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CONTENTS

Autumn Statement **(Lecture B1407 – 17.05 minutes)**

Personal tax

Class 1 NIC reduction

In a surprise move, with effect from January 2024, the Government has decided to reduce the main rate of employee NIC payable, from 12% to 10%. The rate applies to employee earnings between the Primary Threshold £242 per week (£1,048 per month) and the Upper Earnings Limit £967 per week (£4,189 per month). So for example, an employee earning £2,950 per month would see a reduction in NIC payable of £38.04 per month (£456 per year), from January 2024. It is anticipated the new employee rate will be applied for the remainder of the current tax year 2023/24, and for the whole of 2024/25.

The introduction of calculation rate changes partway through the tax year will present some challenges to payroll software, which will be expected to integrate the alterations quickly. The mid-year change may also present issues for individuals subject to an annual NIC calculation (eg company directors), especially those who are not paid at regular intervals.

Venture capital trusts and enterprise investment schemes

Investment in venture capital trusts (VCT) and enterprise investment schemes (EIS) was due to end on 5 April 2025 under the sunset provisions in ITA 2007, s 157(1)(aa) (for EIS) and ITA 2007, s 261(3)(za) (for VCT). However, this is expected to be extended to 5 April 2035 by Treasury Order (subject to domestic and international subsidy obligations being met). The fact that this has been announced almost 18 months before the schemes were due to end gives qualifying companies the necessary certainty when planning ahead.

ISAs

From 6 April 2024, the Government will make changes to the individual savings account (ISA) system to:

1. allow multiple subscriptions in each year to ISAs of the same type;
2. remove the requirement to make a fresh ISA application where an existing ISA account has received no subscription in the previous tax year;
3. allow partial transfers of current year ISA subscriptions between providers;
4. harmonise the account opening age for any adult ISAs to 18;
5. allow long-term asset funds to be permitted investments in the Innovative Finance ISA;
6. allow open-ended property funds with extended notice periods to be permitted investments in the Innovative Finance ISA.

These changes will be introduced by statutory instrument.

It is unclear from the information published at the Autumn Statement whether these changes will mean those with cash ISAs can open more than one cash ISA in the tax year. This can catch out those with existing cash ISAs that have to be renewed each year in order to get the best interest rates.

The Government also announced its intention to digitise the ISA reporting system to enable the development of digital tools to support investors and it has tasked HMRC with establishing stakeholder forums and communication channels for ISA managers and relevant trade bodies to ensure the pace and sequencing of the move to a digital system reflects the needs of ISA providers and investors.

The Government will also engage with the finance industry on allowing certain fractional shares contracts to become permitted ISA investments. This follows on from HMRC’s announcement in the October 2023 Tax-free savings newsletter 9 that a fractional share is not a share and therefore cannot be held in an ISA.

The ISA, Lifetime ISA, Junior ISA and Child Trust Fund annual subscription limits remain frozen at £20,000, £4,000, £9,000 and £9,000 respectively.

Pensions reform

The Government is maintaining the pension triple lock. The basic state pension, new state pension and pension credit standard minimum guarantee will be uprated in April 2024 in line with average earnings growth of 8.5%, with the state pension rising to £221.20 per week.

In the Autumn Statement 2023, the Government announced a whole suite of policies around pensions reform. This includes publishing nine documents including consultation outcomes, calls for evidence and research and analysis papers.

These cover a wide range of issues on pensions around how to make it easier for individuals to manage and access their pensions, how pensions invest and options to put changes in place, including legislation.

The key point in these announcements for employers providing pensions is the launch of a call for evidence for defined contribution pension schemes on a ‘lifetime provider’ model called Looking to the future: greater member security and rebalancing risk.

The lifetime provider model intends that individuals will have a single pension for their lifetime. This might mean that they take their pension with them when they change employers, with the intention of having fewer pension providers and creating a framework for employers to enable this with set defaults for those individuals who do not actively engage in pension decisions. This differs from the current model where it is common for individuals to have many jobs over a lifetime, building up many pension pots from different providers, with the potential for confusion and complexity in managing their pension savings and decision making at the point of accessing their pension. The Government’s stated aim is that ‘the future is one where we can reduce as far as possible the need to make complex financial decisions on the part of the individual, while retaining choice for those who want to exercise it’.

Business taxes

Class 2 NIC abolition

From 6 April 2024, self-employed people with profits above £12,570, the lower profit threshold, will not be required to pay Class 2 NIC but will still have access to contributory state benefits including the state pension. Prior to 6 April 2024, self-employed people with profits between the small profits threshold of £6,725 and the lower profit threshold of £12,570 did not pay Class 2 NIC but had access to contributory benefits and therefore this will remain the same from 2024 onwards. The option to voluntarily pay Class 2 NIC where profit levels are below £6,725 is still available in order to allow self-employed people to obtain NIC credits and will remain at the weekly rate of £3.45 for 2024/25.

Class 4 NIC main rate reduction

From 6 April 2024, the main rate of Class 4 NIC will reduce from 9% to 8%.

Expansion of the cash basis

Legislation will be introduced to expand the cash basis for self-employed taxpayers including those in partnerships from the tax year 2024/25. The changes will not apply for property businesses, companies or those entities already excluded from the current cash basis regime.

Currently, the default method for calculating profits of trading businesses is the accruals basis and in order to use the simpler cash basis, businesses have to opt in. The changes will make the cash basis the default method of calculating profits and businesses will have to opt to use the accrual basis instead.

Businesses can only currently use the cash basis if their turnover is less than £150,000 and business must leave the cash basis where their turnover exceeds £300,000 in certain circumstances. These restrictions will be removed completely so the cash basis will be available for all sizes of businesses.

There is also a limit of £500 on the amount of interest which the business can deduct for tax against the profits for the year, this limit will be abolished allowing tax relief for full interest costs as long as they are wholly and exclusively for the purpose of the trade.

Lastly, the current restrictions on the utilisation of losses under the cash basis will be removed so that losses can be set sideways against general income of the same period or carried back to earlier years as with losses under the accruals basis and subject to the same conditions.

Full expensing for companies

'Full expensing' of expenditure by companies on plant and machinery is to be made permanent. 'Full expensing' refers to first-year capital allowances available to companies only at 100% for main rate expenditure and 50% for special rate expenditure. The allowances were introduced by F(No 2)A 2023 and were originally available for expenditure incurred in the period 1 April 2023 to 31 March 2026. The sunset date of 31 March 2026 will now be removed by legislation to be included in the Autumn Finance Bill 2023.

Full expensing is not currently available for expenditure on plant or machinery for leasing. A technical consultation will be published to consider draft legislation extending full expensing to such expenditure. The Government has indicated that no final decision on extending full expensing in this way has yet been made.

The Government has also announced a technical consultation on possible simplification of the legislation for capital allowances on plant and machinery. Working group meetings will be held with stakeholders from January 2024 with the aim of publishing draft legislation in Summer 2024.

R&D tax reliefs

The Chancellor confirmed at the Autumn Statement 2023 that the proposed reform of the R&D tax reliefs will be going ahead, with the merged RDEC and SME scheme applying for accounting periods beginning on or after 1 April 2024. The enhanced support for R&D intensive SMEs will also go ahead with effect for expenditure incurred from 1 April 2023, and the intensity threshold will reduce to 30% (from 40%) from 1 April 2024. This is expected to bring 5,000 more companies within the scope of the relief. Finally, it was confirmed that R&D claimants will not be able to nominate third-party payees from 1 April 2024, and no new assignments of R&D tax credits will be possible from 22 November 2023.

New policy papers for these changes have been published today, with draft legislation previously published in July 2023. Updated draft legislation will be included as part of Autumn Finance Bill 2023.

The Government has now closed its R&D tax reliefs review, noting HMRC will be publishing a compliance action plan in due course to reduce the unacceptably high levels of non-compliance in this area.

Pillar 2 — multinational top-up tax and domestic top-up tax

Multinational top-up tax and domestic top-up tax were introduced by Finance (No 2) Act 2023 and have effect for accounting periods beginning on or after 31 December 2023. After the introduction of these provisions, draft legislation was published in July 2023 to introduce the undertaxed profits rule (UTPR) and to make amendments to the existing multinational top-up tax and domestic top-up tax regimes. Further amendments to this draft legislation were made on 27 September 2023.

The Government announced in Autumn Statement 2023 that an additional raft of technical amendments will be made to the multinational top-up tax and domestic top-up tax legislation to ensure the legislation continues to adhere to the OECD's Global Anti-Base Erosion (GloBE) rules, including a number of changes to clarify technical definitions.

It was announced today that they will be included in Autumn Finance Bill 2023.

The Government also confirmed that the UTPR will still take effect for accounting periods beginning on or after 31 December 2024 as originally announced, but clarified that it will be introduced in a future Finance Bill.

In a related announcement, the Government confirmed it will abolish the 'offshore receipts in respect of intangible property' (ORIP) rules for income arising from 31 December 2024. The repeal of the ORIP rules will be legislated for in an upcoming Finance Bill alongside the introduction of the UTPR, which is expected to comprehensively discourage the multinational tax planning arrangements that ORIP sought to counter.

Making Tax Digital small business review outcome

No major changes were announced to Making Tax Digital for Income Tax (MTD ITSA) for trading and property income. The previously announced dates of April 2026, for gross income / turnover over £50,000 and April 2027, for gross income / turnover over £30,000 remain. Future extension to businesses with gross income / turnover will be kept under review.

A number of easements and simplification will be introduced. Quarterly reporting will change. Although updates will still be every three months, these will now be on year-to-date figures. This avoids the need to put through amendments to previous quarters as envisaged in the original proposals. There will no longer be a need to submit end of period statements, the final declaration will now suffice.

An easement will apply for landlords with jointly held property. Expenses for jointly held property may be submitted annually, rather than quarterly, with less detailed information required.

Exemption from MTD will be extended to cover foster carers with qualifying care income and individuals who do not have a national insurance number. Where gross income / turnover is below the VAT registration threshold, three-line accounts will still be available.

The Government is committed to developing a solution allowing multiple agents to act on behalf of the same taxpayer.

HMRC will publish a technical consultation on draft regulations to move the process forward.

Other direct tax measures

Post office compensation schemes:

The Autumn Finance Bill 2023 will include provisions to exempt corporate entities from tax on payments made under the Suspension Remuneration Review (SRR) Scheme and the Post Office Process Review Scheme in addition to the Horizon Shortfall Scheme and the Group Litigation Order as was previously announced, with a policy paper setting out further details.

In addition to the exemptions for payments under the Horizon Shortfall Scheme and the Group Litigation Order which were legislated for in July 2023, statutory instruments will exempt payments to be made (including top-up payments) under the SRR scheme and the Post Office Process Review Scheme from income tax, NIC and capital gains tax.

NIC relief for hiring veterans

The Government is extending the employer NIC relief for employers hiring qualifying veterans for a further year until April 2025.

Digitisation of pension contributions relief at source

It has been announced that the changes expected to apply from 6 April 2025 are to be pushed back to at least 6 April 2027 due to feedback from the pensions industry.

Creative industries

The changes to the creative industries tax reliefs will come into effect in 2024 as previously announced, with some amendments to the draft legislation for the administrative changes to correct anomalies and prevent abuse.

Electricity Generator Levy

A new exemption from the Electricity Generator Levy will be introduced (in a future Finance Bill) for receipts from new electricity generating stations where the substantive decision to invest is taken on or after 22 November 2023.

Energy Profits Levy

Following a consultation in June 2023, the thresholds for the Energy Profits Levy (EPL) Energy Security Investment Mechanism (ESIM) have been set at $71.40 per barrel of oil and £0.54 per therm of gas, with further details set out in the technical note.

VAT and other indirect taxes

Women's sanitary products

Plans were announced to introduce legislation to extend the scope of the VAT zero rate to include reusable period underwear.

Currently, reusable period underwear is specifically excluded from the zero rate for women's sanitary products by way of VATA 1994, Sch 8, Pt II, Group 19, Item 2 which states that the zero rate does not include 'protective briefs or any other form of clothing'.

The change will take effect from 1 January 2024. This measure aims to reduce the cost of products for consumers, however, this will rely on retailers 'passing on' the VAT saving.

Reforms to the VAT energy-saving materials relief

The Government will introduce legislation to expand the VAT relief available on the installation of energy-saving materials by extending the relief to additional technologies, such as water-source heat pumps, and bringing buildings used solely for a relevant charitable purpose within scope of the relief.

This measure follows on from broader changes introduced in April 2022 which amended the liability of the installation of certain energy-saving materials from the reduced rate to the zero rate.

The expansion of reforms will be implemented from February 2024. Full details on these reforms are expected to be published shortly.

Other indirect tax measures

A range of other measures were also announced, which include the following:

- confirmation that previously published draft legislation on the interpretation of VAT and excise law will be included in Autumn Finance Bill 2023;
- a consultation will be launched on the VAT treatment of private hire vehicle operators following the Hugh Court's ruling in *Uber Britannia Ltd vs Sefton MBC* ([2023] EWHC 1975 (KB));
- an increase in tobacco duty rates from 22 November 2023;
- an increase in the rate of aggregates levy in line with the RPI from 1 April 2024 and again from 1 April 2025;
- an increase in the standard and lower rates of landfill tax in line with the RPI from 1 April 2024;
- an increase in the rate of plastic packaging tax in line with the CPI from 1 April 2024;
- an increase in the rate of air passenger duty for 2024/25 in line with the RPI;
- an increase to VED rates for cars, vans and motorcycles in line with the RPI from 1 April 2024 and a freeze on the rates for HGVs;
- a freeze on the rates of alcohol duty until 1 August 2024;
- a freeze of the main and reduced rates of climate change levy from 1 April 2025;
- a consultation to bring remote gambling (ie gambling via the internet, phone, TV and radio) into a single tax;
- the small business rates multiplier will be frozen for another year at 49.9p, while the 75% relief for retail hospitality and leisure (RHL) businesses will be extended for 2024/25. The standard multiplier will be uprated in line with September's CPI to 54.6p.

Personal tax

Can festive celebrations be tax free? (Lecture B1408 – 17.03 minutes)

Annual parties or similar social functions

HMRC has agreed a concession for annual parties and other similar social functions, but not one-off events, which are open to all staff and cost in total no more than £150 (including VAT) per head, including guests.

The annual event, or annual events, must be open to all employees or if the employer has several sites then open to all employees at each site. An event for selected employees would not be covered by the concession and so must be reported on the same basis as a one off event – see below.

The employer must work out the total cost, with VAT, of all the annual events. This is then divided by the total number of people attending – both employees and non-employees. All costs incurred on each event must be recorded in order to consider whether the figure of £150 is exceeded and so will include:

- Venue hire;
- Dinner and drinks;
- Gifts to staff;
- Free bar before and after dinner;
- Entertainment on the night – band, Magician, singer, cartoonist;
- Travel to and from venue;
- Overnight accommodation.

Where the total cost of the party is less than £150 per head, it falls within the concession.

But if the cost of the event exceeds £150 per person the whole event is subject to tax and NIC. The employer cannot take the cost per head, of say £180, then deduct the first £150 leaving only £30 to be subject to tax and NIC. The employer will report the events liable to tax and NIC om form P11D section M or agree with HMRC to include in the PAYE Settlement Agreement (PSA) if one in place with HMRC.

Multiple events

Some employers may put on several annual events in a year on a regular basis. They may want to celebrate Diwali, Eid, Christmas with their employees and in addition arrange a summer barbeque. The concession will apply to multiple events as long as the rules are met – regular annual events, open to all employees and cost of all the events does not exceed £150 per head.

Example

The Christmas party costs £120 per head and the barbeque costs £75 per head so in total £195. The £150 figure is therefore exceeded. The employer would use the concession against the event costing £120 leaving the £75 to be reported on the P11D section M or under a PSA.

Example

In the above example 50 employees attend both events, 10 attend the Christmas party only and 2 attend only the barbeque.

The treatment would be:

- 50 Employees – taxed on £75 or £150 if they took a guest;
- 10 employees – nothing to report as party covered by the concession;
- 3 employees – taxed on £75 or £150 as that event is not within the concession.

Virtual parties

HMRC confirmed that annual party exemption can apply to costs relating to virtual parties in the same way. The expenses of hosting a virtual party including entertainment, equipment and refreshments will be exempt.

One-off events

A one-off event, such as celebrating 25 years of the business, would not qualify under this concession. It would be taxable as staff entertaining and should be reported on form P11D section M or considered for inclusion in the PSA if the employer has one agreed with HMRC.

Where an employer gives gifts instead of holding a party, such as non-cash vouchers or hampers, these could be covered by the trivial benefit exemption depending on cost. Alternatively, the employer might consider putting into a PAYE Settlement Agreement, PSA or report on the P11D section M.

Trivial Benefits

From 6 April 2016 a statutory exemption was introduced which allows employers to treat certain low value benefits in kind (BiKs) provided to employees as “trivial” and so there is no requirement to these to report to HMRC. The exemption sets a number of conditions that must be met for a BiK to qualify as trivial, including an upper limit per individual BiK of £50.

All of the following conditions must be met:

1. The cost of providing the benefit does not exceed £50, including VAT;
2. The benefit is not cash or a cash voucher;
3. Employee must not be entitled to the benefit as part of contractual obligations;
4. The benefit is not provided in recognition of services performed by the employee as part of their employment duties

Examples of trivial benefits would include a store voucher, bottle of wine, box of chocolates, flowers, champagne, gift voucher, a turkey, a food hamper or other kind of gift provided the cost does not exceed £50 including VAT.

Any non-cash voucher would be as a trivial benefit if it met all the conditions. So a voucher of up to £50 as a birthday gift or a Christmas gift would be exempt. The benefit can be given to recognise a life event: birthday, wedding or the arrival of a new baby.

In the case where the cost of the trivial BiK exceeds the £50 limit, or is given as part of contractual obligation, or is given in recognition of services, it is fully taxable and must be reported on P11D section M or added to the PSA if one set up with HMRC.

Example

An employer gives a £30 gift voucher to the employee that meets their sales target for the month. Whilst the value is below the £50 trivial benefit limit, it has been given in recognition of services as so becomes a taxable benefit.

How many trivial benefits can be given in a tax year?

There is no annual cap on how many trivial benefits an employee can receive in a tax year but there is an annual cap for office holders of close companies.

Where the employer is a close company, there is an annual cap of £300 for trivial benefits provided to office holders of close companies and their family members. Those affected by the cap will only be able to receive, tax free, an annual maximum of £300 of trivial BiKs. If the £300 cap is exceeded, the excess is reported on P11D section M or added to the PSA if agreed with HMRC.

Referring to EIM21869, a close company is one broadly under the control of 5 or fewer participators and their associates, or under the control of directors who are participators and their associates.

Examples

Director A receives seven benefits of £50 each: Following the rules above, the first six (totalling £300) are tax free, but last benefit must be reported on the P11D or under the PSA.

Director B receives these benefits, as follows: five benefits of £50, then one of £40, then one of £45 and finally a benefit of £10.

The five £50 benefits plus the next benefit of £40 total £290 and so are tax free as they are covered by the £300 limit. The £45 benefit is taxable as takes the total over £300. However, the last £10 benefit can be used to top up the £290 benefits to £300 and so, it too, is tax free.

PAYE Settlement Agreements (PSAs)

All employers can agree a PSA with HMRC, regardless of their size. It is a flexible arrangement under which an employer can settle with one payment, the income tax and NIC liability on three types of expenses and benefits in kind – minor, irregular or where it is impracticable to operate PAYE. It is not intended to be an alternative to operating PAYE so cannot be applied to the payment of wages and salaries. Additionally, a PSA cannot be used to cover major benefits such as cars and fuel provided to an individual employee, loans or shares.

Once a PSA has been agreed with HMRC no entries are required on form P11D for the items covered. But employer will pay tax on the benefit plus employer's Class 1B NIC on the grossed-up value of the benefits in the PSA.

Amending and Updating PSAs

From April 2018 once a PSA is agreed and in place the agreement will stay until the employer needs to change it or the employer or HMRC cancel it. HMRC can withdraw a PSA if it can be established that the employer is operating outside the agreed terms or the employer fails to account for tax under the agreement. During the course of the tax year, employers can alter their PSA, if necessary.

It is important to review the scope of the PSA in case items need to be added. Any amounts under a PSA which are subject to Class 1 NIC remain liable to payroll NIC until the PSA is agreed. If the PSA is agreed Class 1B NIC is payable by the employer and the employer/employee Class 1 liability ceases.

For example, if an employer intends to give employees vouchers at Christmas, not within trivial benefit limits, and plans to include these in a PSA, the PSA needs to be in place before the vouchers are given to the employees. If it is not, then Class 1 is due on the vouchers in the pay period in which they are given.

What benefits can be included under the PSA?

PSAs will apply to expenses payments and benefits which are *"minor",* or if not minor are either payable on an "*irregular"* basis or where it is *"impracticable" to apply PAYE* or apportion the benefit between the employees receiving the benefit. These terms have not been defined as the regulations require the employer and the tax inspector to agree where payments fall within the terms.

Minor benefits and expenses

An expenses payment or benefit in kind can be dealt with as a PSA if it is 'Minor', either in the sum paid or the type of benefit provided.

This means it must be decided whether an expense or benefit is minor in value, but the nature of the item and the circumstances in which it is paid will also be taken into consideration. For example: small long-service awards, employee's use of pooled car, late night taxis, staff entertainment, gift vouchers and small gifts outside trivial benefit.

Irregular benefits and expenses

An item can be included in a PSA if it is paid Irregularly. In this case the inspector will look at the nature of the item, the normal frequency of payment and how often it was paid or given to the employee. The inspector will generally look at how often the item is provided in the year, items provided to the same employees each year are unlikely to satisfy this test. For example: relocation expenses which exceed the £8,000 tax exempt threshold or one off gifts which are not minor.

Impracticable expenses and benefits

This is relevant where it is impracticable for the employer to operate PAYE on it or to identify how a shared benefit should be allocated to the employees for P11D purposes. Here employers must be able to show that record keeping would be time consuming and disproportionate in view of the number of employees concerned and the nature of the item. For example: shared cars or vans, corporate subscription to a gym or health club, hairdressing services or Christmas party.

Tax

When calculating the tax due on the benefits under a PSA employers have to ascertain the value of the expense or benefit provided including VAT, the number of employees receiving the expense or benefit and the marginal rates of tax to be used. Where some employees are basic rate taxpayers and others pay 40% or 45% the benefit must be grossed up separately for each group of employees. Scottish tax rates should be used for Scottish taxpayers.

Class 1B employer's NIC

This is payable, at 13.8% from 6 April 23. It is calculated on the value of the items including VAT, and then grossed up for tax.

The completed PSA calculation must be filed with HMRC by 31 July following the end of the tax year.

HMRC will agree and confirm the tax and NIC liability between 6th July and 19th October and payment is due no later than 19th October, or 22nd if paid electronically.

Contributed by Alexandra Durrant

Replacement shares options (Lecture P1406 – 25.57 minutes)

Summary –Replacement share options were taxable under the employment related securities deeming provision. It did not matter that the original options had been granted to the individual's consultant company for services delivered at that earlier time.

Vermilion Software Ltd was incorporated in 2003 to market a fund management software product and provide support for that product.

In 2006 the business arranged further equity funding from new investors, which involved creating a holding company, Vermilion Holdings Ltd. Quest Advantage Ltd, owned by Mr Noble and one other, had provided corporate advisory services. With costs exceeding the budget, an option was granted to Quest Advantage Ltd to acquire shares in Vermilion Holdings Ltd.

In financial difficulty, Vermilion Holdings Ltd appointed Mr Noble as director. As part of further restructuring, it became necessary to amend the terms of the 2006 option. This was replaced with a new option in 2007, on amended (and less beneficial) terms, which included Mr Noble becoming the option-holder, instead of his consultant company.

HMRC considered that, although the 2006 option was not an employment-related share option, the replacement option granted in 2007 was an employment-related share option because it was granted by Vermilion Holdings Ltd, Mr Noble's then employer. It was therefore deemed to be made available by reason of his employment (s.471(3) ITEPA 2003).

The inner House of the Court of Session had found for the taxpayer, holding that, on a realistic view of the facts, the reason Mr Noble received the 2007 option was that he had agreed to give up part of his entitlement under the 2006 option. It was therefore not in fact made available by reason of his employment as required by s 471(1). The deeming provision in s 471(3) did not apply because it would give an 'anomalous, absurd and unjust' result.

The case moved to the Supreme Court.

Decision

The Supreme Court stated that the purpose of s.471 ITEPA 2003 was to define when the employment-related share option rules would apply.

S.471(1) provided a causal test; whether the option was granted by reason of Mr Noble's employment, but this could be difficult to decide. Consequently, the deeming provision in s.471(3) sought to avoid the inquiry into causation. Here, if an employer grants an option to one of its employees, the option is conclusively treated as granted by reason of that employee's employment.

The Supreme Court stated:

"It is not open to the taxpayer to defend a demand for tax from HMRC by carrying out the subsection (1) exercise in order to disapply the subsection (3) deeming provision."

The Supreme Court found that the 2006 option was cancelled, not varied and a new option over a different and new class of shares conferred by Vermilion Holdings Ltd to Mr Noble, an employee at the time. Under the deeming provision in s.471(3), this was an employment related security liable to income tax.

The argument that the 2007 option was made available as a replacement for the option granted in 2006 as a reward for services held no ground as the deeming provision applied.

HMRC v Vermilion Holdings Ltd [2023] UKSC 37

Backdated Income Protection Plan payments (Lecture P1406 – 25.57 minutes)

Summary - Backdated Income Protection plan payments were subject to National Insurance Contributions in the tax year they were paid, not in the tax year that they related to.

Kirin Kalia was an employee of Crowe LLP and participated in the LLP's Income Protection plan entitling employees to be paid an amount corresponding to roughly 75% of their basic salary whilst they are not working due to sickness.

Crowe LLP:

- insured their risk to cover 75% of the participant's basic salary, and certain specified benefits, Crowe's liability for pension contributions and employers' NICs.
- Only paid out *if and when* the insurance company paid out under the policy.

Due to illness, Kirin Kalia ceased working on 19 October 2017 and was paid:

- her contractual sick pay at her full rate of pay until the end of December 2017;
- statutory sick pay until April 2018.

At that point, payments under the Income Protection plan should have kicked in but Aviva claimed that the employee's illness was excluded from cover.

Kirin Kalia challenged Aviva's refusal to make payments with the Financial Ombudsman where it was found that her illness was in fact covered by the policy. As a result, in June 2020, 15 months' worth of backdated payments were paid over in one sum.

Crowe LLP reported the payment as a single payment of earnings in June 2020, accounting for PAYE and NICs on that basis. Further, interest was paid to compensate Kirin Kalia for the delay in payment.

The issue in this case was whether the sum paid should have been treated as 15 late payments of monthly sick pay which were paid simultaneously. According to Kirin Kalia, this treatment for NICs purposes had a bearing on her entitlement to employment and support allowance. The Tribunal made no findings as regards her entitlement to state benefits.

The basic rule under s.6 Social Security Contributions and Benefits Act 1992 is that a liability to Class 1 NICs arises when earnings are paid.

However, this basic rule is modified by Regulation 7, Social Security (Contribution) Regulations 2002 where earnings are paid otherwise than at regular intervals. Kirin Kalia argued that Regulation 7(1)(a) applied which states:

> "if on any occasion a payment of earnings which would normally fall to be made at regular interval is made otherwise than at the regular interval, it shall be treated as if it were a payment made at that regular interval'

She claimed she was entitled to be paid sick pay each month under the terms of the Income Protection plan, meaning that the June 2020 payment represented 15 delayed monthly payments of sick pay.

However, HMRC argued that the payment made represented arrears of pay, which should be treated as a single payment made in June 2020.

Decision

The First Tier Tribunal found that under the terms of Regulation 7, each individual payment should be allocated for the purposes of NICs to the earnings period in which the payments would normally fall, in other words to the earnings periods for the months of April 2019 to June 2020 respectively.

However, paragraph (3) overrides this where the monthly earnings relate to months falling into the earlier tax year. This meant that the April 2019 to March 2020 related payments were still assessable in June 2020. The effect of this override meant all of the NICs fell in 2020/21 and the appeal was dismissed.

The Tribunal did point out that for the purposes of claiming state benefits, Kirin Kalia may under Regulation 58 apply to reallocate to the 2019/20 tax year the NIC payments excluded from treatment under Regulation 7(1).

Kirin Kalia v HMRC (TC08952)

Top-slicing relief for basic rate taxpayers (Lecture P1407 – 12.42 minutes)

Profits made on the surrender of certain life insurance policies are taxed as income. It is taxed as the top slice of income after taxing all other income.

But the profit often arises after holding the policy for many years, so the legislation recognises that it is unfair to tax it as one amount as a large profit could mean crossing a tax band.

Top slicing relief makes adjustment for this by calculating an annual equivalent profit, calculating the tax on this, then multiplying the tax by the number of years the profit was made over.

Life assurance gains are taxed like interest income and can utilise the PSA and starting rate band for interest if available. The gains carry 20% tax credit if the bonds are UK located.

If the investment is in offshore bonds there is no tax credit.

You will need to check calculations produced by your software to ensure it is correct – especially if the client is not a higher-rate taxpayer.

HMRC has claimed that TSR cannot be claimed by basic-rate taxpayers and that it effectively gives them multiple use of the personal savings allowance but there is nothing in the legislation to prevent this.

The legislation is contained at s535 and s536 ITTOIA 2005.

"**535 Top slicing relief**

1) An individual is entitled to relief under this section for a tax year if—
    a) the individual's liability for the tax year, as calculated under subsection (3), exceeds
    b) the individual's relieved liability for the tax year, as calculated under—

        s.536 (top slicing relieved liability: one chargeable event), or

        s.537 (top slicing relieved liability: two or more chargeable events).

2) The relief is given by a reduction in or repayment of income tax equal to the excess

2A) If the relief is given by a reduction in income tax, it is given effect at Step 6 of the calculation in section 23 of ITA 2007.

3) An individual's liability for a tax year for the purposes of subsection (1)(a) equals TL — BRL , where—

    TL is the amount of the individual's total liability to income tax on income charged to tax under this Chapter for the tax year, calculated on the basis that no relief is available under this section and the highest part assumptions apply, and

BRL is the amount of income tax at the basic rate that the individual is treated as having paid under section 530(1) for the tax year.

4) For the purposes of subsection (3) and sections 536 and 537, the highest part assumptions, in calculating liability to income tax on an amount, are that—

    a) the amount is the highest part of the individual's total income for the tax year, and

    b) any provision directing any other amount to be treated as the highest part is ignored.

5) For the purposes of this section and sections 536 and 537, an individual's total income is treated as not including any amount which—

    a) is charged to tax under Chapter 4 of Part 3 (profits of property businesses: lease premiums etc.) as the profits of a UK property business, or

    b) counts as employment income under section 403 of ITEPA 2003 (payments and benefits on termination of employment etc.).

6) For the purposes of this section and sections 536 and 537—

    a) any chargeable event under section 525(2) (chargeable events where annual personal portfolio bond calculations show gains),

    b) any gain treated as arising on the occurrence of such an event, and

    c) the amount of any liability to income tax arising on such a gain, are ignored.

7) For the purposes of the calculations mentioned in subsection (1) any relief under Chapter 2 or 3 of Part 8 of ITA 2007 (which relate to gift aid and other gifts to charities) is ignored.]

8) For the purposes of the calculations mentioned in subsection (1)—

    a) section 25(2) of ITA 2007 (deductions of reliefs and allowances in most beneficial way for taxpayer) does not apply, and

    b) reliefs and allowances are available for deduction from an amount that, for the purposes of those calculations, is the highest part of the individual's total income for the tax year only so far as they cannot be deducted from other amounts."

S.536 ITTOIA then sets out the calculation of the relief, and again, makes no mention of the relief only applying to higher-rate taxpayers.

Example

A client has general income of £35,000 and dividend income of £800 in 2023/24. They encash a single-premium offshore investment bond.

The certificate from the investment company shows a chargeable event gain of £9,080 and it was held by the client for 2 complete years.

Calculate the income tax payable by the client for 2023/24

Analysis

Tax liability ignoring top-slicing relief:

	General	*Interest*	*Dividends*
Income	35,000	9,080	800
PA	(12,570)		
	22,430	9,080	800

Tax:	22,430	20%	4,486
	1,000	0%	-
	8,080	20%	1,616
	800	0%	-
	32,310		6,102

Tax liability with top-slicing relief:

	General	**Interest**	**Dividends**
Income	35,000	4,540	800
PA	(12,570)		
	22,430	4,540	800

Tax:	22,430	20%	4,486
	1,000	0%	-
	3,540	20%	708
	4,540*		708*
	800	0%	-
	32,310		5,902

* Divide the gain of £9,080 by 2 years – tax the result (£4,540) then multiply the tax by the 2 years again

By claiming TSR, the tax liability is £200 smaller. HMRC and 3rd party software do not calculate TSR where the taxpayer is a basic-rate taxpayer - this is incorrect.

Contributed by Malcolm Greenbaum

Navigating the pension Annual Allowance (Lecture P1408 – 13.42 minutes)

The generous tax regime

Pensions are the most tax efficient investment on the market. We all know that.

Just as a reminder of how good they are, we receive:

- Tax relief going in (either by way of relief at source through PAYE and/or by the Government adding 25% to personal pension contributions with higher rate relief given via self-assessment);

- A tax-free benefit for employer contributions (plus a corporate deduction for the payer);

- Tax-free growth while the funds remain invested; and

- A 25% tax-free lump sum when funds are withdrawn.

And it doesn't stop there.

There are the often-overlooked secondary benefits of personal pension contributions as they are treated as reducing income (even though they don't). Taxpayers with income over £100,000 can therefore use personal pension contribution top-ups to reduce income and claw back personal allowances which would otherwise be withdrawn. At the slightly lower end, taxpayers with income over £50,000 can make sufficient personal pension contributions to prevent a clawback of child benefit. These knock-on benefits can lead to a very attractive effective rate of tax relief on personal pension contributions of 60% (or even more for large families – 69% for a family with three eligible children, 77% for a family with four). There even reaches a point with families with many eligible children where pension contributions can be made effectively free of charge with relief given at over 100%.

The sting in the tail

But it's not all wine and roses.

Firstly, individuals cannot obtain tax relief on contributions in excess of their earnings. Earnings means employment (including taxable benefits), self-employment (including partnership profits) and furnished holiday let profits. If an individual makes contributions in excess of earnings, most of the time these contributions are allowed to stay in the fund but will have no impact on the tax computation.

Individuals with low or no earnings can make gross annual contributions of £3,600. By the way, this includes children, so parents making net contributions of £2,880 to a person pension for a minor child will find that the Government adds a further £720 of free money. That fund will then grow tax-free for four or five decades (at which point the children will posthumously thank you for it).

More importantly for planning purposes, the pension rules place a restriction on annual "pension input". Pension input means employer plus employee contributions in a tax year. It does not take account of any growth in the fund itself in that period.

This is a slight simplification as "pension input" itself is not restricted as you can pretty much pay in what you like. However, if pension input exceeds the annual allowance (AA), an annual allowance charge will be triggered, thereby taxing these excess contributions at the individual's marginal income tax rate. The AA charge is made via self-assessment and is either paid by the individual or can be taken from the pension fund if the tax is more than £2,000. Either way, it's a cost which is best avoided.

Topping up the pension fund

With all this in mind, it is common end-of-tax-year planning for individuals to look at their pension arrangements with a view to using excess cash to top-up the pension in a tax efficient way. The key driver here is to avoid the AA charge.

The eagle-eyed among you will note that it's not the end of the tax year. But a) time flies, b) your client might need a bit of notice to get their ducks in a row and c) pension providers tend to be busy in March (and extra busy in the first five days in April), so getting plans in place early is never a bad idea.

Also remember that pension contributions must be physically paid before 5 April to qualify for relief in that year. There is no longer a facility to carry back a contribution to the previous tax year. Which is another reason to start having those conversations with your clients earlier rather than later as some educated guestimates of income may be necessary.

The AA is currently £60,000 for 2023/24 (having been £40,000 up to and including 2022/23). We therefore have an extra £20,000 to play with which your clients should be made aware of.

The AA can be increased by any unused relief brought forward from the previous three tax years (here 2020/21 through to 2022/23), but only if the individual was a member of a registered pension scheme in those three years. Unused relief before 2020/21 can no longer be used. For individuals opening a pension for the first time in 2023/24, the AA is therefore a hard £60,000.

Where brought forward relief is being utilised, the current year AA is used first, followed by brought forward relief on a first-in-first out basis.

Typically, this will be tracked as shown:

Tax Year	Employee Contributions	Employer Contributions	Total Pension Input	Annual Allowance	Unused Relief
	£	£	£	£	£
2020/21	15,000	15,000	30,000	40,000	10,000
2021/22	16,000	16,000	32,000	40,000	8,000
2022/23	17,000	17,000	34,000	40,000	6,000
					24,000

This means that in 2023/24, the maximum pension input without triggering an AA charge will be £84,000 (60,000 + 24,000). If pension input is less than this (say £75,000), current year relief (£60,000) is used first, then £10,000 from 2020/21 then £5,000 from 2021/22. The remaining unused relief from 2021/22 (£3,000) plus the £6,000 from 2022/23 can be carried forward to 2024/25 giving £69,000 of headroom.

High Income Individuals

The AA is tapered for "high income individuals". For this population, the AA is reduced by £1 for every £2 of "adjusted income" above £260,000 (£240,000 before April 2023). The AA cannot be reduced below £10,000 (which it will be for individuals with income over £360,000).

There are two tests to perform to determine whether a person is a "high income individual", these being the "threshold income" test followed by the "adjusted income" test. The tapered AA only applies to individuals who pass (or fail depending on how you look at it), BOTH of these tests. So, if the £200,000 threshold income test is not met, you can stop there and happily use the full AA of £60,000. If not, we test again using adjusted income.

"Threshold income" is:

	£
Total income from all sources (P60 + benefits + other gross income)	A
Less: Employee personal pension contributions (gross)	(B)
Threshold income	X

If X is more than £200,000, we need to carry on to adjusted income which is:

	£
Total income from all sources (P60 + benefits + other gross income)	A
Add: Employee contributions under a net pay arrangement	B
Add: Employer pension contributions	C
Adjusted income	X

If X here is more than £260,000, the AA is subject to tapering.

Note: The threshold income test is designed to protect those employees who have occasional "spike years" where high employer contributions are made (which would then satisfy the adjusted income test).

Illustration

Lewis receives a gross salary of £230,000 and has taxable benefits of £5,000.

He also receives investment income of £15,000 per annum.

He makes personal pension contributions of £24,000 (net) per annum.

His employer matches his net contributions and also pays £24,000 to his personal pension scheme.

Lewis has no unused relief to bring forward.

Threshold income is:

	£
Total income from all sources (230,000 + 5,000 + 15,000)	250,000
Less: Personal pension contributions (24,000 x 100/80)	(30,000)
Threshold income	220,000

As threshold income exceeds £200,000, we carry on.

Adjusted income is:

	£
Total income from all sources (230,000 + 5,000 + 15,000)	250,000
Add: Employee contributions under net pay arrangement	Nil
Add: Employer pension contributions	24,000
Adjusted income	274,000

As adjusted income exceeds £260,000, both tests are met and the tapered AA applies.

Tapering is based on adjusted income in excess of £260,000 and will be as below:

	£
Standard AA	60,000
Less tapering: ½ x (274,000 – 260,000)	(7,000)
AA 2023/24	53,000

We then compare this to pension input:

	£
Personal contributions (gross)	30,000
Employer contributions	24,000
Pension input	54,000
Less: Annual allowance	(53,000)
Excess	1,000

This excess will be taxed at Lewis's marginal rate of 45% giving an AA charge of £450 (payable via self-assessment).

The Money Purchase Annual Allowance

Finally, here be aware that if your client has already accessed their pension fund, they may be subject to the money purchase annual allowance (MPAA) which is only £10,000. This will apply if income has been drawn from the pension (it will not apply if just the tax-free lump sum is taken or if income is taken from an annuity). The rules are complex so talk to a pension specialist if necessary.

Once the MPAA is triggered, pension input above £10,000 per annum will bring about an MPAA charge. This is therefore a question you should ask when dealing with clients over the age of 55 who have the ability to access their pensions.

Contributed by Steve Sanders

Capital taxes

Share sale consideration (Lecture P1406 – 25.57 minutes)

Summary – The First Tier Tribunal had not erred in law when interpreting the sale and purchase agreement in respect of a £1.1 million loan repayment. Further, it was under no obligation to consider if an adjustment to consideration was required for working capital.

Michelle McEnroe and Miranda Newman were the sole shareholders in Kingly Care Partnership Limited

On 25 October 2013 they entered into a share sale and purchase agreement (SPA) to sell their shares to Active Assistance Finance Limited for £8 million, subject to a working capital adjustment and an earn out.

On at completion, £1.1 million was paid to Allied Irish Bank to redeem a loan owed, with the buyer's solicitors transferring the remaining £6.9 million payable to the couple, after having deducted professional fees.

In their Self Assessment tax returns, Michelle McEnroe and Miranda Newman each showed the consideration received for the disposal of their shares as one half of £6.9 million, plus the working capital adjustment and the earn out received later.

Following an enquiry, HMRC issued closure notices stating that the consideration should be one half of £8 million plus the earn out, the amount stated in the sale and purchase agreement.

Michelle McEnroe and Miranda Newman appealed to the First Tier Tribunal, with the only point in dispute being whether the consideration for the shares was £8 million, or £8 million less the bank debt. Neither the additional payment following the reconciliation of the working capital adjustment nor the earn-out were not in dispute at that time.

Having never received the full £8 million, the taxpayers argued that the reported proceeds should be £6.9 million, the sum that they received.

The First Tier Tribunal found in HMRC's favour and the taxpayers appealed to the Upper Tribunal, including an additional argument that the First Tier Tribunal should have considered the working capital adjustment referred to in clause 3.3 of the sale and purchase agreement.

Decision

The Upper Tribunal found that based on the facts presented at the time, the First Tier Tribunal had correctly found that:

> "there was no ambiguity in the SPA and that no reference to the (bank) debt is made in any clause relevant to the consideration for the purchase of the Shares".

Referring to the case notes, the Upper Tribunal noted that the First Tier Tribunal had considered the working capital clause at the time stating that:

> "Clause 3.3 refers to Completion Accounts and any adjustment in relation to them. Neither the Appellants nor HMRC argue that this clause did or should adjust the [consideration]"

It was reasonable for the First Tier Tribunal not to have given further consideration to this point as neither party had argued at the time that an adjustment to consideration was needed to reflect clause 3.3 on working capital. It was too late to amend the First Tier Tribunal's findings of fact, which is the only stage at which the facts of a case can be established.

The case was dismissed.

Michelle McEnroe and Miranda Newman v HMRC [2023] UKUT 00255 (TCC)

No gain, no loss on separation **(Lecture P1406 – 25.57 minutes)**

Summary – No gain no loss treatment applied to a property where the beneficial interest was effectively transferred in the tax year that a couple separated.

Abigail Wilmore married in 2012. She worked as an HR Director in the fashion industry and her 'high paying job' was the main source of income for the couple.

The couple lived in a property, Ravenshurst, registered in her sole name which had been bought using a mortgage raised based on Abigail Wilmore's income.

In the spring of 2015, the couple bought a second property, Thornfield, with the intention being that once renovated, it would become their main residence. The major renovations were expected to take about 12 months.

To facilitate the purchase, the couple re-mortgaged their first property as a buy-to-let property and took out a mortgage on the new property based on Abigail Wilmore's income.

In September 2015, the couple separated with Abigail Wilmore continuing to live in Ravenshurst, and her husband moving into Thornfield, which was still being renovated.

By December 2015, correspondence indicated that the couple had agreed each of them would retain the property that they were living in and that from that time Abigail Wilmore stopped contributing to the Thornfield mortgage and was not involved in any decision making in relation to the property. She converted her buy-to-let mortgage on Ravenshurst, the first property, back to a home-owner's mortgage.

This arrangement was confirmed in a draft petition dated 4 April 2016, with a lump sum payment of £75,000 being due to her. The sum was reduced to £35,000 in June 2016 and the final consent order sealed by the Family Court on 17 October 2016, taking effect from the Decree Absolute on 23 December 2016.

In September 2016, her husband had sold Thornfield, but she took no proceeds from the property's sale.

Abigail Wilmore accepted that legal title of Thornfield did not pass until after 5 April 2016. However, she believed that her beneficial interest was transferred to her husband after separation in 2015 but before 5 April 2016, meaning that the transfer took place on a no gain no loss basis.

HMRC disagreed and in November 2020, issued a discovery assessment for £14,377, representing the capital gains tax due on her half share of the Thornfield property sold in 2016/17. HMRC argued that any agreement reached between 10 September 2015 when they separated and 5 April 2016, whether verbal or written, was not legally binding and could have been varied at any time. This meant that there was 'no formal transfer of the appellant's interest' in Thornfield prior to 5 April 2016.

Abigail Wilmore appealed.

Decision

The First Tier Tribunal concluded that:

- by the agreement entered into by the separated couple in December 2015, Abigail Wilmore had effectively transferred her beneficial interest in Thornfield to her husband;
- from December 2015, a constructive trust arose whereby she was the legal joint owner of Thornfield, but no longer held any beneficial interest in the property;
- the disposal of her beneficial interest in Thornfield had taken place by 5 April 2016 on a no gain no loss basis.

The Tribunal found that the October 2016 consent order was not relevant as it was preceded by the December 2015 agreement reached between the parties.

Finally, the Tribunal found that the lump sum order was not a payment linked to Abigail Wilmore transferring her equitable interest in Thornfield but rather it was "a ball-park figure" towards recognising her greater financial contributions to the marriage.

Abigail Wilmore v HMRC (TC08959)

NOTE: For disposals on or after 6 April 2023, the application of the no gain no loss rule that applies to divorcing couples is now extended beyond the end of the tax year of separation.

Fee not deductible (Lecture P1406 – 25.57 minutes)

Summary – An introducer's fee payable on the sale of a property to a third party was not a deductible expense for capital gains tax as it was not capital in nature.

Wayne and Beverley Bottomer were interested in investing in property and were told about a potential property by a third party who, due to cashflow issues, was unable to buy it himself. It was agreed informally that if the couple went ahead with the purchase, the third party would receive a fee.

The couple bought the property and had intended to renovate it themselves. However, with Wayne Bottomer seriously ill and requiring hospital treatment for cancer, the couple approached the third party, who verbally agreed to manage the project on their behalf, in return for a 50% share of any profit when the property was sold.

Having completed the project, the property was sold for a profit of £64,000, half of which was paid over as agreed. The couple declared the sale on their Self Assessment tax returns, with each claiming a deductible expense of £16,000 against their respective gains.

HMRC agreed that the disposal gave rise to a chargeable gain rather than a trading profit but disallowed the deductions made, arguing they did not fall within s.38 TCGA 1992 as they were neither property acquisition costs nor incidental costs of acquisition or disposal.

The taxpayers appealed.

Decision

The First Tier Tribunal found that the sum paid was not expenditure incurred on the property nor was it represented in the state of the property when it was sold.

The sum paid had not been agreed at the time of acquisition and so could not be wholly and exclusively for the purposes of the acquisition.

The payment was not incidental costs of either purchase or sale and so were not deductible for CGT purposes. The third party had simply found the property and subsequently overseen the renovation works. This was more akin to a shared business project. One might ask how the payment would have been treated if it had been found to be a trading transaction? It may well have been deductible.

Wayne and Beverley Bottomer V HMRC (TC08968)

Incorporation relief: A debt trap **(Lecture P1409 – 7.46 minutes)**

In November 2023, HMRC commenced a 'One to Many' campaign, targeting taxpayers who incorporated their property businesses in the tax year 2017/18 but reported no capital gains tax (CGT) liability in their tax returns on the basis that 'incorporation relief' (TCGA 1992, s 162) applied in full.

How the relief works

In the legislation, the relief in TCGA 1992, s 162 is headed 'Roll-over relief on transfer of business.' In practice, it is commonly referred to as incorporation relief.

Incorporation relief is mandatory if certain criteria (in section 162(1)) are met. These are:

- A person who is not a company (i.e., a sole trader or individual partner) transfers to a company a business as a going concern;
- The whole assets of the business (or possibly the whole assets of the business excluding cash) are transferred to the company; and
- The consideration for the transfer is satisfied wholly or partly by the issue of shares in the company to the person transferring the business.

Broadly, the base cost of the shares is reduced by the capital gains on the disposal of chargeable assets of the unincorporated business. Those gains are therefore ‘rolled over’ on incorporation. The gains are effectively deferred until a later disposal of the shares.

There are provisions for apportionment where the consideration is not wholly in shares, such as the creation of a director’s loan account with an amount being credited to it (TCGA 1992, s 162(4)).

Transfer of liabilities

The former sole trader or partner is not required for incorporation relief purposes to transfer business liabilities to the company. However, in practice they will often do so.

In strictness, business liabilities taken over by the company represent additional consideration for the transfer, which means that incorporation relief ought to be restricted. However, an extra-statutory concession (ESC D32) enables business liabilities taken over by the company to be ignored for the purposes of quantifying any consideration received for the business other than the shares.

As indicated, the cost of the shares to the former sole trader or individual partner is the value of what was given for them; in other words, the value of the business. In essence, the value of the business is the difference between its assets and liabilities.

Anything to declare?

In its ‘One to Many’ campaign, HMRC is sending out ‘nudge’ letters to taxpayers who claimed incorporation relief in respect of a property business in 2017/18. Those taxpayers are being asked to check certain aspects of their incorporation relief claims. These include:

- Checking that the capital gain on incorporation was not greater than the value of the property business that was transferred; and

- When calculating the incorporation relief available, that the amount of any gain held over did not exceed the value of any shares received.

What HMRC are seeking to check is that the capital gains held over have not exceeded the base cost of the shares. If they have, incorporation relief will be subject to possible restriction.

Dangerous assumption

HMRC’s ‘nudge’ letter seems to suggest some taxpayers have automatically assumed that because incorporation relief is available, there is no residual gain. However, as indicated situations can arise where all the assets are transferred, and only shares are issued, but a gain still arises.

HMRC’s ‘One to Many’ campaign concerns property businesses, which will normally be ineligible for business asset disposal relief. However, had it been (for example) a manufacturing business instead, there may be other assets transferred upon incorporation not included on the balance sheet, but which would increase the net assets of the business, most commonly goodwill. In addition, business asset disposal relief would potentially be available, resulting in a CGT rate of 10%. The former sole trader or business partner’s annual CGT exemption may be available too.

Nevertheless, if there is a high level of debt in the business, and the debt is being transferred to the company along with the assets of the business, advisers should consider the level of potential capital gains arising, and forecast the company's opening position, in advance of the incorporation taking place. As indicated, it is not a requirement of incorporation relief that liabilities of the business are transferred to the company; but not doing so will have other tax implications, such as in respect of interest relief on the borrowings, and there would also be commercial considerations such as the borrower no longer having rental income from which to repay the borrowings and loan interest.

Be careful

Care is needed if debt is being refinanced through the company. For example, if the company takes on fresh debt and uses the proceeds from those borrowings to repay borrowings of the sole trader or partner, that could cause a restriction in incorporation relief on the basis that the repayment represents consideration other than in the form of shares, which is not covered by incorporation relief. So, this could give rise to a large and unexpected CGT liability.

Contributed by Mark McLaughlin

Diversification of farming business (Lecture P1406 – 25.57 minutes)

Summary – Business Property Relief was not available for an LLP that let a barn to be used as a wedding venue. The lack of services provided meant that its business was "wholly or mainly an investment business."

On her death in May 2015, Helen Butler was a member of Tufton Warren Farm LLP, with the only other members being the trustees of her late husband's will trust, in which she had a life interest.

This case concerned a claim for business property relief made by the personal representatives and trustees against the value of the LLP. All parties agreed that the LLP was carrying on a business. The issue was whether the estate interests were "relevant business property". If its activities were found to consist of "wholly or mainly of...holding investments" (s.105(3) IHTA 1984) Business Property Relief would not be available.

The LLP's activities fell into three categories agreed between the parties as follows:

1. farming (non-investment activity);
2. commercial lettings (investment activity);
3. a disputed wedding venue business operating from an historic barn on the farm.

The wedding business was the most significant aspect of the LLP's activities. The taxpayers argued that the LLP provided a package of facilities and wedding related services meaning that Business Property Relief was available.

However, from 2013 when Helen Butler became ill, the LLP was involved with little other than its staff showing potential customers around the venue. An independent third party took on everything else, including the bookings, setting up the venue, the catering and staffing the event.

HMRC argued that this was a business wholly or mainly holding investments, and so denied the relief.

Decision

Having looked at the LLP's activities as a whole, the First Tier Tribunal concluded that simply providing the venue and effectively outsourcing the wedding related services meant that the property was held predominantly for investment purposes. This was not a fully serviced property but rather more like a village hall.

The judge said that at no point did the LLP "provide amenities and services that went significantly beyond the amenities that are provided in a property held predominantly for investment purposes."

Business Property Relief was denied.

Eva Mary Butler and others v HMRC (TC08949)

Garages and communal garden

Summary - The purchase of a flat, three garages and a right to access communal gardens were found to be residential property, with the higher rate of SDLT applying.

Espalier Ventures Property (Lansdowne Road) Ltd, a property developer, bought property interests registered with the Land Registry for £5,350,000 consisting of a basement and ground floor flat at 43 Lansdowne Road, London and three lock-up garages, roughly 3 metres from the flat. The flat also had access to a communal garden. The garages had been in common ownership with the flat since 10 June 1960 to the current day.

On 12 February 2019 the SDLT1 return was filed showing SDLT due of £257,000, on the basis that the purchase was of a mixed-use property.

On 31 July 2019 HMRC opened an enquiry into the SDLT return and in November 2020 issued a closure notice increasing the SDLT by £459,250 on the basis that the acquisition was of a wholly residential property. The garages had never been in commercial use and formed part of the grounds. Since 2016, the plan had been to convert the garages into a garden room forming part of a single dwelling when the flat and upstairs property were converted into a single dwelling.

The company appealed.

Decision

Having considered the historic use of the garages, their proximity to the flat and the fact that the flat and garages had been in common ownership for many years, the First` Tier Tribunal found that the garages were buildings within the grounds of the flat (s. 116(1)(b) FA03). Further, at the point of purchase, planning applications showed that the company planned to develop the property, including the garages, into a single dwelling.

Moving to the communal garden, the First Tier Tribunal found that the right to enjoy the garden was a legal right and 'part and parcel of its acquisition of the flat'.

The appeal was dismissed.

Espalier Ventures Property (Lansdowne Road) Ltd v HMRC (TC08914)

ATED charge did not apply (Lecture P1406 – 25.57 minutes)

Summary – With a property value of below £500,000, the ATED charge did not apply and so no penalties were payable.

Derrida Holdings Limited is a property investment company owned jointly by a married couple.

In January 2017, the company bought a derelict pub for £265,000 which was financed by refinancing its first property that had been acquired in 2016. The property was gutted and refurbished for a total cost of £191,000 and then let from August 2019.

In January 2021, in the course of a conversation with others, the husband learned about the existence of ATED. He telephoned the company's accountant, who was unaware of ATED but advised that the company should submit an ATED return even though the value of the property was less than £500,000.

An ATED return was submitted on 31 January 2021 for the year ending 31 March 2021, but the return did not include any value for the property.

HMRC wrote to explain that an ATED return must be submitted and paid within 30 days of the first day within which the company became liable in a period. Having failed to submit and pay by 30 April 2020, HMRC issued late filing penalty assessments. These were upheld by HMRC following a statutory review.

Having learned that a decision can only be reviewed once, the company appealed to the First Tier Tribunal.

The company's main argument was that not only did it not know about ATED's existence, it was also unaware that they had risen above the threshold. Indeed, they believed they had not.

HMRC's argued that a reasonable person seeking to check their tax position would visit the HMRC website, where the ATED guidance is easy to find and the information is clear and unambiguous.

Decision

Although an ATED return had been submitted, this did not automatically mean that the company was liable to the ATED charge.

The First Tier Tribunal stated that the ATED charge is an annual tax charge on UK residential properties over £500,000 which are held by companies, partnerships or collective investment schemes.

The company had been asked to provide confirmation of the value of the property at the revaluation date for ATED periods from 2018/19, which was 1 April 2017.

The Tribunal found that:

> "On the balance of probability, the value of the property as at 1 April 2017 was certainly not above the threshold and was unlikely to have been very different to its purchase price and indeed might have been less."

With the property's value below £500,000, the First Tier Tribunal found that the company had been wrong to submit the return. This was "a simple error that was swiftly rectified."

The Tribunal found that "as a matter of fact, although a return was submitted, the appellant was not within the charge and therefore there was no requirement for the return.

Consequently, the penalties were cancelled.

Derrida Holdings Limited v HMRC (TC08905)

Administration

Underpaid PAYE and National Insurance

Summary – As the company had not acted deliberately, personal liability notices transferring penalties to the company's directors were found to be invalid.

Sharon Suttle and John Jaekel were directors of Earn Extra 139 Ltd, an umbrella company providing employees to various clients.

Following an investigation, HMRC concluded that the company had deliberately submitted P35 returns, P14 returns and RTI returns, which they knew to be inaccurate and concealed those inaccuracies.

Consequently, HMRC issued determinations to recover underpaid PAYE and Class 1 National Insurance Contributions totalling £12.5 million for the years 2010/11 to 2015/16. Further, a penalty assessment was raised for £10.5 million on the basis that disclosure was prompted, the behaviour was deliberate and concealed.

Earn Extra 139 Ltd went into liquidation and HMRC issued personal liability notices on the two directors for £5 million each. Sharon Suttle and John Jaekel appealed these notices.

Decision

The First Tier Tribunal found that:

- there were inaccuracies in the returns which led to an understatement of tax;
- HMRC had neither established that the company knew about the inaccuracies nor that it had ignored concerns around the reporting of expenses;
- the company's processes were inadequate rather than the inaccuracies being deliberate.

As the company's behaviour was not deliberate, the personal liability notices were found to be invalid.

Sharon Suttle and John Jaekel v HMRC (TC08950)

WhatsApp proves enquiry out of time

Summary - WhatsApp messages to the taxpayer's adviser sent on 1 February 2022, included photos of HMRC's enquiry notice, proving the notice was issued out of time.

On 29 January 2021, Richard Monks submitted his Self Assessment tax return for 2019/20.

On 27 January 2022, two days before the closing date, HMRC issued an enquiry notice, informing Richard Monks that they would be conducting a check of that return under section 9A TMA 1970. This correspondence included a schedule of the information and documents that were required to be submitted by 28 February 2022. HMRC produced a Post Office receipt dated 27 January 2022 as proof of posting.

As Richard Monks had not produced the requested information, HMRC followed up with a Schedule 36 information notice dated 3 March 2022, setting a required deadline for the information of 3 April 2022.

Richard Monks then wrote to HMRC stating that he believed the enquiry to be out of time. He had not received the enquiry notice until 1 February 2022, so after the closing date of 29 January 2022.

He agreed that if the enquiry notice was shown to be valid, he would provide the requested information. HMRC refused to withdraw the information notice, arguing that it was for Richard Minks to prove he had not received the enquiry notice on time.

Richard Monks appealed.

Decision

The First Tier Tribunal accepted that HMRC's enquiry notice had been posted first class on 27 January 2022, and that it was reasonable to assume that it had been delivered the next day. As a result, the onus was on Richard Monks to prove otherwise.

Richard Monks produced a number of WhatsApp messages sent to his adviser that included a photograph of each page of the enquiry notice. These messages were dated 1 February 2022. He claimed that he checked his post daily and immediately sent mail relating to his finances on to his adviser, who confirmed that this was the case. The First Tier Tribunal accepted this evidence, finding that the enquiry notice had not been received on time.

Although his appeal against the enquiry notice was allowed, Richard Monk’s appeal against the Schedule 36 notice was dismissed. There was a reason to suspect tax may have been under-assessed and so the information was reasonably required.

Although successful in terms of the enquiry relating to 2019/20, if when the requested information is provided by Richard Monks it shows there has been a loss of tax, HMRC would seek to issue discovery assessments.

Richard Monks v HMRC (TC08954)

HMRC – Voluntary restitution (Lecture P1410 – 10.59 minutes)

This article will consider the position where HMRC invite a taxpayer to make “voluntary restitution”.

What is voluntary restitution?

Voluntary restitution is the payment of tax or National Insurance Contributions (NIC) where HMRC do not have a legal ability to assess the tax or NIC.

When can HMRC seek voluntary restitution?

HMRC will usually be able to rely on an offence by a taxpayer to recover tax or NICs that have been “lost”. This can include where a taxpayer has failed to notify liability, or where a taxpayer has submitted an incorrect tax return and HMRC have issued an enquiry notice within the statutory timeframe for doing so.

However, that is not always the case. There can be instances where there has been a loss of tax or NICs, but HMRC are not able to legally recover those amounts. This can include where:

- the taxpayer had a reasonable excuse for the failure to notify liability;
- the taxpayer successfully demonstrates that his incorrect returns (or accounts) were submitted innocently for periods where the filing date for the return is on or before 31 March 2009;
- the taxpayer successfully demonstrates that, for periods beginning on or after 1 April 2008 where the filing date for the return is on or after 1 April 2009, that the inaccuracy in the return(s) arose despite the taxpayer taking reasonable care;
- the taxpayer has died and HMRC’s right to assess is limited (by Section 40(2), Taxes Management Act 1970);
- the taxpayer submitted a return (or accounts) at the proper time but HMRC failed to open an enquiry in time.

Where HMRC are not able to legally recover lost tax or NICs, those amounts, plus related interest and penalties, cannot be assessed, or included in an expected offer to HMRC (under a contract settlement).

HMRC’s position

HMRC’s view is that, that even though they cannot legally recover lost tax or NICs (in the circumstances noted above), they are justified in inviting voluntary restitution on equitable grounds. This position is confirmed in HMRC’s Enquiry Manual (at EM3980). HMRC are appealing to the client’s inner moral compass, or philanthropic nature, to pay tax that is not legally due.

In these circumstances, HMRC will seek the amount of the expected offer, and the irrecoverable tax and NIC with simple interest, but without any penalty.

HMRC officers are told that the invitation to make voluntary restitution should be made only after the maximum penalty that could be charged and HMRC’s policy of abatement (or reduction of type and quality of disclosure for periods beginning on or after 1 April 2008 where the filing date is on or after 1 April 2009) has been full explained. HMRC officers are also told that where the taxpayer or personal representative does not agree to make voluntary restitution, it should not be pressed, and any subsequent negotiations should be conducted without reference to the amounts which HMRC cannot legally recover. HMRC acknowledge that any offer in excess of the expected offer will be acceptable.

The client's position

The adviser will need to establish whether HMRC has a legal basis for recovering the tax, etc, that is being sought. This will involve consideration of the client's circumstances, including the relevant assessing time limits, HMRC actions, and the client's behaviour, where appropriate.

When it is determined that HMRC are not able to legally assess tax or NICs, the client will need to consider whether they wish to pay tax (or NICs) in such circumstances. If a client decides to make voluntary restitution to HMRC, they are not obliged to pay interest or a penalty on the relevant tax or NIC. As noted above, HMRC will request the payment of simple interest, but there is not any obligation on the taxpayer to make such payment.

HMRC cannot enforce payment of the irrecoverable tax (or NIC), and the client may decide to make full or partial payment of the tax that HMRC are not able to legally assess. If the client decides not to make voluntary restitution, decides to make only a partial payment, or decides not to pay interest, HMRC cannot take any enforcement action in relation to those amounts.

It is for the client to decide whether they make voluntary restitution to HMRC. I have dealt with numerous instances over the years where the issue of voluntary restitution has arisen and needs to be discussed with the client. Some clients may choose to make a payment, whether in full or part, and others may decide not to make a payment to HMRC. Where a client decides not to make a payment to HMRC, they may, instead, choose to make a donation to a charity of their choice.

Apart from the moral dilemma, a client may decide to make voluntary restitution to HMRC to avoid another tax liability, and associated interest charge, as some taxpayers did a few years ago in relation to the loan charge.

Practical considerations

When advisers are dealing with a voluntary disclosure, or an HMRC enquiry, they need to carefully consider the legal position, and HMRC's ability to assess a particular year. This will, usually, require consideration of the relevant behaviour. Where, for example, the client's deliberate behaviour has resulted in the submission of an incorrect return and an underpayment of tax, the resulting tax liabilities, and associated penalties, should be calculated. It would not be appropriate to submit calculations for six years, and claim careless behaviour, but offering voluntary restitution for earlier years to avoid the imposition of a penalty.

When a case is being settled by a contract, the adviser will need to check that the wording is amended to reflect the inclusion of the voluntary element of the payment to HMRC.

Contributed by Phil Berwick, Director at Berwick Tax

Deadlines

1 December 2023

- Corporation tax for periods to 28 February 2023 for SMEs not paying by instalments
- Check HMRC website for advisory fuel rates changes.

7 December 2023

- VAT returns and payment for 31 October 2023 quarter (electronic)

14 December 2023

- Quarterly corporation tax instalment for large companies (depending on year end)
- File monthly paper EC sales list – businesses in Northern Ireland selling goods

19 December 2023

- PAYE, NIC, CIS, student loan liabilities for month to 5 December 2023 (not electronic)
- File monthly CIS return

21 December 2023

- File online monthly EC sales list –businesses in Northern Ireland selling goods
- Submit supplementary intrastat declarations for October 2023
  - arrivals only for a GB business
  - arrivals and despatch for businesses in Northern Ireland

22 December 2023

- PAYE, NIC, CIS, student loan liabilities should have cleared into HMRC bank account

30 December 2023

- Submit online SATR if underpayments to be collected by a PAYE coding adjustment

31 December 2023

- Companies House should have received accounts for:
  - private companies with 31 March 2023 year ends
  - public limited companies with 30 June 2022 year ends
- File CTSA returns for companies with accounting periods ended 31 December 2022
- End of CT61 quarterly reporting period.

News

Scottish Budget

Scottish government ministers have announced that the Scottish Budget for 2024/25 will be presented to Parliament on 19 December 2023.

Welsh Budget

The Welsh Parliament has announced that its outline and detailed draft budget will be published on Tuesday 19 December 2023.

The final Welsh budget will be published on 27 February 2024.

Business Taxation

No cash accounting under FRS 105 (Lecture B1406 – 13.25 minutes)

Summary – A company, trading as a property development company reporting under FRS 105, was required to adopt the accruals basis of accounting.

Hart St Maltings Ltd was a property development company that prepared accounts to 28 February each year under FRS 105.

The company acquired a building and redeveloped it into two properties, referred to as 'House 3' and 'House 4'.

In its year to 28 February 2018, the company:

- sold House 4 and included the income from its sale in the accounts;
- deducted the costs of developing both Houses 3 and 4 to that date but at that point, House 3 remained unsold.

In February 2022, HMRC raised a discovery assessment stating that the costs relating to House 3 were not deductible as the accruals rather than cash basis of accounting applied.

The company appealed and HMRC applied to have the appeal struck out.

Decision

The First Tier Tribunal noted that it was clear that during the accounting period ended 28 February 2018, when House 4 was sold, the company was a trading company, and the sale of that property was a trading transaction.

The First Tier Tribunal confirmed that s.46 CTA 2009 requires a company's trading profits to be calculated in accordance with Generally Accepted Accounting Practice. With the company adopting FRS 105, it was required to use the accruals basis of accounting. This meant that the costs relating to House 3 could not be deducted in the year ended 28 February 2018 as the property was unsold.

With no real prospect of success, the company's appeal was struck out.

Hart St Maltings Ltd v HMRC TC08961

Expenditure on environmental and technical studies (Lecture B1406 – 13.25 minutes)

Summary – Expenditure on environmental and technical studies carried out prior to the installation of wind turbines was not eligible for capital allowances.

The companies in this case formed part of the Danish Orsted A/S group, generating and selling electricity from UK offshore windfarms.

To decide the best positioning for wind turbines, the companies incurred around £48 million carrying out various studies relating to wind, ocean and seabed conditions.

These costs, together with the wind turbines themselves, were claimed as expenditure eligible for capital allowance purposes.

HMRC accepted that the costs incurred to build and install the wind turbines qualified but rejected the claim for the cost of the various studies.

The First Tier Tribunal found that the studies were 'necessary' for the installation of the turbines and allowed the claim.

HMRC appealed to the Upper Tribunal.

Decision

The Upper Tribunal found that the study expenditure put the companies in a position to be able to provide plant, by advising on how to make and install the plant. This was not the same as being money spent 'on the provision of plant' or its installation. Although the expenditure may be 'necessary' to allow the manufacture and installation to go ahead, it did not have the effect of providing the plant. Consequently, the expenditure did not qualify for allowances.

The companies had also argued that if the expenditure did not qualify as plant for capital allowance purposes, it should be eligible for a revenue deduction. As non-qualifying capital expenditure, it was not revenue in nature and so no such deduction was available.

Gunfleet Sands Ltd and other companies v HMRC [2023] UKUT 00260 (TCC)

Share for share anti-avoidance (Lecture B1406 – 13.25 minutes)

Summary – A share deal that was renegotiated so that cash consideration was replaced with preference shares did not mean that the deal fell foul of the anti-avoidance rule contained in s.137(1) TCGA 1992.

Euromoney had agreed to transfer its shares in Capital Data Limited to Diamond Topco Limited in exchange for ordinary shares (US$59 million) and cash (US$21 million).

Realising that this would result in a large chargeable gain, the agreement was restructured so that the cash was replaced with preference shares. No gain would be chargeable as s.135 TCGA 1992 applied and by waiting 12 months before the preference shares were redeemed, the Substantial Shareholding Exemption applied.

However, HMRC argued that to decide whether s.137(1) applied, one should look at the elements of the "scheme or arrangements" separately, rather than as a whole. The preference shares had been introduced into the scheme to avoid paying tax on the cash element of the consideration. This element of the scheme formed part of a scheme or arrangements of which the main purpose, or one of the main purposes, was the avoidance of liability to tax. HMRC amended the company's return, denying relief under s.135 TCGA 1992,

Both the First Tier and Upper Tribunal's found in the company's favour.

HMRC appealed to the Court of Appeal.

Decision

The Court of Appeal stated that s.137(1) TCGA 1992 "envisages that there may be tax avoidance so long as that is not the sole or a main purpose of the scheme or arrangements".

The Court of Appeal stated that the statutory test contained within s.137(1) TCGA 1992 required two questions to be answered:

1. Was the exchange of shares effected for bona fide commercial reasons?

2. Did the entire exchange of shares form part of a scheme or arrangements of which the main purpose, or one of the main purposes, was tax avoidance?

The Court of Appeal found that the First Tier Tribunal had identified the entire exchange and the entire scheme that Euromoney had entered into and then addressed both of these questions finding that:

1. It was common ground that the entire exchange of shares was effected for bona fide commercial reasons;

2. Tax avoidance was not the main purpose, or one of the main purposes, of entering into that entire exchange of shares.

The First Tier Tribunal had decided that avoiding corporation tax on gains was one of the purposes of the arrangements as a whole because there was no commercial purpose for receiving consideration in the form of preference shares rather than cash. However, because the preference share arrangements were not significant in the context of the arrangements as a whole, the Tribunal decided that this was a purpose, but not one of the main purposes, of the arrangements.

The reasons given by the First Tier Tribunal for this decision had not been challenged in this appeal and so HMRC's case was dismissed.

Delinian Limited (formerly Euromoney Institutional Investor PLC) v HMRC [2023] EWCA Civ 1281

Permanent Establishment: The New Challenge (Lecture B1409 – 19.34 minutes)

The concept of permanent establishment has been around for over a century and is one of the building blocks of the corporation tax system. A permanent establishment in a country leads to a corporation tax liability and can often lead to a PAYE as well as a social security liability as well.

The Organisation of Economic Cooperation and Development (OECD) has given some useful guidelines to tax administrations regarding what does and does not constitute a permanent establishment. The relevant article in the double tax treaty is article 5 of the model treaty. Permanent establishments include:

- Places of management;

- Factories;
- Mines;
- Facilities for the exploitation of natural resources.

There are also exclusions such as:

- Warehousing;
- Preparation of goods;
- Research and development;
- Public relations;
- Assessing claims;
- Collecting goods.

For a number of reasons, the definition of permanent establishment (PE) has become more rigorous in terms of what is included and the exemptions from establishing a PE have become more circumscribed. If you look at the change to article 5 of the model OECD treaty, you will see that the exclusion for agents of independent means has been more limited and those individuals who substantially draw up the terms for contracts, even if they are rubber stamped elsewhere, will have created a PE.

Two other factors have complicated permanent establishment rules. The first is the effect of the COVID-19 pandemic which meant that workforces were dispersed, sometimes over several countries, and directors were performing duties in countries where this had not been anticipated. Most tax authorities took a more lenient view of the changes in where business activities took place and were not asserting that either the residence of companies had changed nor that a new permanent establishment had been created, so long as the company reverted to its previous patterns pre-COVID. This was backed up by OECD guidance on this point. The OECD distinguished between regular patterns and unusual ones.

The second issue is the advent of new technologies which has made it easier for employees to work remotely. This, of course, can create its own employment tax issues. However, potentially, it also creates a challenge for the company as it may be creating a new permanent establishment. This means that small and medium sized enterprises who never had to be worried about permanent establishment rules may now find that this becomes a major issue.

There have been a number of cases both pre and post COVID which have drawn the attention of tax authorities. In particular, Denmark which has similar double tax treaties to the UK has produced a number of interesting rulings. Effectively, where one is employing someone who is setting up a sales operation in Denmark which may not be for the entire week, there is a significant danger of creating a permanent establishment. By contrast, where one engages an independent company to perform sales and marketing services, this may not create a permanent establishment.

HMRC has also recently published its own guidelines as to when it considers there may be a permanent establishment created by the actions of employees. Whilst HMRC's guidance does not have the force of law, it does create legitimate expectations and guidance which may be useful.

The guidance looks at the dilemma about whether an individual's personal plans which result in them remaining in the UK and working for longer than anticipated would create a PE for the company. The upshot of the guidance is that generally where there is a temporary stay in the UK, for example, after a holiday, this does not create a PE in the UK. However, if the stay is planned as part of say a project and involves potentially staying in the UK for a series of months every year, on a planned basis, a PE may be created. The examples are HMRC's, and this is taken from an extract of an article published in Tax Journal on 22nd September 2023.

Example 1

Juan, who works for a foreign entity in State D, comes to Brighton on holiday and stays on to work here for a total of 40 calendar days including his holiday, using the office of a UK affiliate company as a base. He enjoys the experience so much he decides to do the same thing six months later.

HMRC confirms that, in this scenario, Juan's presence would not create a fixed place of business PE because the permanence test would not be met. However, if the arrangement was expected to be an annual occurrence for Juan and/or his successors or colleagues in his team, HMRC consider that there is a possibility that the cumulative time spent in the UK could trigger a PE. This example is helpful in confirming that workdays being tagged on to holiday will not create a UK PE provided UK presence is ad hoc, rather than amounting to a committed and sustained presence in the UK.

Example 2

Francine, a French national with an English partner, joins a French company on a permanent contract which permits her to spend a fixed three-month period each year working in the UK.

In contrast to example 1, HMRC consider that Francine's presence would meet the permanence test for a fixed place of business PE because the cumulative time she is anticipated to spend in the UK over the coming few years is significant and her presence in the UK is fixed and so not random or sporadic. Whether a UK PE would be created would depend on the wider facts and circumstances, such as the nature of the activities carried out by Francine and whether the actual location used by Francine is 'at the disposal' of the business. Generally, example 2 indicates that HMRC take the view that having a contractual entitlement to spend a fixed amount of time in the UK, and this being expected over a number of years is enough to potentially meet the permanence test.

Example 3

Alexei, Luca and Sara all work for a foreign entity in State C. They come to the UK on holiday for the same part of the year with their families, staying at different addresses. They are all permitted to stay on an additional 30 days to work in the UK by their employer, using the office of a UK affiliate company as a base.

HMRC confirms that, under such an arrangement, the employees' presence would not create a fixed place of business PE because the permanence test would not be met. This example is helpful in confirming that ad hoc presence (as in example 1) will not give rise to a PE, even where the ad hoc presence takes place at the offices of an affiliated business.

Example 4

Company T has a team of staff in its Zurich office. Over the course of nine months, six staff are permitted to spend six weeks each, in turn, at an affiliate company's office in London working on a project.

HMRC considers that this scenario would meet the permanence test for a fixed place of business PE because the changing identity of the visiting personnel doesn't affect the continuity of Company T's presence in the UK. Ultimately, the test is whether the business has a PE in the UK, and the fact that each individual may not spend a significant time in the UK does not prevent a PE arising where there is continuity and permanence of presence through the company's staff generally.

The challenge of Permanent Establishment is not going away as companies and employees develop new patterns of work, they will be potentially creating Permanent Establishments in a large number of countries. Whilst HMRC’s guidance is reassuring to companies who had hitherto banned their employees from extending their time in another country from a holiday to work, the guidance still leaves plenty of scenarios where unwittingly Permanent Establishments can be created in multiple jurisdictions.

What used to be a challenge for multinationals and large companies, has increasingly become a challenge for small and medium sized companies who do not necessarily have the resources to deal with this in a systematic manner.

Contributed by Jeremy Mindell

VAT and indirect taxes

Blissful biscuits (Lecture B1406 – 13.25 minutes)

Summary – A baked snack that was partly covered with chocolate was found to be standard-rated for VAT.

United Biscuits (UK) Ltd manufactured McVitie's 'Blissfuls' which consisted of a:

- biscuit cup with a flat bottom base;
- layer of chocolate hazelnut and a layer of chocolate;
- McVitie's logo made of biscuit on top that did not cover the entire top, so leaving some of the underlayer exposed.

The company zero rated this product as food (Sch 8 Group 1 VATA 1994).

HMRC argued that the product should be standard rated as it fell within excepted item 2 being 'biscuits wholly or partly covered with chocolate or some product similar in taste and appearance'.

The company appealed, claiming that the product's lid served more than a decorative function; it ensured that the product kept its shape and provided a crunch texture before the consumer tasted the chocolate filling. To be a covering the chocolate must be the first part of the biscuit to be bitten into. As the chocolate was not the first part, it was simply a filling, and the exception did not apply.

Decision

The First Tier Tribunal found that to be standard rated, the legislation requires the product to be wholly or partly covered with chocolate. Further, the term 'partly' should be interpreted in such a way that it could apply to any part of the biscuit, so long as it was covered to some extent with chocolate.

This meant that the question to be answered was: "What covered the remaining area of the product that was not covered by the biscuit logo lid?"

The Tribunal found that the ordinary man in the street would say that the biscuit was covered by the logo biscuit lid and 'in part' by a layer of chocolate. Being partly covered in chocolate, it fell within the exception to zero-rating and standard rated VAT applied.

United Biscuits (UK) Ltd v HMRC (TC08941)

Loan administration services (Lecture B1406 – 13.25 minutes)

Summary - The administration services provided by the taxpayer did not transfer funds or change the legal and financial position in anyway, meaning the supplies did not qualify as exempt financial services.

Shawbrook Bank Limited provided mortgages and loans, with Target Group Ltd administering these loans by providing instructions through BACS, calculating fees, interest and principal repayments due and making the relevant entries in loan accounts. Target Group Ltd did not make loans.

Target Group Ltd argued that they were providing exempt financial services falling within article 135(1)(d) of the Principal VAT Directive, contained within Sch 9 Group 5 items 1, 2, 2A and 8 VATA 1994. The exemption covers transactions including negotiation of deposit and current accounts, payments, transfers, debts, cheques and other negotiable instruments, but excluded debt collection.

HMRC disagreed arguing that the exemption did not apply because case law made it clear that the exemption only applies to the execution of an order for transfer or payment. Simply processing the payment did not qualify.

The Court of Appeal, as well as the Upper Tribunal, had upheld HMRC's case and the company appealed to the Supreme Court.

Decision

The Supreme Court stated giving instructions which automatically resulted in payment from the borrower's bank accounts to Shawbrook's bank accounts was not enough to fall within the exemption. Interpreting the legislation narrowly, to be exempt, the services provided must transfer funds and change the legal and financial situation of the parties involved.

The Supreme Court found that entries made by Target Group Ltd in the ledgers were simply the process of recording the effect of payments made by customers to Shawbrook Bank Limited. This process did not legally change anything for either party.

The services did not fall within the financial services exemption.

The appeal was dismissed.

Target Group Ltd v HMRC [2023] UKSC 35

VAT group joining date **(Lecture B1406 – 13.25 minutes)**

Summary – There was no statutory right to retrospectively amend the date that the taxpayer's parent company joined its VAT group meaning it was unable to recover the VAT accounted for under the reverse charge.

Dollar Financial UK Ltd was the representative member of the Dollar Financial UK VAT Group which included other members from the same corporate group.

On 27 June 2013, Dollar Financial Group Inc (DFGI), the company's US parent, applied for its UK branch to be added to the DFUK VAT Group with immediate effect.

On 12 August 2013, HMRC issued a letter approving its inclusion with effect from 27 June 2013.

Later, on 29 September 2016, Dollar Financial UK Ltd wrote to HMRC requesting an amendment to the date on which the parent company had joined the group, amending the date back to July 2012. The company argued that the parent had failed to identify it had a UK fixed establishment prior to June 2013, which had been created by the secondment of its employees to the UK. This fixed establishment gave rise to both a UK registration requirement and an entitlement to join the UK VAT group from July 2012.

The company argued that because the supplies made were provided solely by the employees located in the UK fixed establishment and not bought in, there was no requirement for Dollar Financial UK Ltd to account for over £2 million of VAT under the reverse charge.

In March 2018, HMRC wrote to refuse the requested retrospective amendment back to 2012 and so also declined the VAT repayment arguing that HMRC only permitted backdating of group registration to exceed 30 days in exceptional circumstances.

Having failed at the First Tier, the company appealed to the Upper Tribunal.

Decision

The Upper Tribunal reminded us that VAT grouping is not mandatory, but that eligible companies established in the UK can apply to register as a group if they satisfy the conditions set out in s.43B VATA 1994.

The Upper Tribunal rejected the claim that S.43B "imposes no bar on present group members applying to be a member at an earlier time in the group's existence, or, alternatively, that s43B(2)(a) can be read so that DFGI was 'another body corporate' because it was not a member of the group between 1 July 2012 and 27 June 2013."

The Upper Tribunal stated that under s.43B, any application to HMRC to join a VAT group must be for 'another' body corporate as a member of the group cannot apply again to be treated as a member of the group if they are already a member.

As Dollar Financial Group Inc was already part of the VAT group on 29 September 2016 it could not apply retrospectively to change it, unless HMRC agreed there were exceptional circumstances.

The Upper Tribunal stated that:

> "If Parliament had intended to permit a body corporate to amend the date from which it is to be treated as a member of the group, it could very easily have done so."

Consequently, the retrospective application was not a valid application. However, it was open to Dollar Financial UK Ltd to invite a decision from HMRC to consider whether exceptional circumstances applied. Where HMRC declined to do so, it remained possible to apply for judicial review.

Dollar Financial UK Ltd v HMRC [2023] UKUT 256 (TCC)

Changes to VAT penalties (Lecture B1410 – 20.47 minutes)

Changes to VAT penalties

The new filing and payment regime replaces the old default surcharge regime, and applies for VAT for accounting periods beginning on or after 1 January 2023.

There are no transitional rules when moving from the default surcharge to the new regime so all traders will start with a clean slate under the new regime.

This same regime is due to be rolled out for direct taxes on a graduated basis from April 2026 so as to tie with MTD for income tax.

Late filing regime

After reaching a 'points' threshold, there is a late submission penalty of £200 for each late submission.

Taxpayers receive one point for each late submission and will be notified each time a point is awarded. Whilst below the 'points' threshold, the points have a two-year shelf life, after which time they effectively expire.

The 'points' threshold varies, and depends on the submission frequency of the trader:

Returns submitted	Points
Annually	2
Quarterly (including MTD IT)	4
Monthly	5

So for quarterly submissions, penalties will apply after four late quarterly returns. At this time, four points will have been awarded and with that fourth point will come a £200 penalty.

Once the 'points' threshold is reached, the two-year expiry window for points becomes irrelevant. A £200 penalty will be charged for each late return until the taxpayer has filed returns on time for:

- 24 months where annual submissions are made;
- 12 months where quarterly submissions are made;
- 6 months where monthly submissions are made.

At this time, the points will be reset to zero but only if all returns for the last 24 months have actually been submitted. You cannot benefit from the reset if you have earlier returns still outstanding.

HMRC have a time limit for levying a point which is:

- 48 weeks for annual submissions;
- 11 weeks for quarterly submissions;
- 2 weeks for monthly submissions.

This will be extended to 12 months when HMRC were unaware of a taxpayer's submission obligations.

Reasonable excuse for late filing

Taxpayer's can appeal against HMRC's decision to issue a penalty point, or against a penalty charged once you have reached the 'points' threshold, provided there is a reasonable excuse for late filing.

Reasonable excuse could include:

- Computer breakdown before or during the preparation of the VAT return;
- Illness of the only person able to prepare/submit the VAT return but the taxpayer must take reasonable steps to get someone else in cases of prolonged illness;
- Loss of the only person who can prepare the VAT return leaves at short notice;
- Unexpected cash crisis such as the unexpected withdrawal of bank overdraft, non-payment by a regular payer, burglary or act of God;
- Loss of records where they are stolen or destroyed.

All of these excuses could apply for late payment as well as late filing.

Late payment regime

Under the new late payment regime, interest will always be charged on late payments at base rate plus 2.5%.

In addition to the late payment interest, the taxpayer may be liable to two late payment penalties.

Provided that the tax is paid within 15 days of the payment deadline, additional penalties are avoided. After that, a first penalty will be payable as follows:

- Late payment between Day 16 to 30: penalty is 2% of the outstanding tax at Day 15;
- If the tax is paid more than 30 days late, then a further sum is due calculated as 2% of the outstanding tax at Day 30.

In addition, there is a second penalty representing daily interest calculated by applying a 4% annualised rate on outstanding tax due after 30 days.

As with the filing regime, taxpayers with a reasonable excuse or special circumstances can apply to have the penalties cancelled.

Time to pay arrangement

Under a Time To Pay (TTP) arrangement, the taxpayer is treated as if they paid the tax on the date of the TTP agreement. Consequently, from this date penalties cease to accrue but only if the TTP terms are honoured.

If a TTP arrangement is agreed during days:

0 to 15	No penalties will be payable;
16 to 30	Only the initial 2% penalty will apply;
> 30 days	First penalty will increase to 4% but the second penalty will stop accruing at the date the TTP is agreed.

Note that late payment interest cannot be avoided and will continue to be charged.

Example 1

VAT return to 31 August 2023 shows a VAT liability of £10,000 and the taxpayer fails to pay this by the due date of 7 October 2023.

The taxpayer approaches HMRC to agree a TTP on 18 October 2023 which is Day 11. Having agreed the terms, the taxpayer honours those terms.

For the purposes of the first and second penalties the taxpayer is deemed to have settled the VAT on 18 October 2023. No penalties are due as the tax is deemed to have been settled by Day 15.

Interest will continue to accrue on any outstanding amounts.

Example 2

What if the taxpayer approaches HMRC to agree a TTP on 27 October 2023 which is Day 20 and subsequently honours the terms agreed?

For the purposes of the first and second penalties the taxpayer is deemed to have settled the VAT on 27 October 2023, which is after Day 15 but before Day 30. Consequently, the initial penalty of 2% is charged but no further penalties are payable (but see light touch approach below).

Interest will continue to accrue on any outstanding amounts.

Example 3

What if the taxpayer approaches HMRC to agree a TTP on 10 November 2023 which is Day 34 and subsequently honours the terms agreed?

For the purposes of the first and second penalties the taxpayer is deemed to have settled the VAT on 10 November 2023 which is after Day 30.

Consequently, the first penalty of 4% is charged (2% + 2%) and the second penalty will run for 4 days calculated at 4% per annum.

Interest will continue to accrue on any outstanding amounts.

Light touch approach

As this is a new system and taxpayers may struggle to contact HMRC within 15 days to agree a TTP, HMRC are adopting a light touch approach.

This will apply to the initial 2% penalty for the first year of operation of the new system only.

Where a taxpayer is seen to be doing their best to comply, HMRC will not assess the first 2% penalty for the 16-to-30-day period. This effectively allows a taxpayer 30 days to agree a TTP arrangement.

However, if a taxpayer has not agreed a TTP by Day 30, the first 2% penalty will be fully charged as well as the 2% of tax outstanding at Day 30.

Reviews and appeals

HMRC will tell you when you have a late submission point or a £200 penalty in a penalty decision letter, which will also offer you a review with HMRC.

Where a taxpayer has a reasonable excuse, it could be worth a review. This can be requested through their online account.

If the review is unsuccessful, the taxpayer could appeal to the First Tier Tribunal. However, given the level of the penalty, this is unlikely to be worth it for late filing.

Created from the seminar by Dean Wootten