees then forwarding the income to the beneficiary.
7. Investments are held by an investment manager in nominee accounts and the manager is given ad hoc instructions to pay the income into the beneficiary's bank account.
8. Land is held in a trust, but the life tenant manages the property and collects and returns the rent directly.

HMRC's response was as follows:

> 'In simple terms, the interest in possession trust income is mandated to the beneficiary when the beneficiary will receive that income directly from the source.
>
> So any scenario where the trust income does not go via the trustees' bank account but straight into the beneficiary's is one within Para TSEM3763. In these circumstances, there is no basis for taxing the trustees because they are not in receipt of the income. The beneficiary is chargeable on the income because he is entitled to it.
>
> The examples given in your question are all within Para TSEM3763, except numbers (5) and (6) where the trustees receive the income directly from the source – they are therefore taxable as being in receipt of the income. They should include this in the Trust and Estate Tax Return.
>
> The term "mandated" has been causing confusion and so we are in the process of amending our guidance to clarify this matter.'

Contributed by Robert Jamieson

SDLT returns and payment not needed

Summary - Costs incurred because of HMRC's unreasonable and erroneous insistence that an SDLT return and tax were due were not recoverable.

Deepak Tanna and Natverial Tanna, were the registered owners of a freehold property that they had bought with the help of a mortgage from Lloyds Bank. They defaulted on their mortgage repayments and on 3 November 2015 Lloyds appointed Receivers to sell the Property by auction where their offer to buy it for £279,000 was accepted by the auctioneer.

The sale was completed on 26 January 2016 and the transfer document records that the transferor and transferee of the Property were the same, namely Deepak and Natverial Tanna.

HMRC claimed that a Stamp Duty Land Tax return and payment of SDLT was due as a result of the purchase of the Property. A return was therefore filed and the SDLT paid.

However, under s109(2) of the Law of Property Act 1925 the Receivers, when selling the Property, were acting as the agents for the mortgagors, Deepak Tanna and Natverial Tanna, who were also the purchasers of the Property. As such they could not convey it to themselves and accordingly a liability to SDLT could not arise.

The taxpayer appealed but before the appeal was heard, HMRC confirmed that its decision had been incorrect and a repayment would be made.

Deepak Tanna sought an order that HMRC pay the costs of £2,101.50, which had been unnecessarily incurred in respect of work undertaken by his solicitors over a period of 11 months.

Decision

The First Tier Tribunal agreed that the costs had been incurred because of HMRC's unreasonable and erroneous request for a SDLT return to be filed and paid.

However, as that conduct had occurred prior to the commencement of the appeal and before the tribunal had had jurisdiction, it could not provide the basis for an order for costs.

Therefore, the application for an order for costs could not succeed and the application was dismissed.

Deepak Tanna v HMRC (TC06150)

SDRT on transfer into clearing service

Summary - the CJEU found that a transfer of securities into a clearance service as part of a listing transaction could not be subject to stamp duty reserve tax.

In 2006, Air Berlin, a commercial airline incorporated in the UK, undertook the listing of its shares on the Frankfurt Stock Exchange. To do so, German law required it to list all shares of the same class, including those that were not going to be sold in the initial public offering.

In order to meet that requirement, Air Berlin transferred the legal title to the existing ordinary shares, which represented the entirety of its share capital, to Clearstream Banking, as nominee of the Frankfurt Stock Exchange's settlement and clearing service. Under s70 FA 1986, this transfer triggered a 1.5% stamp duty reserve tax charge. Air Berlin incurred further charges in 2009 when it issued shares that were also transferred to Clearstream. It requested a repayment of the tax, which was denied.

Decision

2006 transactions: the CJEU noted that the transfer had not resulted in a transfer of beneficial ownership. The transfer of legal title, which was required under German law, was therefore merely an operational requirement of the clearance system and had no impact on the right to dispose of the shares or to have the benefit of them. This was therefore not a transfer of securities within the scope of article 12 of the Capital Duty Directive, on which capital duty could be charged.

The transfer was an incidental transaction, integral to the listing of the shares that could not be subject to any form of taxation.

2009 transfer: The CJEU observed that the shares transferred to the clearance service were new shares and corresponded to an increase in capital. To allow the levying of duty on the acquisition of a newly issued security amounts, in reality, to taxing the very issue of that security which was precluded by article 5.

Air Berlin v HMRC (Case C-573/16)

Adapted from the summary in Tax Journal (27 October 2017)

SDLT on incorporation **(Lecture B1047 – 10.10 minutes)**

Transfer to connected company (S53 FA 2003)

This is a general anti avoidance charge to prevent individuals enveloping property into companies without paying sufficient SDLT. Under S53 FA 2003, a SDLT charge is imposed on market value whenever property is transferred to a connected company. This means that where a buy to let landlord transfers a property into a company that the landlord controls, SDLT is payable on the market value of the property. Clearly the rate that applies depends on whether the property is residential or commercial.

There is an exception to this rule where a bona fide partnership or LLP incorporates as Schedule 15 takes precedence over s53. In principle, if the interest in the property is the same before and after the incorporation, then the chargeable consideration is nil and no SDLT is due.

Where a partnership incorporates, there is a special formula used to calculate the SDLT due:

Market value x (100% - SLP%) (SLP = Sum of the lower proportions)

The ‘sum of the lower proportions’ is essentially the partners (and their connected parties) who continue to own an interest in the property after the incorporation. They are added together to find the SLP. SLP will always be 100% where partners are connected within s1122 CTA 2010, so typically husband and wife or father and son. Clearly in these scenarios no SDLT is payable. Where a corporate partner is involved, there will be some SDLT to pay.

Co-ownership of property alone is unlikely to satisfy HMRC so the partnership should have a partnership agreement, partnership bank account and have been filing partnership tax returns with the individual partners entering their share of profits on their own tax returns.

Article created from a seminar by Peter Rayney

Administration

Late filing of nil return

Summary – The taxpayer had mistakenly registered as self employed and HMRC should have withdrawn the notice to file a self-assessment return and cancelled the penalties.

Aurelie Berthet was an Avocat à la Court and Mediateur practising in Paris. On 24 February 2015, she became a Registered European Lawyer in England and Wales and in November 2015 she notified HMRC of her self-employment online using form CWF1.

On 26 November 2015, HMRC issued a Notice to File for the year ending 5 April 2015. As the return was issued outside the normal cycle for the year, she was given 3 months and 7 days to complete and return it (TMA s 8(1A)(b)), making the last filing date 3 March 2016, regardless of whether a paper or electronic return was filed.

As she had no income for 2014/15, she did not submit a return. HMRC issued a notice of penalty assessment on or around 8 March 2016 for £100 and as a result of receiving this penalty, she filed a nil return online in July 2016. She appealed against the penalty, saying that she had a reasonable excuse as she did not know she had to file a return even if she had no income in the UK. This case was heard in October 2016 with the judge finding that the taxpayer did not have a reasonable excuse and confirmed the £100 penalty.

However, after receiving the return, HMRC issued daily penalties. The taxpayer appealed against these.

Decision

The First-tier Tribunal acknowledged that the taxpayer had mistakenly registered as self employed from February 2015, even though her self-employment did not start until June. However, she was never advised that she could request that the notice to file a return could be withdrawn under s88 TMA 1970.

They held that, although HMRC is not obliged to give advice to taxpayers, it was 'reasonable to expect some assistance when a taxpayer, particularly one from abroad … has so obviously misunderstood their position'. The judge also referred to the taxpayers' charter that states that HMRC want to 'make it as easy as we can for you to get things right… We'll help you understand what you have to do and when you have to do it'.

In this case, HMRC should have withdrawn the notice to file and cancelled the penalties.

The appeal was allowed.

Aurelie Berthet v HMRC (TC06113)

Late filing due to accountants

Summary – Suffering with depression and relying on accountants to file his return, was a reasonable excuse.

Mr Roderick Northam filed his 2011/12 tax return online in October 2013, some eight months after the 31 January 2013 deadline and as a result, HMRC imposed penalties.

Roderick Northam claimed that he had signed the return before 31 January but left it to his accountants to send to HMRC. He was suffering with depression and too ill to check that they had submitted the form, as promised.

Decision

In reaching their decision, the Tribunal said that the taxpayer was a man who was intending to comply with his obligations regarding his tax. He had employed accountants, had never filed his return late before and had signed the form before the deadline. The accountants had not told him at the time that they would not submit the return by 31 January because they required more information, even though they later asserted this was the cause of the delay.

The tribunal allowed the appeal.

Roderick Northam v HMRC (TC06125)

Reasonable excuse: Unusual submission message

Summary – Receiving no error message or correspondence, the taxpayer was unaware that there was a problem.

Mr Robert Morris completed his 2012/13 tax return online on or very soon after 1 January 2014 He said that he did this in early January to allow him a month to resolve any problems if they arose. On completing his online filing of the 2012/13 return, the website generated a receipt and a long reference number. In the event, there were no difficulties with the submission of his 2012/13 return and so it was successfully filed within time.

On or soon after 1 January 2015, Mr Morris set about filing his 2013/14 tax return online. The due date for an electronic return for 2013/14 was 31 January 2015. When he came to what he treated as the final stage of inputting the return, he pressed the relevant keys for submitting the return. Mr Morris' evidence as to what happened next was that his experience differed to that of January 2014. Neither a receipt nor a reference number were generated. Instead, Mr Morris said that he received an onscreen message on a very basic web page saying either, "Thank you for your submission" or "Submission complete". There was no other instruction on the page. He took this as an unqualified confirmation of submission. He did not wait for any other page or reference and none came onto his screen. He did not print the page and did not receive an email or other confirmation. Mr Morris recognised that this stage was a different process to the previous year. However, he told us that he did not question this because he assumed that HMRC had changed or updated the system.

When Mr Morris filed his 2014/15 tax return online on or soon after 1 January 2016, his experience was the same as for 2013/14.

HMRC sent various notices and reminders to the addresses on their system. These addresses were incorrect because Mr Morris had moved on various occasions before the letters were sent. Mr Morris did not inform HMRC about his house moves at the time, but instead did so at the time of filing his online returns. In the same way that the online filing had been unsuccessful, the changes of address had also been unsuccessful.

Decision

The First Tier Tribunal found that on the balance of probabilities that Mr Morris' experience of filing the 2013/14 and 2014/15 returns was in accordance with his evidence. As he had received no error message or correspondence from HMRC, he was unaware that there was a problem. He first became aware when he received a letter dated 7 January 2017 and he successfully filed his 2013/14 and 2014/15 returns on 7 January 2017. Mr Morris had a reasonable excuse for not filing his returns and special circumstances continued until 7 January 2017.

The appeal was allowed and penalties cancelled.

Robert Morris v HMRC (TC06160)

Deadlines

1 December 2017

- Payment of corporation tax liabilities for accounting periods ended 28 February 2017 for small and medium-sized companies not liable to pay by instalments;

7 December 2017

- Due date for VAT returns and electronic payment for 31 October 2017 quarter 14 December 2017;
- Quarterly corporation tax instalment for large companies (depending on accounting year end);
- Monthly EC sales list if paper return used;

19 December 2017

- Pay PAYE, NIC, construction industry scheme and student loan liabilities for month ended 5 December 2017 if not paying electronically;
- File monthly CIS return.

21 December 2017

- File online monthly EC sales list;
- Submit supplementary intrastat declarations for October 2017;

22 December 2017

- PAYE, NIC, CIS and student loan liabilities should have cleared with HMRC;

30 December 2017

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

31 December 2017

- Accounts to Companies House for private companies with 31 March 2017 year ends and public limited companies with 30 June 2017 year ends;
- File CTSA returns for companies with periods ended 31 December 2016;
- 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 2017
- End of year for cross-border acquisitions of taxable goods in the UK for VAT registration purposes.

HMRC News

New offshore leaks

The International Consortium of Investigative Journalists (ICIJ) has released leaked files from offshore law firms and other sources containing information on the offshore activities and structures of prominent individuals and companies from all over the world.

A large proportion of the information comes from Appleby, an established international law firm with its origins in Bermuda. This information is said to include details of tax planning by nearly 100 multinational corporations, including Apple, Nike and Uber. Files include details of investments by the Duchy of Lancaster, part of the Queen's estate, and members of the US administration.

The ICIJ says it intends to publish more stories in the coming days and weeks, including:

- strategies used by multinational corporations to shift profits to low-tax jurisdictions;
- private jets and yachts registered by wealthy owners in offshore tax havens;
- offshore trust funds held by rich and powerful people;
- use of offshore financial structures by prominent political donors in the US; and
- tax haven shopping by multinational companies in Africa and Asia using shell companies in Mauritius.

HMRC has requested access to this data.

www.icij.org/blog/2017/918/icij-releases-paradise-papers/

Paying HMRC

From 13 January 2018, HMRC will no longer accept payments made from personal credit cards. It will be allowed to accept payments this way only if there is no cost to the public purse. The EU Payment Services Directive 2, which comes into effect on that date, prohibits HMRC passing on associated fees to customers.

Corporate, business and commercial credit cards are not affected by this change and HMRC will continue to accept personal and commercial debit cards.

Employers who currently use the Transcash service at the Post Office to pay HMRC need to be aware that this service is being withdrawn from 15 December 2017.

Other payment methods include direct debit, faster payment, BACs, and CHAPs.

Scottish income tax proposals

The discussion paper, 'The Role of Income Tax in Scotland's Budget', contains a comparison of the income tax policies put forward by the main Scottish parties. The finance secretary intends to host two stakeholder roundtables later this month to discuss the proposals with business organisations, trade unions, civic society and tax professionals.

Any new income tax policy for Scotland must meet four tests:

1. Revenue test – any income tax changes in 2018-19 should raise additional revenue, over and above the current policy, to help protect public services in Scotland;

2. Progressivity test – any changes to the income tax system should increase the progressivity of the tax system and reduce income inequality;

3. Protecting lower earners test – at a time when living costs are rising, taxpayers in lower income brackets should not pay more tax; and

4. Economic growth test – changes in income tax policy, and the accompanying change in public spending, must support the economy

The four alternative income tax proposals are:

1. Three tax bands – increases both the higher and additional rates of income tax to 41% and 46% respectively, with the basic rate unchanged at 20%;

2. Four tax bands – introduces a new income tax band for low earners based around the median income, giving 20% on earnings between £11,850 and £24,000, 21% on earnings between £24,001 and £44,290, 41% on earnings between £44,291 and £150,000, with the additional rate increased either by 3p to 48%, or by 5p to 50%;

3. Five tax bands – splits the current higher rate band at £75,000, with earnings up £44,290 following Approach 2, extra 1p on earnings between £44,291 and £75,000 (to 41%), extra 2p on earnings between £75,001 and £150,000 (to 42%) and 50% on earnings above £150,000; and

4. Six tax bands – introduces new 19% rate on earnings between £11,850 and £15,000, with 20% on earnings between £15,001 and £24,000 and other rates and bands following Approach 3.

news.gov.scot/news/a-discussion-on-the-role-of-income-tax

Employer Bulletin - Construction Industry Scheme

Key points to remember

In their latest Bulletin, HMRC have highlighted 5 key points to remember:

1. Limited company subcontractors should report the total value of CIS deducted from their company's income as a subcontractor, during the year to date;

2. If they are also a contractor, they should not include deductions from payments made to subcontractors each month. These should be reported on their CIS return, through HMRC's CIS online service or commercial CIS software;

3. File their EPS by the 19th of the following month, off-setting their company's deductions against any other PAYE liabilities where possible;

4. Businesses that are not a limited company, or have gross payment status and therefore have not had deductions taken from payments within CIS, should not report any CIS deductions on the EPS

5. Non-limited companies should report their CIS deductions on their Self Assessment or Partnership returns.

Correcting any EPS reporting errors

If CIS deductions have been reported incorrectly or by mistake, this should be corrected by submitting a further EPS for the relevant tax year with the correct total year to date figures.

If a revised EPS for an earlier tax year cannot be submitted for an earlier year, HMRC's Basic PAYE Tools should be used to do so.

Student Loans

The Department for Education have confirmed that from 6 April 2018 the threshold for

- Plan 1 loans will rise to £18,330 and

- Plan 2 loans will rise to £25,000.

New NMW social care compliance scheme

The government has launched a new compliance scheme for social care providers that may have incorrectly paid workers below legal minimum wage hourly rates for sleep-in shifts.

Social care employers will be able to opt into the new Social Care Compliance Scheme (SCCS), giving them up to a year to identify what they owe to workers, supported by advice from HM Revenue and Customs (HMRC). Employers who identify arrears at the end of the self-review period will have up to three months to pay workers.

HMRC will write to social care employers who currently have a complaint against them for allegedly underpaying minimum wage rates to encourage them to sign up to the scheme. Employers that choose not to opt into the scheme will be subject to HMRC's normal enforcement approach.

The government is exploring options to minimise any impact on the sector. The government has opened discussions with the European Commission to determine whether any support, if deemed necessary, would be subject to EU state aid rules.

www.gov.uk/government/news/new-sleep-in-shift-pay-compliance-scheme-launched-to-support-social-care-sector-and-identify-back-pay-for-workers

Pension schemes newsletter 92

This edition of the newsletter includes details of the new pensions online service and details about the delayed introduction of lifetime allowance online service through the personal tax account.

New pensions online service

In Pension Schemes Newsletter 90 HMRC explained that they had decided to bring forward transferring existing scheme administrator data onto the new Pensions Online Digital Service to April 2018. This is to allow existing pension scheme administrators to register new schemes on the new service. To ensure that they have enough information to move existing scheme administrators to the new service they asked scheme administrators to log into Pension Schemes Online and check that their details were complete and up to date. However, many have not done so. Failure to do so could result in them having to register as a new user on the new service from April 2018.

Over the next 6 to 8 weeks HMRC will start work on building prototypes for the new service. Anyone wanting to volunteer to take part in user research and testing of the prototypes as they build them, should email pensions.businessdelivery@hmrc.gsi.gov.uk and put 'Pensions Online – User Research' in the subject line of your email.

Lifetime allowance service

The lifetime allowance online service is still currently unavailable through the personal tax account. This means that scheme members who log onto their personal tax account to apply for lifetime allowance protection, will not be able to do this through their personal tax account.

Scheme members can still apply to protect their pension savings using the link to the lifetime allowance online service in the GOV.UK guide Pension schemes: protect your lifetime allowance - GOV.UK

Members can also still view details of their protection using the link on the Pension schemes: protect your lifetime allowance - GOV.UK. The lifetime allowance scheme administrator look-up service is unaffected.

www.gov.uk/government/publications/pension-schemes-newsletter-92-october-2017

NIC Bill delayed

Classes 2 and 4 National Insurance were to be merged from 6 April 2018, with class 2 abolished from that date.

The government is to delay the introduction of the NICs Bill announced in this year's Queen's speech to allow more time to consult on the legislation abolishing Class 2 NICs. It will now take effect from April 2019.

Trusts Registration Service goes live

Where a trust is liable to certain taxes, including income tax, capital gains tax, stamp duty land tax and inheritance tax, it must report these details to HMRC for inclusion on the new Trust Register via the Trusts Registration Service.

Technical issues have been preventing agents gaining access to the new service but HMRC have now announced that the service finally became available to agents on 17 October.

Agents will have to set up a new 'agent services account' (ASA) as part of gaining full access to the system. They will need to think carefully about who should set up this account, as an ASA created during registration for TRS will become the sole access point to other HMRC services in the future. It is therefore unlikely that the trust department will be best placed to set this up for the firm.

To allow time to complete the registration of a trust or complex estate for self-assessment and provide beneficial ownership information, there will be no penalty imposed where registration is completed after 5 October 2017 but before 5 December.

For both UK and non-UK express trusts which are either already registered for self-assessment or do not require self-assessment registration, but incur a liability to relevant UK taxes, the trustees are required to provide beneficial ownership information about the trust, using the Trusts Registration Service, by 31 January following the end of tax year. This means, if the trustees of a UK or non-UK express trust incurred a liability to any of the relevant UK taxes in tax year 2016-17, in relation to trust income or assets, then the trustees or their agent need to register that trust on Trusts Registration Service by no later than 31 January 2018.

The CIOT and ATT have written to HMRC to request the adoption of a 'soft landing' approach to registrations under the new Trust Registration Service. The bodies are asking for the deadline for self-assessment registration for 2016/17 for trusts and complex estates be extended to 5 January 2018, and the deadline for registration for existing trusts who need to report for 2016/17 be extended to 5 April 2018.

www.tax.org.uk/policy-technical/technical-news/trust-registration-service-goes-live-agents

https://www.tax.org.uk/sites/default/files/171025%20Trust%20Registration%20Service%20-%20CIOT%20and%20ATT%20comments%20CLEAN.pdf

New Banking Manual

HMRC has published its new Banking Manual (BKM), containing guidance on bank related issues. It covers:

- BKM200000 Bank compensation restriction
- BKM300000 Bank loss restriction
- BKM400000 Banking surcharge

www.gov.uk/hmrc-internal-manuals/banking-manual

Late payment interest rate rise

HMRC interest rates are linked to the Bank of England base rate. As a result of the increased base rate, HMRC interest rates for late payment will be increased.

These changes will come into effect on:

- 13 November 2017 for quarterly instalment payments;
- 21 November 2017 for non-quarterly instalment payments.

Repayment interest rates remain unchanged.

www.gov.uk/government/news/bank-of-england-increases-interest-rate-to-05

Making Tax Digital

By the end of 2017, HMRC will start work with software developers on technical testing for the Making Tax Digital for Business service for VAT.

In Spring 2018, it will pilot the service with a few VAT-registered businesses and their agents. The pilot will expand in numbers and features as the April 2019 deadline approaches.

Business Taxation

Film schemes that failed

This month we have two cases involving film schemes that failed as the partnerships involved were not trading.

Case 1 – First Tier Tribunal

John Hardy and Richard Moxon bought shares in companies, the 'PartnerCos'. The PartnerCos paid the sum to a general partnership governed by Jersey law. The partnership entered into various transactions to acquire films from producers under arrangements including a put option that the partnership could exercise and a call option that could be exercised by the producer. The trigger thresholds for exercise of the options were linked to the predicted performance of the film as determined by a film valuer. The resulting cash-flows were linked in part to a percentage value of the film budget and in part to the actual performance of various film related revenue streams over time less certain deductions for costs and fees.

John Hardy and Richard Moxon acquired the shares with the assistance of substantial loans and sold their shares in the PartnerCos at a loss. John Hardy sought to claim share loss relief for £1,153,717 for the 2008/09 tax year while Richard Moxon sought to claim relief for £137,564 for the same tax year.

Decision

The First Tier Tribunal concluded that the partnership was unlikely to make a profit as there was limited screening and high distribution fees. PartnerCos was not trading but merely existed to facilitate the use of a tax scheme. Even if the partnership carried on a trade, it was not carried out on a commercial basis. The presentation to investors focused on accessing s131 loss relief and did not mention other advantages of using a company, such as limited liability. It was always planned that the shares in the PartnerCos were going to be sold, most likely at a loss. The disposal of the shares was not at arm's length as required for s.131(3). The Tribunal found that s.17 TCGA 1992 applied to the acquisition of the shares making their cost lower than the amount paid on subscription, and the alleged capital losses were outside the definition of 'allowable loss' under s16A TCGA 1992, as the disposal was connected to tax avoidance arrangements.

John Hardy and Richard Moxon v HMRC (TC06165)

Case 2 – Court of Appeal

Mr Degorce was a French national who lived in the UK with his family, working as a fund manager. His income for the year 2006/07 was expected to be approximately £19m. He had implemented the Goldcrest Film Scheme, involving the acquisition and distribution of film rights, to produce a trading loss to set off against that income. The scheme, was expected to create substantial losses in the first year for relief under s380 ICTA 1988. HMRC argued that Mr Degorce had not been carrying on a trade but had simply purchased an investment in film distribution rights, so that no trading loss was available.

Decision

The Court of Appeal referred to its decisions in Eclipse [2015] EWCA Civ 95 and Samarkand [2017] EWCA Civ 77. Although neither schemes 'bore any close similarity' to the Goldcrest scheme, they were relevant in providing an 'authoritative and recent re-statement of the principles'. Two key principles referred to by the court are particularly worth noting:

1. The need to consider the 'whole picture' when deciding if a taxpayer has been trading; and

2. The fact that a transaction has been entered into for tax purposes does not preclude it from constituting a trade.

The Court of Appeal found that the Upper Tribunal had not made an error of law when it upheld the First Tier Tribunal's decision. The court accepted the taxpayer's submission that, to the extent that the First Tier Tribunal declined to take account of his film-related activities before or after April 2007, the First Tier Tribunal had been in error (as recognised by the Upper Tribunal). However, the court also pointed out that under s12 Tribunals, Courts and Enforcement Act 2007, if the Upper Tribunal finds that the First Tier Tribunal has made an error of law, 'it may (but need not) set aside the decision' of the First Tier Tribunal. The Upper Tribunal could therefore allow the decision of the First Tier Tribunal to stand if its error was immaterial.

Agreeing with the Upper Tribunal, the court found that there was no 'realistic possibility' that the First Tier Tribunal would have reached a different conclusion had it considered Mr Degorce's activities before or after April 2007 in circumstances where the transactions at issue were self-contained and the relevant steps had been implemented over a few days.

Interestingly, the fact that the taxpayer had previously been involved in two Ingenious film schemes was irrelevant, as the success of those schemes depended on the LLP carrying on a trade, as opposed to individuals, as in this case.

P Degorce v HMRC [2017] EWCA Civ 1427 (6 October)

Adapted from Tax journal (13 October 2017)

Artificial loss

Summary - A scheme was too artificial to amount to a trade and so loss relief was denied.

Clavis, a Jersey limited Partnership, entered into a scheme to buy the right to the bulk of dividends to be declared by a company known as Helios for a price of £59,958,000. When declared, this would entitle the partnership to dividends of £60,000,000, generating a profit of £42,000.

The Partnership believed that s730 ICTA 1988 deemed the dividends to be the income of the seller and not of the Partnership and if that was how the provisions worked, then the Partnership would bring in the cost of buying the dividend as an expense but would not bring in the dividend as income. This is what is said to have given rise to the loss available to the members of the Partnership.

The First Tier Tribunal found that the scheme failed under the Ramsay doctrine [1981] STC 174; 'viewed realistically', the sale of the right to receive the dividends and the payment of those dividends were a 'single composite transaction'. The transaction was therefore not a trade, as it was too artificial to be viewed as such.

Decision

The Upper Tribunal pointed out that:

- the transaction had involved the purchase of a right to a dividend in a company set up for the express purpose of being funded to pay the dividend. There was 'nothing at all normal about that structure';
- it is an odd trade where the trader finances their own profit;
- all the partners had lost their personal contributions to the capital of the partnership and yet there was no evidence of any complaint.

In the Upper Tribunal's view, the transactions were so artificial that they could not amount to a trade.

Clavis Liberty Fund 1 LP v HMRC [2017] UKUT 418

Simplified cash basis for unincorporated property businesses

2017/18 sees the introduction of the statutory simplified cash basis for unincorporated property businesses. For each type of property business run (UK, Overseas, FHL etc), the simplified cash basis must be used rather than the accruals basis unless any of the following conditions apply:

- The business is carried on by a company, an LLP, a partnership with a corporate partner or a trust;
- The gross property income exceeds £150,000 for the tax year, reduced proportionately if the business is only carried on for part of the year;
- The business is owned jointly by spouses or civil partners and the profits are shared 50:50, where one party makes an election for the accruals basis to apply then the other party must also use the accruals basis;
- Business premises renovation allowances have been claimed in relation to the property business and there would be a balancing adjustment in the tax year if the profits were calculated under the accruals basis;
- The owner makes an annual election to use the accruals basis.

Where the landlord engages a letting agent, HMRC's view is that the date on which the rent is collected or expenses paid by the letting agent is the relevant date for the simplified cash basis.

Many consultation respondents took the view that it should be the date on which the letting agent pays the net rent to the landlord. HMRC will clarify the position in its guidance, which is to be published “after the enactment of the legislation”.

Capital and revenue expenditure

Expenses are recognised when paid and must be incurred ‘wholly and exclusively’ for the purpose of the property business. Care needs to be taken where expenditure has a dual purpose, as only the business element will be tax deductible.

In the first year of using the simplified cash basis, transitional adjustments ensure that income is not taxed twice and that expenditure is only relieved once. This is achieved by applying the existing adjustment on change of basis rules that usually apply to trading businesses.

Adjustments will be applied in reverse if, in future, the property business moves from the simplified cash basis back to the accruals basis. However, it is possible to spread the adjustment income that arises on leaving the simplified cash basis over six years.

Where a residential property is let on an assured shorthold tenancy, the amount retained by the landlord at the end of the tenancy will be recognised as income under the simplified cash basis.

Under the simplified cash basis, the capital versus revenue distinction is removed and all expenditure incurred wholly and exclusively for the purposes of the property business is allowed as a deduction from income unless it falls into any of the categories below:

- acquisition or disposal of a the whole or part of a property business ;
- provision, alteration or disposal of:
    - land;
    - an asset used in a dwelling house (this exclusion does not apply to FHL businesses in the UK or EEA) ;
    - non-depreciating assets (useful life of 20 years or more);
    - assets not acquired or created for use on a continuing basis in a trade (eg expenditure on goodwill);
    - cars, although capital allowances can be claimed by commercial and furnished holiday letting businesses;
    - intangible assets (unless the asset has a definite, fixed life of fewer than 20 years);
    - financial instruments.

As capital allowances cannot generally be claimed under the simplified cash basis, adjustments will be required for capital allowances on entry into the simplified cash basis. Generally, on entry into the simplified cash basis, balancing adjustments are required to reduce all the capital allowances pools to nil.

So long as the capital expenditure would have been deductible under the simplified cash basis, had it applied at the time the expenditure was originally incurred, and the asset has been fully paid for, the balancing allowances generated can be deducted from the cash basis profits. In practice, many small property businesses may not be affected by this transitional rule because they will have no unrelieved expenditure in capital allowances pools as it has been covered by the annual investment allowance.

Amounts paid for qualifying assets during tax years in which the simplified cash basis applied, which are still in use when the business leaves the simplified cash basis, are brought into a capital allowance pool. The amount of those payments already relieved for tax must be deducted in the pool. In many cases, this will result in a net nil balance on the capital allowances pool, but bringing the items into a capital allowances pool means that any future disposal proceeds from selling such equipment will have to be brought into the pool.

Finance costs

The tax treatment of the finance costs depends on the type of property they relate to:

- Commercial property and qualifying FHLs - The full amount of the finance costs can be deducted from the cash basis profits;

- For residential property, the new rules being phased in from 2017/18 restricting the finance costs to the basic rate of income tax apply.

Losses

Under the simplified cash basis, losses can be carried forward and set against profits from the same property business or, where possible, set against FHL profits from the same territory,

Increasing professional costs

The election to opt out of the cash basis is an annual election, so it is important that there is an annual review of which basis of assessment is preferable; switching between the two could make capital allowances very complicated and will increase the professional costs for the client;

Where joint property jointly are able to elect for different bases of assessment, this could mean the adviser has to calculate the profits from the same business on both the simplified cash basis and the accruals basis, so doubling the advisors work and related costs.

Making tax digital

From April 2020 when it is expected that Making Tax Digital will apply to property businesses with receipts above the VAT threshold, the key will be knowing the basis of assessment at the beginning of the tax year. However, a property business may not know at the beginning of the tax year whether the cash basis receipts will exceed £150,000 for the tax year, and so may find later that they have been using the wrong basis.

New double taxation dispute resolution directive

Estimates show that there are currently around 900 double taxation disputes in the EU today, estimated to be worth €10.5 billion. On 10 October 2017 EU finance ministers formally adopted the new directive on double taxation dispute resolution mechanisms at the ECOFIN meeting. Member states have until 30 June 2019 to implement the directive.

The directive introduces a binding procedure for resolving disputes within two years. It will apply to disputes involving tax years starting on or after 1 January 2018, although member states may agree to apply it earlier.

The directive will give taxpayers more certainty when it comes to seeking resolution to their interpretation of tax treaties or double taxation problems. In particular, a wider range of cases will be covered and Member States will now have clear deadlines to agree on a binding solution, giving citizens and companies more timely decisions. Member States will now have a legal duty to take conclusive and enforceable decisions under the improved dispute resolution mechanism. If not, the national courts will do this for them.

europa.eu/rapid/press-release_IP-17-3727_en.htm

Group relief and the appointment of a receiver

Summary –The appointment of a receiver resulted in loss of control and the company being degrouped for group relief purposes.

Farnborough Airport Properties Company and Farnborough Properties Company referred to collectively as 'Farnborough', as well as Piccadilly Hotels 2 Limited were each at least 75% subsidiaries of Kelucia Ltd.

On 30 May 2014, both Farnborough Airport Properties Company and Farnborough Properties Company submitted amended corporation tax returns for the period ended 31 May 2012 including claim for group relief totalling £10.5million for losses surrendered to it by Piccadilly Hotels 2 Limited.

However, on 27 June 2011 Piccadilly Hotels 2 Limited had been placed into receivership which was effected by the appointment of a receiver by Bank of Scotland plc over the whole of the property of Piccadilly Hotels 2 Limited. The Bank of Scotland's rights flowed ultimately from its appointment as Security Trustee under a Deed of Debenture dated 10 October 2006

HMRC had disallowed Farnboroughs' claims for £10.5m of group relief under s154 CTA 2010 in relation to losses surrendered by Piccadilly Hotels 2 Limited, on the ground that Piccadilly Hotels 2 Limited had ceased to be a member of the same group of companies as a result of the appointment of receivers over Piccadilly Hotels 2 Limited.

The issue was whether the appointment of the receivers had the effect of degrouping Piccadilly Hotels 2 Limited from Farnborough Airport Properties Company and Farnborough Properties Company.

Decision

The First Tier Tribunal said that the debenture gave extensive powers to the receivers but the debenture was not a constitutional document akin to articles of association, so that the reference to 'other documents' in s 1124(2)(b) CTA 2010 did not include a debenture. They concluded that the receivers had not acquired 'control' of Piccadilly Hotels 2 Limited under s 1124.

The First Tier Tribunal found that once the receivers were appointed, their powers were so extensive that the shareholders could no longer be 'fairly said' to have 'the power to secure that the affairs' of Piccadilly Hotels 2 Limited were 'conducted in accordance with their wishes'. They also found that even if the shareholders were able to recover control of Piccadilly Hotels 2 Limited by paying off the receivership debt, this did not mean that Effect 2 in s154 CTA 2010 did not apply in a situation where the shareholders had lost control of Piccadilly Hotels 2 Limited.

The Upper Tribunal agreed with the First Tier Tribunal and the appeal was dismissed.

Farnborough Airport Properties Company and Farnborough Properties Company v HMRC [2017] UKUT 394

Disallowed interest

Summary – HMRC were correct to disallow interest paid by the UK branches of two Irish companies.

The First Tier Tribunal heard joined appeals covering the same issue relating to two Irish registered companies:

1. Irish Bank Resolution Corporation Ltd;

2. Irish Nationwide Building Society.

Both Irish companies had a Permanent Establishment in the UK in the form of a branch and they acknowledged that they were liable to UK corporation tax. They submitted UK corporation tax returns for the relevant periods and between 2003 and 2007, they claimed a deduction for interest paid by their Permanent Establishments to their respective Irish head office.

HMRC disallowed these interest deductions arguing that s11AA(3) ICTA 1988 requires an assumption to be made that a Permanent Establishment has a certain level of capital, and that it disqualifies for deduction interest and other costs which would not have been incurred if the assumed level of capital was in fact held.

The companies argue that the attribution of a notional level of capital differing from the actual level of capital employed in the Permanent establishment, as s11AA(3) ICTA 1988 requires, is incompatible with the provisions of art 8 of the double taxation convention of 2 June 1976 between the United Kingdom and the Republic of Ireland (DTC), and so the interest should be deductible.

The disallowance of costs for which s11AA ICTA 1988 provided is known as a capital attribution tax adjustment, or CATA. In this case the companies and HMRC had agreed, on a without prejudice basis, what the CATA should be if HMRC are right and, also on a without prejudice basis, the companies had paid that amount. They would clearly be entitled to a refund if they were successful in the appeals.

So the sole issue to be decided was whether s11AA(3)(b) ICTA 1988 precludes such deduction. Both parties agreed that, were it not for s11AA(3)(b), the deduction would be allowed.

S11AA ICTA 1988 reads:

1) This section provides for determining for the purposes of corporation tax the amount of the profits attributable to a permanent establishment in the United Kingdom of a company that is not resident in the United Kingdom ('the non-resident company').

2) There shall be attributed to the permanent establishment the profits it would have made if it were a distinct and separate enterprise, engaged in the same or similar activities under the same or similar conditions, dealing wholly independently with the non-resident company.

3) In applying subsection (2) –

   (a) it shall be assumed that the permanent establishment has the same credit rating as the non-resident company; and

   (b) it shall also be assumed that the permanent establishment has such equity and loan capital as it could reasonably be expected to have in the circumstances specified in that subsection.

   No deduction may be made in respect of costs in excess of those that would have been incurred on those assumptions.

Decision

The First Tier Tribunal concluded that s11AA(3) does not offend art 8 of the DTC.

1) Even though the method of doing so may have changed, it has been recognised in the UK, and has been the UK practice, since at least the 1950s that it is necessary to determine the amount of free capital properly to be ascribed to a Permanent Establishment in order to assess the amount of profit chargeable to tax in the jurisdiction in which that Permanent Establishment operates;

2) The OECD Model and Commentaries likewise recognise, even if until 2010 and 2008 respectively they did not spell out, the same necessity; and that art 7 of the pre-2010 version of the OECD Model, reflected in art 8 of the UK-RI DTC, did not preclude the attribution for which HMRC argue.

The Tribunal concluded that it seemed impossible to argue that there is anything offensive about s 11AA(3). The assumptions for which it provides are no more than art 8(2) requires: that the Permanent Establishment has the same credit rating as its parent, reflecting the art 8(2) assumption that the Permanent Establishment is trading "under the same or similar conditions"; and that it "has such equity and loan capital as it could reasonably be expected to have", reflecting the art 8(2) assumption that it is a "distinct and separate enterprise". In other words, s 11AA(3) seems to do no more than give effect to the art 8(2) requirements.

The appeals were dismissed

(1) Irish Bank Resolution Corporation Ltd (In Special Liquidation) / (2) Irish Nationwide Building Society V HMRC (TC06121)

BEPS goes local and global (Lecture B1048 – 8.18 minutes)

With more than 80 countries now having agreed to adopt at least the minimum elements of the Base Erosion and Profit Shifting (BEPS) Action Plan, there is no getting around BEPS. But partial or modified application in different local markets is creating an even more complex patchwork of requirements than before. A lack of sophisticated tax management capabilities can result in competing demands and a greater risk of tax disputes and double taxation that follows. So what are the complexities facing your clients, why are the risks increasing and how can you help clients manage the impact?

BEPS was spearheaded by the OECD, has strong backing from the G20. All the countries that have signed up have looked at the rules involved and agreed to try to put a stop to treaty shopping, provide more transparency in tax and provide more harmonised rules around the world. Quite a few non-OECD countries, including China, India and South Africa, have accepted that BEPS is a good way forward. The offshore territories of Jersey, Guernsey and Liechtenstein have also come on board.

But there are still a number of significant markets outside the fold including Thailand, Malaysia, Panama and Mauritius. Thailand, Malaysia and Panama have engaged in the BEPS development and may get on board at some stage. India has re-negotiated its tax treaty with Mauritius, which includes a withdrawal of the capital gains exemption. While the treaty re-negotiation had been under discussion for some time, the conclusion of the BEPS project seems to have encouraged India and Mauritius to finalise the new agreement.

Accelerating and simplifying implementation

The acceleration in take-up owes much to the OECD's introduction of an 'inclusive framework for the implementation of BEPS'. By focusing on the minimum rather than the broader recommended BEPS standards, the framework aims to encourage states to 'work collectively on an equal footing and in a co-ordinated manner to level the playing field'.

To avoid re-negotiating many bilateral treaties, the OECD is developing a multilateral instrument that would allow countries to easily add the BEPS tax-treaty recommendations into their agreements. More than 90 countries are involved in the development of the multilateral instrument and they're aiming to agree the terms by the end of the year.

Both the multilateral instrument mechanism and the international co-operation that underpins it have never been seen before. But there may be sticking points – for example, some countries including India are unlikely to accept a mandatory arbitration clause.

Businesses operating internationally

What does this mean for businesses operating internationally? The growing application of BEPS in both developed and emerging markets worldwide means that it will impact on all firms with an annual turnover above the BEPS threshold (€750 million). And some countries are planning to set much lower qualifying thresholds for the reporting requirements – as low as €45 million in Spain, €50 million in the Netherlands and €100 million in Germany. Even if you do not think that your clients will fall within these thresholds, they could still be impacted. Governments are acting differently and there is a trickle down effect for smaller entities that means that the way that tax authorities operate is likely to impact on all clients. For example, the shift in transfer pricing rules means that taxable income is likely to be distributed across many more jurisdictions than before.

An awareness of BEPS is going to be hugely important for all clients working cross border. They may fall foul of thresholds in the future and so setting up structures now that will work in the future will be important for them. Hunting out low tax jurisdictions might not be the way forward if the rules are going to change. It will be worth considering building BEPS and variations in local application into client's strategic planning might make sense. This includes mapping operations against the changing tax rules, determining any new or increased tax exposures and judging what modification, relocation or more fundamental restructuring may be needed to manage these demands. While there will be differences from jurisdiction to jurisdiction, the broad sweep of BEPS is towards aligning tax liabilities with economic substance. This means that you can help clients begin to plan ahead before the different national legislation is put in place and develop a reasonably consistent response across client companies.

Selective application

The new international tax landscape would be reasonably manageable if it were to result in a genuinely level playing field. But selective application and the different pace of implementation across various jurisdictions worldwide actually mean less certainty and consistency than before. Some states such as the UK and Australia are applying most of the recommendations as well as the minimum standards. But the bulk of signatories, including most of those in emerging markets, are only focusing on the inclusive framework minimum for now. Even some of the recommended areas such as interest rate deductions on intra-company debt are open to wide local interpretation and variation. And to add to the complexity, some states are actually going further than the architects of BEPS envisaged. For example, India has introduced an equalisation levy on online advertising, company- to-company e-commerce and many other forms of digital business conducted by organisations with no PE in the country. This approach was considered but not recommended in the Action Plan.

The US has introduced CbC reporting for US- based multinational entities (MNEs) with more than $850 million in annual revenue, though this is probably as far as it will go in applying BEPS.

While the US is involved in the development of the multilateral instrument on tax treaties, it’s unlikely to sign the PE provisions because US MNEs are liable for tax on their global operations and receive credits for the tax they pay abroad. Given what is in effect a worldwide approach to taxation, the US would have little interest in creating more PEs elsewhere.

Over time, more of an international consensus could emerge, albeit with some countries such as the US continuing to go their own way. We’re already beginning to see the emergence of regional tax blocs, within which there is a high degree of harmonisation in how BEPS is likely to be applied. This includes the EU and ASEAN. Many countries in Africa will follow the lead taken by South Africa, which is planning to introduce new transfer pricing policies that take their cue from BEPS. But some countries within these various blocs will still want to apply either more favourable or more stringent tax arrangements than others.

Demands on businesses

These different and possibly competing tax rules multiply the compliance demands. The extra burden will fall most heavily on mid-size MNEs, which tend to lack the well-developed capabilities needed to deal with the increased information gathering, record-keeping and reporting requirements.

Both the disparities in how BEPS is applied and the new information obtained from CbC reporting are also likely to heighten the risk of double taxation and disputes with tax authorities, with mid-size MNEs caught in the middle. Improvements in cross-border tax dispute resolution are one of the minimum requirements for countries signing up for the inclusive framework. But where different tax rules apply, a resolution that favours the taxpayer and avoids double taxation may be hard to accomplish. This is particularly true where one or both of the tax administrations involved is understaffed and under-resourced.

It will be important for clients to build or hire in the capacity to monitor tax developments that are imminent in all the markets in which they operate and those that may eventually have an impact on their business. This will enable them to begin to develop contingency plans.

Clients will need to carry out a global risk assessment across all operating territories to identify, evaluate and mitigate any risks. The evaluations should look at the reputational implications of tax policies, as well as the risks of audit, dispute and double taxation.

BEPS is still in the early stages of implementation but it’s already clear that this will be a genuinely global regime, which embraces developed and emerging markets and offers little or no shelters. For the unwary, there are heightened tax risks and exposures but the ability to anticipate and manage the changes will be a key source of competitive differentiation. Given the uncertainties, complexities and speed of change, following the Marine Corps motto of ‘adapt, improvise and overcome’ would be wise. Get to know the terrain by charting developments, mapping scenarios and putting together clear contingency plans. And find out where clients are vulnerable and address these areas. At the same time, there are also opportunities to create a more informed and streamlined approach to tax management across multiple global operations.

The impact of BEPS could also provide a valuable catalyst for reviewing operating structures as clients look to control costs, improve enterprise-wide oversight and develop the capacity to reach new, fast growth markets.

Adapted from an article by Grant Thornton (BEPS goes global and local: What it means for operations in non-adopting markets)

VAT

Charity's building – Extension or annex

Summary – The subsequent addition of a separate storage facility for the village hall constructed several years earlier was zero-rated.

Litton Cheney had a population of about 350 people and a small village school. According to OFSTED reports in 2001 and 2007 it lacked a suitable hall where physical education could take place.

The school and the villagers raised funds to build a village hall for use by both the school and villagers alike. Plans included a storage room and for the heating system to be housed in a mezzanine space between the stage and the men's toilets. The trustees did not appreciate the amount of space that the heating equipment would require, but once the space requirement was appreciated it became clear that locating the equipment in the mezzanine space was not an option. Instead, it had to be located in storage room or, at least, a large part of it. They decided to add some extra storagespace. While waiting on the planning permission and the additional money that was needed, it was decided to incorporate a steel joist within the east wall of the hall so as to facilitate the necessary support and access when the envisaged storage facility was added. Funding proved difficult and was raised some time later between 1 December 2013 and 20 March 2014, a long time after the original hall had been built.

Group 5 Schedule 8 VATA 1994 provides for the construction of a building to be zero rated but subject to notes 16 and 17 which needed to be considered here.

16. For the purpose of this Group, the construction of a building does not include—

(a) the conversion, reconstruction or alteration of an existing building; or

(b) any enlargement of, or extension to, an existing building except to the extent the enlargement or extension creates an additional dwelling or dwellings; or

(c) subject to Note (17) below, the construction of an annexe to an existing building.

17 Note 16(c) above shall not apply where the whole or a part of an annexe is intended for use solely for a relevant charitable purpose and—

(a) the annexe is capable of functioning independently from the existing building; and

(b) the only access or where there is more than one means of access, the main access to:

(i) the annexe is not via the existing building; and

(ii) the existing building is not via the annexe.

The trustees believed that the storage construction was zero rated as either:

(1) the storage facility was the completion of the original building and neither an extension nor an annex to it. It is their case that the temporal disconnect between the two building processes must be seen in the factual context which we have set out above, with particular reference to the decision to put in a lintel to allow the building to be completed when additional monies and planning permission were available; alongside the fact that we are dealing with a non-commercial organisation and so things simply could not progress as expeditiously as they might have done if those things were being undertaken by a commercial organisation.

(2) The storage facility is exempt from VAT by reference to paragraphs 16(c) and 17 of Group 5 to Schedule 8. In other words, the additional building is an annex intended for use solely for relevant charitable purposes and it meets the conditions set out in paragraph 17(a) & (b).

Decision

The First Tier Tribunal said that the physical appearance of the buildings was rather like a garage being appended to the side of a house rather than appearing as if the house itself has been extended. In terms of layout the additional building is simply a room in which items can be stored. It can be accessed through double doors from both the original building and externally. They said that it was inherently improbable that the additional building could be put to any of the primary uses to which the original building was capable of being put. It has no windows and was entirely dependent upon artificial light. They concluded that it was not an extension but rather an annex to the original building. They held that there could be no doubt that the annex was capable of functioning separately from the original building. It had external double doors which would allow it to be accessed at will. However, they also found that neither means of access, internal or external, was given primacy or used more than the other. They were of equal status, significance and importance to the differing users of the facilities.

HMRC argued that with no original planning permission and with the subsequent, significant passage of time, the storage could not be regarded as the completion of the original building. The Tribunal disagreed, saying that they were satisfied that the delay was explained by the funding issue and that incorporating the lintel clearly indicated their intentions from the outset. They were in no doubt that the additional building assisted or facilitated the original building in functioning in accordance with its originally intended purpose or purposes.

The annex was zero rated and the appeal was allowed.

Litton & Thorner's Community Hall V HMRC (TC06101)

Supply of goods or supply of services?

Summary –'Contract for hire which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment', applied to a leasing contract with an option to purchase if it could be inferred from the financial terms of the contract that exercising the option appeared to be the only economically rational choice that the lessee would be able to make at the appropriate time if the contract was performed for its full term.

Mercedes-Benz offered three types of standard contract for financing the use of motor vehicles:

1. Standard hire agreement known as 'Leasing' and excluded any transfer of ownership; this was a 'supply of services' and subject to VAT on each monthly instalment under art 64 of Council Directive (EC) 2006/112 (the VAT Directive);
2. 'Hire Purchase' agreement where ownership transferred at the end of the contract; the 'Hire Purchase' agreement constituted a 'supply of goods' within the meaning of art 14(2)(b) of the VAT Directive. Consequently, under art 64 of that directive, VAT was chargeable in full upon the handing over of the vehicle, the taxable amount being the total price of the supply;
3. 'Agility' leasing agreement with an option to purchase, allowing customers to delay choosing between leasing and purchase until the vehicle had been handed over.

The dispute arose over the VAT treatment of this last category, the 'Agility' leasing agreement. HMRC argued that it should be treated like the 'Hire Purchase' agreement, and so constituted a 'supply of goods' meaning they claimed full payment of VAT from Mercedes-Benz upon the handing over of vehicles.

Mercedes-Benz appealed to the Firs Tier Tribunal arguing that the 'Agility' agreement, did not necessarily provide for a transfer of ownership, had to be regarded as a 'supply of services' and so VAT was chargeable only on each monthly instalment.

The Fist Tier Tribunal dismissed the appeal and Mercedes-Benz appealed to the Upper Tribunal who allowed the appeal.

HMRC appealed but the Court of Appeal who considered that in order to resolve the issue, they needed the CJEU to interpret art 14(2)(b) of the VAT Directive. They asked whether, and to what extent, the words 'contract for hire which provides that in the normal course of events ownership is to pass at the latest upon payment of the final instalment', used in art 14(2)(b) of the VAT Directive, should be interpreted as applying to a leasing contract with an option to purchase, such as the type of contract at issue in the ‘Agility’ contrcat.

Decision

The CJEU said that it should be interpreted as applying to a leasing contract with an option to purchase if it could be inferred from the financial terms of the contract that exercising the option appeared to be the only economically rational choice that the lessee would be able to make at the appropriate time if the contract was performed for its full term.

It is now for the Court of Appeal to decide whether this is the case.

HMRC v Mercedes-Benz Financial Services UK Ltd C-164/16

Tennis club refurbishment

Queens Tennis Club is a limited company that runs on a sports club located in West London that was established in 1886. It provides its members with the opportunity to play lawn tennis, real tennis, rackets and squash. Each year, the Aegon Tennis Championship is held here which attracts many of the world's leading players.

Queens Tennis Club makes exempt supplies of sporting services to its members and also taxable supplies by selling food and drink in its bars and restaurants. It had incurred costs refurbishing its bar, restaurant and café facilities. Queens Tennis Club considered that it was entitled to a full credit for input tax on those expenses as they were wholly attributable to taxable supplies.

However, HMRC argued that the bars and restaurant are inly available to its members and that input tax should be recovered under Queens Tennis Club's partial exemption method.

Queens Tennis Club appealed.

Decision

The First Tier Tribunal concluded that when the Club makes the restaurant and the bars available to its members it does so as part of a supply of catering services which are standard rated and not exempt.

Viewed objectively, the focus of the Club's offering to its members is on world- class sporting facilities. It does not seek to attract social members, although it does cater for people who, having been playing members, are not able to continue to play sport by admitting them to a social membership category. Nor, viewed objectively, are the Grille restaurant and the bars a means for members to enjoy the Club's world class sporting facilities.

Since the presence of the restaurant and bars does not impact on members' ability to enjoy the Club's world-class sporting facilities, it follows that there is no direct and immediate link between the refurbishment works and the Club's exempt supply of membership.

The appeal was allowed.

The Queen's Club Limited v HMR (TC06119)

Cabin construction - Refund under DIY housebuilders' scheme

Summary – The case was referred to a differently constituted First Tier Tribunal as it was clear that the Frst Tier Tribunal had not considered whether the construction was in the course of a business.

Richard Akester applied for planning permission to build a log cabin as holiday accommodation in the back garden of his home.

Permission was granted on condition that it was used for tourism purposes only and not as a main residence, although this was removed in a later application. Before starting to build the cabin, Richard Akester sold his home and, after the cabin was finished, he occupied it as his main residence.

He claimed a VAT refund under the DIY builders' scheme but HMRC refused the claim on the grounds that the cabin was occupied as a permanent home, contrary to planning permission and was therefore unlawful. Further, had the cabin been used for holiday lets, it would have been in the furtherance of a business and therefore not within the conditions for the DIY scheme.

A person is only entitled to a refund of VAT under the DIY Scheme if certain conditions are met including that the construction works:

- were lawful; and
- not carried out in the course or furtherance of any business.

The First-tier Tribunal dismissed Richard Akester's appeal so he appealed to the Upper Tribunal.

Decision

The Upper Tribunal concluded that the First Tier Tribunal's decision contains errors of law and must be set aside. It was clear from the First Tier Tribunal's decision that it had considered only whether any business had been carried out at the cabin rather than whether the works of construction were in the course of a business.

They did not consider that they were able to remake the decision on the basis of the facts as found by the First Tier Tribunal or make findings of fact necessary to decide the appeal. They decided to remit the case to a differently consitituied First Tier Tribunal because it had misunderstood the concept of business for VAT and the conditions in s35(1) (b).

The appeal was allowed.

Richard Akester v HMRC, [2017] UKUT 0404 (TCC)

Guaranteed rental return scheme

Wilson Leisure Developments Ltd owns and operates three UK holiday parks. It sells holiday lodges to customers who are private individuals and invariably not VAT-registered or, at least, not relevantly VAT-registered. Each lodge is located on a designated plot within a park with the lodge owner paying to buy the lodge as well as an annual site fee plus the cost of utility supplies, insurance, maintenance and repairs.

The lodge owners may let their lodges to holidaymakers but must use one of two schemes devised by Wilson Leisure Developments Ltd. This case related to the second of these schemes, known as the "guaranteed rental income" scheme, and operated as follows:

- The lodge owner makes his lodge available to Wilson Leisure Developments Ltd for a specified number of weeks in the year (typically 46 or 48 weeks) and retains the lodge for their own use for the remaining weeks;

- Wilson Leisure Developments Ltd guarantees that, whether or not the lodge is actually let, the lodge owner will receive a set income, typically 6% of the original cost of the lodge;

- Wilson Leisure Developments Ltd arranges for the lodge to be let to holidaymakers, through a third party booking agent;

- Wilson Leisure Developments Ltd pays all the costs incurred in connection with the lettings, including advertising, the provision of a sufficient quantity of crockery, cutlery, bed linen and towels, cleaning and laundry, utility supplies, maintenance and repair;

- The lodge owner does not pay site fees or any of the other costs that are generally the responsibility of a lodge owner unless the rental income exceeds the amount guaranteed by the scheme. In that case the agreement allows Wilson Leisure Developments Ltd to charge the costs it incurs, as well as site fees and a 20% commission, against the surplus.

Having originally treated the income earned as standard-rated, in 2010 Wilson Leisure Developments Ltd submitted a voluntary disclosure seeking to recover the output tax previously declared, arguing that it acted as agent for the lodge owner in each case. HMRC argued that it acted as principal when letting lodges under this scheme. The company appealed.

Decision

The Tribunal said that they had been told that in no case has the net rental income actually earned to date, exceeded the guaranteed amount so Wilson Leisure Developments Ltd must either have made a loss, or at best broken even, in every case. They concluded that the underlying purpose of the scheme was to encourage potential investment purchasers, rather than to operate a rental scheme for its own sake.

They said that there was nothing in the “guaranteed rental income” agreement, or elsewhere, which could realistically be construed as the appointment by the lodge owner of Wilson Leisure Developments Ltd as their agent to undertake those lettings. Not only is there no express appointment, there is no statement of the scope or extent of Wilson Leisure Developments Ltd’s authority.

In their view, the only realistic conclusion was that the lodge owner hands the lodge over to Wilson Leisure Developments Ltd to let it as they see fit, during the 46 or 48 weeks for which the agreement provides.

The appeal was dismissed.

Wilson Leisure Developments Limited V HMRC (TC06136)

R&C Brief 3/2017: Pension fund management services

Summary – From 1 January 2018, HMRC will no longer allow insurers to treat their supplies of non-special investment fund pension fund management services as exempt from VAT. This follows the conclusion of relevant litigation in the CJEU and the government's recognition that there will be no further review of EU rules in this area before the UK exits the EU.

Prior to the judgement in ATP Pension Services [2014] STC 2145 (C-464/12), HMRC did not consider pension funds of any kind to be special investment funds, and therefore treated services provided in connection with all types of pension fund as falling outside the specific VAT exemption for the management of special investment funds.

In ATP Pension Services [2014] STC 2145 (C-464/12), the CJEU found that a pension fund which pooled investments from a number of defined contribution occupational pension schemes qualified as a special investment fund for the purposes of the VAT exemption for fund management services.

In light of the ATP judgement, HMRC now accepts that pension funds that have all of the required characteristics are special investment funds for the purposes of the fund management exemption, so that the services of managing and administering those funds are, and always have been, exempt from VAT. Pension funds that do not have all those characteristics are not special investment funds and so are not within the scope of the exemption.

HMRC expects most pension fund management services provided by insurers will now relate to defined contribution pension funds, which qualify for exemption in accordance with the CJEU decision in ATP Pension Services.

www.gov.uk/government/publications/revenue-and-customs-brief-3-2017-vat-treatment-of-pension-fund-management-services

Legal fees incurred in relation to a director

Summary - Praesto Consulting UK Ltd was not entitled to recover input tax incurred in defending civil proceedings brought against its director.

Praesto Consulting UK Ltd installs computer software. Mr Ranson is a director of the company and was formally an employee of Customer Systems Plc.

On 4 November 2009, the solicitors acting for Customer Systems Plc wrote a letter before action to Mr Ranson alleging that Mr Ranson had breached his contract of employment with Customer Systems Plc by removing confidential information, had breached fiduciary duties and duties of confidentiality owed to Customer Systems Plc and had made defamatory comments about Customer Systems Plc.

Two days later, the solicitors for Customer Systems Plc wrote a letter before action to Praesto Consulting UK Ltd alleging that Praesto Consulting UK Ltd had made defamatory comments about Customer Systems Plc and had induced employees of Customer Systems Plc to breach restrictive covenants in their contracts of employment.

Mr Ranson and Praesto Consulting UK Ltd instructed Sintons, solicitors who responded to the letters before action on behalf of both Mr Ranson and Praesto Consulting UK Ltd. Sintons invoiced Praesto Consulting UK Ltd for the work done in relation to the claims and Praesto Consulting UK Ltd's claim for credit for the input tax in relation to that invoice was accepted by HMRC.

On 4 May 2010, Customer Systems Plc commenced proceedings against Mr Ranson for breach of contract and breach of fiduciary duty. No proceedings were issued against Praesto Consulting UK Ltd. Mr Ranson successfully appealed to the Court of Appeal, which found that Mr Ranson held no fiduciary duty to Customer Systems Plc. Although there was some discussion as to whether Praesto Consulting UK Ltd should become a party to the proceedings, at no point did this happen.

Sintons issued eight invoices in relation to the legal advice and all of the invoices were addressed to Mr Ranson. The descriptions of the work done supporting the invoices relating to the advice refer to the steps taken in the proceedings. They did not mention Praesto Consulting UK Ltd.

Praesto Consulting UK Ltd paid the invoices and claimed the VAT that was charged from HMRC.

HMRC refused those claims on the grounds that the services were not made to Praesto Consulting UK Ltd for the purpose of their business.

Having lost the case at the First Tier Tribunal, HMRC appealed to the Upper Tribunal.

Decision

The First Tier Tribunal had found that Sintons had provided legal services to Praesto Consulting UK Ltd but it had not established that Praesto Consulting UK Ltd had a legal entitlement to these services; this was an error of law sufficiently material for the decision to be set aside. The Upper Tribunal found that it was not in a position to consider whether such a contractual relationship existed, as further findings of facts were required and it had insufficient evidence to make such findings.

Referring to Becker (Case C-104/12), the Upper Tribunal noted that a 'direct and immediate link' was required between the services and Praesto Consulting UK Ltd's taxable activity. However, the Upper Tribunal found that the legal fees were incurred in respect of proceedings brought against Mr Ranson in his personal capacity that were not part of the general costs of the taxable activities of Praesto Consulting UK Ltd.

The appeal was allowed.

HMRC v Praesto Consulting UK Ltd [2017] UKUT 395

Knew or ought to have known scheme was fraudulent

Summary - Upper Tribunal had been wrong to have concluded that an allegation that a taxpayer knew that its transactions were part of an orchestrated scheme to defraud the HMRC required HMRC to plead and particularise, and therefore prove, an allegation of dishonesty.

HMRC refused to allow both E Buyer and Citybank to deduct input tax on the basis that they 'knew or ought to have known' that the transaction involved was connected with a scheme for the fraudulent evasion of VAT relying on the two limb test set out in the Kittel case. They appealed to the First Tier Tribunal, where E buyer's case was dismissed and in the Citybank case, HMRC were required to expressly plead allegations of dishonesty against Citybank in relation to knowledge of the first limb of the test in Kittel.

Both cases were subsequently appealed to the Upper Tribunal and were heard together. The Upper Tribunal upheld the First Tier Tribunal's decision in the case of Citybank and reversed the E Buyer decision. The Tribunal acknowledged that not all cases where the first limb of Kittel was alleged (actual knowledge) amounted to an allegation of dishonesty, however, in many first limb cases it would be quite plain that the taxpayer would have been dishonest.

HMRC appealed the Upper Tribunal's decision in both cases. The appeal raised the issue of the way in which HMRC could challenge a taxpayer's right to deduct input tax. HMRC contended that the question was whether the Upper Tribunal had been wrong to have concluded that an allegation that a taxpayer knew that the transactions were part of an orchestrated scheme to defraud HMRC required HMRC to plead and particularise and therefore prove an allegation of dishonesty.

Decision

The court found that the First Tier Tribunal had been wrong to have found that the allegations in the original statement of case against Citybank necessarily involved an allegation of dishonesty. Those allegations were first limb Kittle allegations of actual knowledge. The allegations were not pleadings of facts but inferences from facts. That inference was not an allegation of dishonesty, but simply a state of knowledge. On the basis of those allegations, there had been no foundation for either the First Tier or Upper Tribunals to have required HMRC to plead dishonesty against Citybank in order to be allowed to allege that Citybank knew that its transactions (a) had been contrived, (b) facilitated fraud by others, or (c) were connected to fraud. The Upper Tribunal had been wrong not to have identified those errors in the First Tier Tribunal decision.

The same allegations had been made in the E Buyer case. The judge had dismissed E Buyers' claim to be provided with further particulars of the alleged dishonesty. Accordingly there was no basis on law upon which the Upper Tribunal would have held that the First Tier Tribunal had been wrong in law to have dismissed E Buyers claim.

Although the Upper Tribunal's summary of the law was largely accurate, the key point was that whilst HMRC could allege that the taxpayer had acted dishonestly and fraudulently, they had not needed to do so in order to deny the taxpayer the right to reclaim input tax under the Kittel test. It had been inappropriate to have directed HMRC to plead dishonesty when it had expressly informed the First Tier Tribunal that it had not sought to make that allegation.

In the circumstances, the Upper Tribunal had been wrong to have implied that the First Tier Tribunal had been justified in undertaking the task of seeking to ascertain from the statement of case whether or not the conduct alleged automatically had amounted to dishonesty or fraud. Such a process had been unnecessary and inappropriate.

The Case of Citybank would be remitted to the First Tier Tribunal for reconsideration and the order would be reinstated in the E Buyers case.

HMRC v Citybank NA and another [2017] EWCA Civ 1416

Adapted from Tolley Guidance

Duplicate bridge a sport?

Summary – The CJEU ruled that duplicate bridge, characterised by a negligible physical element, was not covered by the concept of 'sport'

The English Bridge Union Ltd was a national non-profit-making body responsible for regulating and developing 'duplicate bridge' in England.

The company organised duplicate bridge tournaments and charged players an entry fee to participate. They believed that those fees should be exempt from VAT pursuant to art 132(1)(m) of Directive (EC) 2006/112 (art 132(1)(m)), but HMRC disagreed.

The Tribunal requested a preliminary ruling from the CJEU as to whether art 132(1)(m) should be interpreted as meaning that a largely mental activity such as duplicate bridge, characterised by a negligible physical element, was covered by the concept of 'sport' within the meaning of that provision.

Decision

The CJEU observed that in the absence of a definition of 'sport' in the directive, everyday meaning must be considered, together with the context in which it is used and the purposes of the rules of which it is part. In everyday language, 'sport' refers to an activity of a physical nature and that exemptions should be interpreted narrowly.

Activities promoting physical and mental health are not enough to constitute a 'sport' within the meaning of the directive; the fact that the activity is practised competitively does not lead to a different conclusion. A wider reading would not comply with the requirement of strict interpretation of directives.

The CJEU concluded that art 132(1)(m) would not include duplicate bridge as a ‘sport’.

English Bridge Union Ltd v HMRC [2017] All ER (D) 169 (Oct)

Adapted from Tolleys Guidance

Supreme Court dismisses Littlewoods' compound interest claim

Summary - The Supreme Court has dismissed Littlewoods' claim for compound interest in respect of VAT overpaid between 1973 and 2004.

Between 1973 and 2004, Littlewoods overpaid VAT to HMRC. Between 2005 and 2008, HMRC repaid the principal sum of £205 million, together with simple interest of £268 million. However, Littlewoods sought additional interest of £1.25 billion, calculated on a compound basis, on the ground that such interest is due under the common law of restitution, either as restitution for a mistake of law, or as restitution of tax unlawfully demanded (a "Woolwich" claim).

The two issues for the Supreme Court in the present case are:

1. Littlewoods appeals on whether Littlewoods' common law claims are excluded by ss.78 and 80 VATA 1994 as a matter of English law, and without reference to EU law. The lower courts found that Littlewoods' common law claims were barred by VATA 1994;

2. HMRC appeals that if Littlewoods' claims for compound interest are excluded by ss.78 and 80 VATA 1994, whether that exclusion is contrary to EU law, in light of the Court of Justice of the European Union's ("CJEU") judgment in Case C-591/10 Littlewoods. The lower courts found that denying compound interest was contrary to EU law.

Decision

S.78 VATA 1994 excludes the claims made by Littlewoods, as a matter of English law as:

1. The scheme created by section 78 is inconsistent with the availability of concurrent common law claims to interest. The right to interest in s.78 is subject to certain limitations, including:

   (i) s.78(1) limiting HMRC's liability to pay to cases of error by HMRC ;

   (ii) s.78(3) which determine that the interest rate is calculated on a simple rather than a compounded basis;

   (iii) s.78(11), which sets the applicable limitation period, which is shorter than the limitation period that would apply to a common law claim. These limitations would be defeated and rendered effectively pointless if it were possible for the taxpayer to bring a common law claim.

2. S.78 states that the liability to pay interest under that section applies "if and to the extent that [the Commissioners] would not be liable to do so apart from this section". On a literal meaning, this would permit a common law claim for interest to be made outside s.78. At the time s.78 was enacted, however, the type of common law claim made by Littlewoods in the present case had not yet been recognised in law, and was thus not contemplated by Parliament when it enacted the legislation.

> It cannot have been Parliament's intention that a common law claim would be permitted in any case where an amount was paid under section 80, as this would render s.78 a dead letter, and would fatally compromise the statutory scheme. As such, the reservation in s.78(1) cannot be read literally. It must be construed as referring only to statutory liabilities to pay interest, not to a common law liability for interest.

The CJEU judgment does not require reimbursement of the losses constituted by the unavailability of money. The CJEU has given member state courts a discretion to provide reasonable redress in the form of interest in addition to the principal sum. The lower courts in this case read too much into the phrase "adequate indemnity" in the CJEU judgment. There is a widespread practice among EU member states of awarding taxpayers simple interest on the recovery of taxes that were unduly paid. The prior and subsequent case law of the CJEU is consistent with the principle that there is an EU right to interest, but that the rate and method of calculation of interest are matters for the member states. Case C-271/91 Marshall, where the CJEU held that interest had to be awarded to take account of the diminution in value of money over time, was a case about the measure of compensation for sex discrimination, and is distinguishable from the present case .

In summary, the payment of interest in this case cannot realistically be regarded as having deprived Littlewoods of an adequate indemnity .

The Supreme Court unanimously dismisses Littlewoods' cross-appeal on the first issue, and allows HMRC's appeal on the second issue.

www.supremecourt.uk/cases/uksc-2015-0177.html

Adapted from Tolleys Guidance

VAT and mixed supplies **(Lecture B1049 – 11.55 minutes)**

Background

A worrying part of the VAT system is when a VAT case goes through the judicial process and different courts reach different conclusions. If the courts can't agree, then how can we give clear advice to our clients? A topic where this seems to frequently happen is the controversial subject of VAT on mixed supplies i.e. what is the VAT liability of a bundle of goods and services sold to a customer where the different elements of the sale have different VAT liabilities? This happened recently with 'round 3' in the Colaingrove Ltd [2017]BVC19 case about gas and electricity charges supplied in holiday caravans but more of this case later.

Mixed supply example

An example of a mixed supply challenge is where a butter dish is sold with a large square of butter inside the dish, which was an issue I dealt with over 30 years ago when I worked for Customs and Excise and was the officer in charge of a major High Street retailer. The challenge was to decide whether the sale should be wholly standard rated ie based on the VAT liability of the butter dish; wholly zero-rated based on the liability of the butter (a food item within VATA1994, Sch 8, Group 1); or a mixed supply where output tax had to be apportioned between the two parts.

Thirty years on, and we are still dealing with many butter dish type situations. We concluded in 1985 that the butter dish sale was a mixed supply, despite the fact that the dish had a higher value than the butter. The same decision would almost certainly be made in 2017, despite a feast of tribunal cases being heard in the interim period.

Landmark CPP case

Back in 1999, we all thought (incorrectly) that the ECJ case of Card Protection Plan Ltd (case ref: C-349/96) had resolved the mixed supply dilemma, with detailed guidance given in the case report about how to decide whether a single or multiple supply was evident:

- Is there one main supply of goods or services with the other supply or supplies being 'incidental' or 'ancillary' to the main supply? If so, then the VAT liability wholly depends on the main supply.
- Is each supply in aim in itself? Does the customer expect to receive all elements of the supply as a priority? If so, this indicates a mixed supply. However, if the purpose of the second supply is to enhance the enjoyment of the main supply, then the second supply is ignored.

Example

A cup of tea and biscuit provided by an airline during a flight is not a supply of standard rated catering. Its purpose is to enhance the enjoyment of the zero-rated air travel. The whole supply is zero-rated.

It is important to always look at supplies from the perspective of the customer. So in the case of the butter dish, the customer clearly expected to enjoy both the butter and the butter dish, otherwise he would have made a separate purchase for just one of the items (and saved some money in the process).

Separate invoicing for the different elements is not conclusive proof of a mixed supply.

Tribunal case - Colaingrove Ltd

The Court of Appeal had to consider whether separate charges for gas and electricity made to holiday makers staying in caravans were subject to 5% VAT under VATA1994, Sch 7A, Group 1, or whether they were subject to 20% VAT because the charges were an element of a single supply of holiday accommodation in the caravan.

To give some background, the taxpayer operates 37 holiday parks throughout the UK and had an arrangement with News International Ltd that meant readers could book holidays in caravans and chalets at reduced rates. The holiday maker was charged 20% VAT on the accommodation cost but only 5% VAT on a separate daily charge of £5.50 for gas and electricity. As you can imagine, HMRC contended that the full payment related to the accommodation, and that the gas and electricity supply was 'incidental' to the accommodation and also standard rated ie adopting the CPP principles.

To highlight the point I made in my opening paragraph, the First-tier Tribunal controversially ruled in favour of the taxpayer but the Upper Tribunal restored sanity by allowing HMRC's appeal against the FTT decision. The Court of Appeal made the score 2-1 to HMRC with the latest hearing. The outcome is also an example of the point I made

above that separate invoicing and payment does not necessarily indicate a mixed supply outcome.

Practical tips

Should taxpayers ask HMRC for a written ruling in cases where the VAT outcome of a mixed supply is not certain ie to give legal certainty and avoid a potential assessment of tax on a future compliance visit? The potential problem here is that HMRC will just refer the business owner to its published guidance and the principles to consider, and put the onus back on the taxpayer to reach a decision for the supplies in question. The comment that "VAT is a self-assessed tax" has developed momentum in HMRC's thinking in recent years.

A second school of thought could be that a business should just adopt a prudent approach and charge 20% on the whole supply, knowing that HMRC will not challenge this conclusion. This might be worthwhile where the zero-rated element has a lower value than the standard rated part of the supply, like in my butter dish example. But an overpayment of VAT will reduce the profit margin of a business if pricing is made on a VAT inclusive basis (as with retailers), so prudence would come at a cost.

However, my main tip is to always look at the issue from the customer's perspective and stand back and ask the question: if the customer didn't get one element of the goods or services being supplied, would he complain to the supplier? This was a key issue in the recent case of The Ice Rink Company Ltd & PI (Milton Keynes) Ltd (TC6117), which I have illustrated in the case below. The case was won by the taxpayer.

Example

Ice Rink charges £10 for an hour's skating on the rink and an extra £2 if the customer wants to hire skates as well. In the case of skate hire for children, the supply is zero-rated as it is linked to children's clothing. Is this a single standard rated supply of "admission with skates" for £12 or a mixed supply where output tax is due on £10 only ie the £2 relevant to the hire of the skates is zero-rated? The court agreed with the taxpayer that this outcome is a mixed supply – the customers expect both the use of the rink and the skates as supplies in their own right.

Contributed by Neil Warren

Credit notes and refunds (Lecture B1050 – 11.58 minutes)

Background

This session will consider two recent First-tier Tribunal VAT cases about issues concerning credits or refunds given to customers. This is a very important issue for most businesses (credit notes and refunds are a fact of business life) and there are practical issues from both cases. However, both were won by HMRC, so there is no indication that their approach on this subject is flawed.

I will also briefly review a historic case from a few years ago about whether a reduced fee following a court case involved a bad debt or a credit situation. This case was lost by HMRC.

RDS Driving Services Ltd (TC6087)

In the case of RDS Driving Services Ltd (TC6087), the First-tier Tribunal considered the VAT treatment of non-refundable fees relevant to students who did not complete their driving instructor courses.

The company offered trainee instructors the chance to pay an advance fee (non-refundable) to cover the cost of all three parts of its driving course. The fee was discounted compared to a separate payment for each of Parts 1, 2 and 3.

RDS accounted for output tax when it received the advance fee but then claimed that if the student dropped out of the course and never started Parts 2 and 3 or Part 3, then part of the output tax on the original payment should be reduced accordingly, even though no refund of money was given to the student. It argued that the element of the fee relevant to the uncompleted parts of the course did not relate to a supply of goods or services and was therefore outside the scope of VAT.

The tribunal supported HMRC's view that the advance payment created a tax point for the right to carry out all three parts of the course, and that outcome did not change if the student dropped out part way through his studies. "I find that as each Part of the Course is integral to the Course as a whole, and the trainee has prepaid for the whole Course, it would be artificial to split the supply", said the judge in his report.

The 'right' is a supply

The RDS case highlights an important VAT principle, namely that "the right" to benefit from goods or services is a supply in its own right. The fact that the students did not complete their journey in some cases did not affect the VAT position. The VAT liability is based on the known facts at the time of a supply ie the full payment is standard rated and there is no scope to reduce output tax if the student does not complete the course.

Inventive Tax Strategies Ltd (in administration) plus three others (TC6094)

In the case of Inventive Tax Strategies Ltd (In administration) plus three others (TC6094), the key issue was whether the taxpayers were entitled to reduce the output tax payable on their VAT returns in relation to the VAT shown on credit notes issued to over 3,000 customers. A key fact was that the customers would receive no actual refund because the supplier(s) were in administration or liquidation and therefore had no funds available to make payment.

The taxpayers sold SDLT schemes to customers (mostly private individuals) and received an advance fee for their services. All of the schemes failed for various reasons and most of the customer contracts said that if the schemes were unsuccessful, a full refund would be given. Credit notes were therefore issued to the customers but they received no refund of money because all four appellants went into either administration or liquidation.

The taxpayer argument was that the credit notes were correctly issued to reflect a 'decrease in consideration' of the original invoices as a result of the scheme failures. The credit should be based on the amount of money the customer was liable to pay (nil) rather than the actual payment (the original fee).

HMRC's main argument was that there could be no reduction in output tax because there had been no actual refunds given to the customers. In other words, the customer had made a full payment for the services received and there could be no 'decrease in consideration' without a refund.

The tribunal concluded that there needed to be "an actual repayment, as opposed to merely conferring an entitlement to one". (para 36). The report added: "It follows that actual payment of a refund is required, in which case there will be a reduction in the price only to the extent of the amount actually refunded…………………. It cannot be right that the Appellants receive a repayment of 100% of the VAT where the customers receive a refund of less than 100% of the fees." (also para 36). The appeal was dismissed.

The irony of this case is that the VAT rebates the companies were claiming from HMRC would probably have been the only source of potential refunds to the customers issued with the credit notes. The tribunal report referred to "common sense and commercial reality" - it would not be appropriate if the legislation allowed a business to retain standard rated fees with no VAT liability. A "decrease in consideration" only takes place when a customer either receives a refund or a credit against an outstanding payment.

(Legislation – 1995 VAT Regulations, SI1995/2518, reg 38 – Adjustments in the course of business).

Barlin Associates Ltd (TC4070) - credit note or bad debt?

This case considered the question of whether a taxpayer had incurred a bad debt or a 'decrease in consideration' as a result of a reduction in the value of his original sale to the customer. Why is this relevant, you might ask, given that credit notes and bad debt relief claims both result in a repayment of VAT by HMRC? The answer is because bad debt relief claims are time barred at four years and six months from the invoice date or due payment date (whichever is later) whereas there is no time limit for issuing credit notes and reducing output tax on a VAT return (VAT Notice 700/18, para 2.3).

Barlin Associates Ltd (TC4070) was a trade mark attorney and made sales of £871k including VAT of £127k to Autonomy Corporation between 2005 and 2010, all of which were unpaid because Autonomy disputed the basis of charging, until legal proceedings resolved the dispute in December 2012. The end result of the dispute was that Autonomy had to pay £260k to Barlin, including VAT of £45k. Barlin issued a credit note which included £82k of VAT on 11 December 2012 and sought to reclaim it from HMRC. HMRC decided that the reduction from £871k to £260k did not represent a reduction in the value of supplies from Barlin to Autonomy but a bad debt situation that was time barred in 2012.

The tribunal rejected HMRC's view that a bad debt situation was evident. To quote from the report (para 17): "HMRC are wrong to say that there is a bad debt….Autonomy owes Barlin nothing……there is no debt so there is nothing to write off."

Contributed by Neil Warren