Tolley®CPD

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Personal tax

Welsh income tax

From April 2019, the UK government will reduce each of the 3 rates of income tax paid by Welsh taxpayers:

- basic rate from 20% to 10%
- higher rate from 40% to 30%
- additional rate from 45% to 35%

As part of its annual budget process, the Welsh Government will decide the Welsh rates of Income Tax to be added to the reduced UK rates. The National Assembly for Wales will then vote to decide whether it agrees those rates.

The Welsh Government has committed not to increase income tax rates in Wales for the duration of the current Assembly, which is due to continue until May 2021. So at the moment this means there will be no change to overall income tax rates for taxpayers in Wales.

Ahead of the 2021 National Assembly elections, it is expected all the political parties in Wales will set out in their manifestos what they would do with income tax if they formed the next Welsh Government.

gov.wales/funding/fiscal-reform/welsh-taxes/income-tax/?lang=en

Individuals investing in cryptoassets (Lecture P1116 – 21.27 minutes)

Back in April 2018, we published an article by Steve Sanders explaining how and why cryptoassets (also known as ‘cryptocurrency’) have evolved. More recently, in December 2018, HMRC has now published a paper explaining how, under current legislation, individuals holding cryptoassets will be taxed and what records should be kept.

HMRC has confirmed that individuals who buy and sell cryptoassets will normally amount to an investment activity and be subject to capital gains tax. It considers it will be unusual for individuals to be transacting with sufficient scale and organisation to be trading.

What are cryptoassets?

Cryptoassets are cryptographically secured digital representations of value or contractual rights that can be transferred or traded electronically.

Currently, there are three types of cryptoasset:

1. Exchange tokens: used as a method of payment and include ‘cryptocurrencies’ like bitcoin. They do not provide any rights or access to goods or services;

2. Utility tokens: Issued by a business or group of businesses and used to buy specified goods or services over a digital platform;

3. Security tokens: provide the holder with interests in a business, perhaps as debt due by the business or a share of profits in the business.

HMRC say that the tax treatment of all tokens depends on the nature and use of the token and not the definition of the token.

HMRC do not consider the buying and selling of cryptoassets to be gambling.

Receipt of cryptoassets

HMRC highlight certain circumstances when Income Tax will be payable on cryptoassets received including those received from:

- their employer as a form of non-cash payment;

- mining;

- airdrops.

Cryptoassets as employment income

HMRC say that cryptoassets received as non-cash employment income are subject to Income Tax and NICs on the value of the asset.

If trading arrangements exist, cryptoassets are ‘readily convertible assets’ and as such, if the employer has a UK tax presence, they must account for tax and Class 1 NIC through the PAYE based on their best estimate of the cryptoasset’s value. Exchange tokens like bitcoin can be exchanged on one or more token exchanges in order to obtain an amount of money and so fall into this category.

Where cryptoassets do not meet the definition of ‘readily convertible assets’, they are still subject to Income Tax and NICs:

- The employer treats the cryptoassets as payments in kind for NIC purposes, and pays any Class 1A NICs to HMRC;

- The individual declares and pays HMRC the amounts due using the employment pages of a Self Assessment return.

Having received the cryptoasset as employment income, it becomes a capital asset in the employee’s hands so that, if and when it is sold, any profit will be chargeable to CGT.

HMRC does not consider cryptoassets to be currency or money so they cannot be used to make a tax relievable contribution to a registered pension scheme.

Mining

Mining typically involves using computers to solve difficult maths problems in order to generate new cryptoassets. This can amount to trading activity with the cryptoassets as trade receipts or alternatively it is treated as miscellaneous income. The correct treatment depends on a range of factors such as degree of activity, risk and commerciality.

If the mining amounts to a trade for tax purposes the cryptoassets will initially form part of trading stock. If these cryptoassets are transferred out of trading stock, the business will be treated as if they bought them at the value used in trading accounts. Businesses should use this value as an allowable cost in calculations when they dispose of the cryptoassets.

Airdrops

An airdrop is where someone receives an allocation of cryptoasset as part of a marketing campaign in which people are selected to receive them. Other examples may involve tokens being provided automatically due to other tokens being held or where an individual has registered to become eligible to take part in the airdrop.

Airdrops that are provided in return for, or in expectation of, a service are subject to Income Tax either as miscellaneous income or as receipts of an existing trade. No income tax is payable if the assets are airdropped without doing anything in return and are not airdropped as part of a trade or business involving cryptoassets or mining.

The disposal of a cryptoasset received through an airdrop may result in a chargeable gain for Capital Gains Tax, even if it’s not chargeable to Income Tax when it’s received. Where changes in value get brought into account as part of a computation of trade profits Income Tax will take priority over Capital Gains Tax.

Trading in cryptoassets

A trade in cryptoassets would be similar in nature to a trade in shares, securities and other financial products. Only in exceptional circumstances would HMRC expect individuals to buy and sell cryptoassets such that it represented a trade. If it is considered to be trading then Income Tax will take priority over Capital Gains Tax and will apply to profits (or losses) as it would be considered as a business.

Investment assets and capital disposals

HMRC expect that buying and selling of cryptoassets by an individual will normally amount to investment activity.

As digital assets, HMRC view cryptoassets as intangible assets that qualify as a chargeable asset for CGT purposes with gains arising when:

- selling cryptoassets for money;
- gifting cryptoassets to people other than their spouse or civil partner;
- exchanging cryptoassets for a different type of cryptoasset; and
- using cryptoassets to pay for goods or services.

HMRC say that cryptoassets gifted to charity are exempt unless the individual makes the donation in order to make a financial gain. That makes donations chargeable if the asset is donated for more than its original cost.

When calculating the gain on disposal, capital costs incurred wholly and exclusively in acquiring or selling the asset are deductible in arriving at the chargeable gain. This would include the original cost of the cryptoasset, advertising for a purchaser, valuation and contract fees.

Like shares

HMRC believes cryptoassets should be treated in the same way as shares and securities so that when they are sold, they are sold in a specified order:

1. Acquisitions on the same day as the disposal;
2. Acquisitions within 30 days after the day of disposal;
3. Shares comprised in the 'section 104 holding'.

Under s104 TCGA 1992 pooling applies to shares and securities but also "any other assets where they are of a nature to be dealt in without identifying the particular assets disposed of or acquired". Instead of tracking the gain or loss for each transaction individually, each type of cryptoasset is kept in a 'pool'. The consideration originally paid for the tokens goes into the pool to create the 'pooled allowable cost'. So that if a person owns bitcoin, ether and litecoin they would have three pools and each one would have its own 'pooled allowable cost' associated with it.

As with other types of assets, individuals can crystallise losses for cryptoassets that they still own if they become of negligible value by making a claim for the cryptoassets to be treated as being disposed of and re-acquired at an amount stated in the claim. As cryptoassets are pooled, the negligible value claim needs to be made in respect of the whole pool, not the individual tokens.

If an individual misplaces their private access key, they will not be able to access the cryptoasset. This does not count as a disposal as technically the asset still exits. If it can be shown there is no prospect of recovering the key or accessing the cryptoassets, a negligible value claim can be made.

Record keeping

The onus is on the individual to keep records for each cryptoasset transaction including:

- the type of cryptoasset;
- date of the transaction
- number of units bought or sold;
- value of the transaction in pound sterling;
- cumulative total of the investment units held;
- bank statements and wallet addresses, for any enquiry or review

www.gov.uk/government/publications/tax-on-cryptoassets

Capital Taxes

PPR following separation (Lecture P1116 – 21.27 minutes)

Summary – 4 months of occupation was insufficient in this case for the property to qualify as the taxpayer's only or main residence and so neither Principal Private Residence Relief nor Lettings Relief was available.

Hezi Yechiel bought a property (Beaufort Drive) in September 2007 with the intention that it would be a family home for him and his fiancée once it was both renovated and extended. Whilst his planning application was in progress, he let out the house. Meanwhile, Mr Yechiel and his fiancée lived in a 1 bedroom flat

The planning permission was granted in March 2008. Mr Yechiel and his fiancée married in August 2008 but in January 2011 his wife instructed divorce lawyers. In April 2011 Mr Yechiel moved into the Beaufort Drive property and remained there until July 2011, when he moved to live in his parent's house which was 15 minutes away.

Mr Yechiel explained that he had two intentions when he moved into Beaufort Drive:

1. To use the property as an escape route; it would allow him to get away from the stress of his divorce;

2. To use the house as a long term home.

A builder confirmed that he had 'kitted up' a bedroom and kitchen for Mr Yechiel in March 2011, and that Mr Yechiel was present at the property every morning April 2011 to July 2011. Council tax bills for the period April 2011 to March 2012 show full council tax being paid.

Mr Yechiel stated that from April 2011 to July 2011, he slept there every night. He brought a bed, and a second-hand side table. The rooms had built in cupboards. He used the kitchen for basics, though he didn't cook there because of his state of mind at that time: cooking for himself alone was not fun. He either ate at his parents or had a takeaway. He did occasionally eat there, sometimes standing up, sometimes in the car, and sometimes in bed. Utility bills were low as he was only really using the master bedroom and kitchen. He took clothes to his parents for washing.

In the period October to December 2011, he came to realise, both financially that he would need to sell the house, and emotionally that his parents' house was 'warm and supportive' and would provide him with the support he needed. Beaufort Drive was advertised for sale in October 2011 and it was sold in August 2012. The completion statement for the property showed a significant mortgage on the property at the time it was sold. The property was sold for just over £1.2m, having been purchased for £605,000.

The issue to decide was whether Mr Yechiel was eligible to claim principal private residence relief and so also letting relief for the period that the property was let. Was Beaufort Drive his 'only or main residence'?

Decision

The First tier Tribunal referred to the Court of Appeal decision, in Goodwin v Curtis [1988] STC 475 , saying that 'it is important not to construe the case stated with too microscopic a degree of precision..... there must be some assumption of permanence, some degree of continuity, some expectation of continuity to turn mere occupation into residence'. So it is important to look at the nature, quality, length and circumstances of a taxpayer's occupation of a property in deciding whether it qualifies as a residence.

In April 2011 Mr Yechiel did not want to continue to live with his wife and he did not want to live with his parents. He needed a home, and he thought that he would live at Beaufort Drive. He moved in with the intention of living there for a period of time.

The Tribunal considered that to have a quality of residence, the occupation of the house should constitute not only sleeping, but also periods of 'living', being cooking, eating a meal sitting down, and generally spending some periods of leisure there.

Overall they concluded that Beaufort Drive was not his only or main residence. The short period of occupation, minimal use of the house other than for sleeping, coupled with use of another house for eating, laundry and social connection, together with the lack of evidence of a firm commitment to living in the house long term indicated his lack of residence. In addition, he concluded that financially he could not afford to stay there.

The appeal was dismissed.

Hezi Yechiel v HMRC (TC06829)

An entrepreneurs' relief rethink **(Lecture P1117 – 20.12 minutes)**

The Chancellor's Budget on 29 October 2018 included two significant announcements in respect of entrepreneurs' relief:

1) For disposals of shares taking place on or after 29 October 2018, an individual, as an additional measure, must be entitled to at least 5% of the company's distributable profits and, in a winding up, must have an entitlement to at least 5% of the company's assets; and

2) With effect from 6 April 2019, the minimum period throughout which the various qualifying conditions must be satisfied in order for the relief to be available is being doubled from one year to two years.

Remember that, in order for a shareholder to be eligible for entrepreneurs' relief on a disposal prior to the changes detailed in 1)) above, he had to hold at least 5% of the company's ordinary share capital and be able to exercise at least 5% of the voting rights in the company. The new tests require the claimant also to be entitled to (as a minimum) 5% interests in the profits and assets available for distribution to the company's equity holders.

The definition of 'equity holder' in this context is taken from S158 CTA 2010. This definition includes some types of preference share as well as – potentially – certain loans. However, normal commercial loans (as defined in S162 CTA 2010) are ignored along with most bank lending.

The new legislation's main problem spotted by many tax advisers related to companies having share structures which involve more than one class of capital, e.g. 'A', 'B' and 'C' shares (commonly known as alphabet shares). Typically, these shares will rank equally in all respects, except that dividends are often voted unevenly across the different classes. This provides valuable flexibility in distributing profits, especially in the case of private companies that are often quasi-partnerships. However, where the proportion of the dividend paid which is allocated to any particular share class is completely discretionary (and could therefore be anything from zero to 100%), the argument was that it is difficult to see how the holder of, say, the 'A' shares is entitled to any percentage of the profits available for distribution. This, it was said, applies even if, historically, the shareholder has always received at least 5% of the amount distributed.

On 13 November 2018, the accountancy firm BDO published a piece on their website which was somewhat melodramatically entitled 'Entrepreneurs' relief – the death of alphabet shares?'. BDO's conclusion was:

> 'It therefore appears that, as the legislation is currently drafted, no alphabet shares will be eligible for entrepreneurs' relief, unless the Articles rank all shares pari passu or give a right to a proportion of every dividend declared.'

The author of the report then gave the following example in relation to a hypothetical company:

> 'Mr A owns 50 'A' ordinary shares and Mr B owns 50 'B' ordinary shares. The shares rank equally in voting power and assets in a winding up. There are no other shareholders.
>
> The Articles permit dividends to be voted independently between the two classes of share.
>
> Following the Budget announcement, it now appears that neither shareholder will qualify for entrepreneurs' relief, as they have no absolute right to receive at least 5% of the dividends.'

On the assumption that this argument is correct, even if the two shareholders were able to take steps to restore relief, there would be a gap in the qualification period – given that the new rules are already in force – and so the shares would need to be held for another two years before they were again eligible for entrepreneurs' relief.

Interestingly, when HMRC were approached about this dilemma, they denied that it had been the Government's intention to attack alphabet share arrangements. However, the CIOT and other professional bodies were quickly in detailed discussions with the authorities over the wording of the proposed legislation and the outcome of this is explained below.

A similar problem was identified where a class of share (for example, share capital issued to a venture capitalist) has a priority right to a dividend. In such a case, although a holder of other ordinary shares may be beneficially entitled to 5% or more of what is left, that may not be 5% of the total profits available for distribution. This could also be the position where a shareholder is entitled to a preferential claim on assets in a winding up.

Other shareholders who could be affected are those whose companies have:

(i) growth shares; or

(ii) ratchet share structures; or

(iii) shares with different nominal values.

In this context, note the helpful technical note on the meaning of 'ordinary share capital' which was published by the CIOT on 19 September 2018.

Fortunately, the Government seem to have accepted that the revised legislation was not wholly satisfactory. As a result, on 21 December 2018, they tabled an amendment to the Finance Bill. This amendment adds an alternative test to the CGT definition of 'personal company', based on the shareholder's entitlement to proceeds in the event of a hypothetical sale of the whole company. The question being asked by the new test is whether it is reasonable to suppose that, if the whole of the ordinary share capital of the company were to be sold for its market value on the date of the shareholder's actual disposal, he would be entitled to at least 5% of the proceeds. If this question can be answered in the affirmative, entrepreneurs' relief should normally be available.

The latest test does not rely on meeting the 'equity holders' criteria, but is set out as an alternative. Note that the two original tests based on profits available for distribution and assets in a winding up have been retained by the Finance Bill, apparently 'to provide certainty to those with straightforward company structures'. One of the complications that this will cause is that the original tests took effect for 29 October 2018 onwards, whereas the new hypothetical sale test only came into being on 21 December 2018.

This latest amendment should, it is thought, be effective in restoring relief for companies with alphabet share structures, certainly in the common situation of a private company where genuine co-owners use alphabet shares to maintain flexibility in allocating profits on a year-by-year basis without affecting the underlying equity ownership of the company. In other scenarios, especially where venture capital investment is involved, it will still be necessary to take extra care when examining the precise impact of the arrangements in question.

Contributed by Robert Jamieson

Voting rights and entrepreneurs' relief **(Lecture P1118 – 14.13 minutes)**

In George v HMRC (2018), the First-Tier Tribunal held that, following a sale of shares, a key equitable maxim did not apply to allow voting rights to operate: from the date:

- of an agreement to confer those rights; rather than
- on which they were actually conferred.

As a result, the taxpayer (Mr G) failed in his claim for entrepreneurs' relief.

Mr G worked for Thornton & Ross Ltd (TRL), a company that developed, manufactured and supplied over-the-counter medicines and healthcare products, becoming TRL's chief executive in March 2002. TRL had been owned since its incorporation in 1922 by members of the Thornton family and by Thornton family trusts. The chairman of the company was Mr Jonathan Thornton (Mr T).

In 2005, Mr G acquired a large number of 'C' and 'D' shares in TRL. These new shares represented 6.9% (by nominal value) of the ordinary share capital of TRL, but they carried no voting rights – only family members and family trusts held voting shares that were classified as 'A' and 'B' shares.

Following an unsuccessful attempt to sell TRL in 2010/11, Mr T and Mr G came to an agreement in February 2012 that TRL should again be put up for sale – this was planned to be at some point within the next two years – and that Mr G's shares should be given voting rights in order to enable these shares to attract entrepreneurs' relief. The necessary special resolution for this voting change was not, however, passed until January 2013 owing to a combination of external circumstances and the need for Mr G to indemnify the other TRL shareholders against any possible tax liability that might arise by virtue of the value shifting rules in S29 TCGA 1992. There were no minutes or other record of the February 2012 meeting between Mr T and Mr G, which was not entirely surprising given that the two of them worked closely together and their relationship was based on trust.

However, in December 2012, Mr T received an unsolicited offer to acquire TRL from a company called Stada and this led to the sale to Stada going through in August 2013.

On the face of it, Mr G's shares did not qualify for entrepreneurs' relief since he had not satisfied the 'personal company' requirement in S169S(3)(b) TCGA 1992 for at least one year prior to the sale. Mr G's shares had only received their voting rights in January 2013 and the disposal took place some seven months later.

Nevertheless, it was argued that the February 2012 agreement was legally binding and enforceable and that, as equity looks on that as done which ought to be done, the shares should be treated as having acquired their voting rights back in February 2012. It was this line of argument that led to the case.

The First-Tier Tribunal, in finding against the taxpayer, identified four conditions that would all have to be satisfied in order for entrepreneurs' relief to be available on this basis:

1. there must have been a legally binding contract concluded between Mr T and Mr G in February 2012;

2. a court of equity would make an order for specific performance of that contract;

3. the equitable maxim that 'equity looks on that as done which ought to be done' must apply; and

4. the statutory requirement in S169S(3)(b) TCGA 1992 must be met by application of the equitable maxim.

The First-Tier Tribunal decided that the February 2012 agreement between Mr T and Mr G did not represent a legally binding contract because its terms were not sufficiently certain and anyway there was no consideration.

As far as the CGT legislation was concerned, the requirement in S169S(3)(b) TCGA 1992 would not be met because the voting rights attached to Mr G's shares must be exercisable 'by virtue of that holding', whereas, if the equitable remedy applied, Mr G would obtain his voting rights from the February 2012 agreement, and not from his shareholding.

Contributed by Robert Jamieson

Meaning of 'ordinary share capital' (Lecture P1119 – 16.36 minutes)

On 19 September 2018, the CIOT published – with permission – minutes of an HMRC meeting on CGT that took place some months ago attended by representatives of all the main professional bodies. One of the matters discussed was the meaning of the words 'ordinary share capital' in the context of tax legislation.

The term 'ordinary share capital' is defined in S989 ITA 2007 as follows:

> 'all the company's issued share capital (however described), other than capital the holders of which have a right to a dividend at a fixed rate but have no other right to share in the company's profits'.

This definition, despite being found in ITA 2007, applies for CGT matters such as entrepreneurs' relief as well as for income tax. There is an identical definition for corporation tax purposes in S1119 CTA 2010.

Following the decision of the First-Tier Tribunal in McQuillan v HMRC (2016), where it was held that a class of redeemable ordinary shares with no dividend entitlement constituted shares which have a right to a dividend at a fixed rate (i.e. 0%) and therefore did not form part of the ordinary share capital of the company concerned, there was widespread uncertainty as to the precise meaning of the term. This was particularly problematic, given that the First-Tier Tribunal's ruling went against HMRC's long-established understanding that, earlier in the same year, had been approved in the case of Castledine v HMRC (2016).

In the event, following an appeal, the Upper Tribunal judges overturned the previous decision (see HMRC v McQuillan (2017)). The Upper Tribunal did not consider that there was any ambiguity or difficulty about the interpretation of S989 ITA 2007. That legislation, in the judges' opinion, did not countenance a right to no dividend as being a right to a dividend at a fixed rate. They stated:

> 'It is in our plain view, on the literal meaning of S989 ITA 2007, that to be within (the) excluded class the shares in question must have a right to a dividend. Once it is determined, as a matter of fact, that the shares carried no right to a dividend, there is no question of the shares falling outside the definition of "ordinary share capital".'

The published examples, which were considered at that HMRC meeting, can be found in the 'Technical News' section of the CIOT's website (www.tax.org.uk). The heading for the various examples is 'Preference shares – when are they ordinary share capital?' The details of the more relevant ones are set out below:

Description of situation (+ HMRC's official view)

- Shares with no dividend rights: These count as ordinary share capital – the statutory definition is silent on the question of rights, other than a fixed rate of return.

- Fixed rate preference shares with a zero coupon: These count as ordinary share capital, given that a right to nothing is not a right to something and so these are not shares which entitle the holder to a return at a fixed rate.

- Fixed rate preference shares with a coupon of 0.000001%: These do not count as ordinary share capital – although negligible, it is hard to argue that the coupon is not a fixed rate (however, in avoidance cases, one might expect the Courts to look at the reality and decide otherwise).

- Shares with a fixed rate of 10% cumulative: These do not count as ordinary share capital – the holder knows that the return is fixed even when profits are not available (and so the investment looks more like debt than equity).

- Shares with a fixed rate of 10% non-cumulative: These count as ordinary share capital, given that, in some years, no dividend will be paid and so there is no fixed rate – the return is dependent on the results of the business and consequently the investment looks more like equity than debt.

- Preference shares with a right to 'tiered' dividends: These count as ordinary share capital – although the terms are fixed, the rate is not and so HMRC regard this as representing a non-fixed rate of return.

- Shares which have a right to the greater of a specified sum or the dividend paid in respect of another class of shares: These count as ordinary share capital, given that there is no fixed rate – this type of condition will usually be dependent on the results of the business, again pointing to equity rather than debt.
- Fixed rate preference shares where the holders receive a special payment above the par issue price based on the figure for reserves in the event of the shares being redeemed (or the company being sold or put into liquidation): These count as ordinary share capital – the holder is entitled to a fixed rate of return, but the payment above par represents an 'other right to share in the company's profits' which brings the shares back into the category of ordinary share capital.

- Preference shares with two alternative fixed rates, where the rate used depends on certain events during the year (e.g. the level of the company's profits): These count as ordinary share capital – there is no fixed rate but rather a rate fluctuating between two alternatives which vary according to business results (this again looks more like equity than debt).

- Preference shares where a rate of interest is added if the dividend is unpaid: The cautious view is that these count as ordinary share capital, but, provided that the rate is fixed and cumulative, it should not be so regarded (the additional amount payable in respect of the unpaid dividend represents interest on the sum outstanding rather than a return on the original equity investment).

Although these examples were published with specific reference to entrepreneurs' relief, the definition of 'ordinary share capital' is of relevance in numerous places in the tax legislation and so the illustrations are likely to be useful in helping to understand HMRC's views with regard to many different kinds of preference share capital.

Contributed by Robert Jamieson

Planning a multiple completion share buy-back (Lecture P1120 – 21.12 minutes)

Purchase of own shares - capital gains treatment

For individual sellers, the main conditions that must be satisfied to prevent the purchase of own shares ('POS') from being a distribution (subject to income tax rates) – and therefore falling within the capital gains tax ('CGT') regime are as follows:

- The 'purchasing' company must be an unquoted trading company or holding company or a trading group;
- The purchase must be for the benefit of the purchasing company's trade (or the trade of any of its 75% subsidiaries) (s1033 CTA 2010);

  (SP2/82 outlines the various factors that HMRC uses to determine whether the benefit of trade test has been satisfied. These include the retirement of a controlling shareholder-director who wishes to make way for new management or buying out a disinterested or aggrieved shareholder.)
- To meet the 'trade benefit' text, HMRC expect the outgoing shareholder to sell all their shareholding (although retention of 5% 'sentimental' stake is permitted). If appropriate, the seller must also resign as a director;
- The seller must be UK resident in the relevant tax year (s1034 CTA 2010);
- The seller must have held the shares for at least five years (s.1035 CTA 2010). There are special provisions which 'look through' a prior CGT reorganisation, so that the 'new holding' is deemed to be acquired at the same time as their former shareholding for these purposes (s1035 (3) CTA 2010).

Entrepreneurs' relief issues for purchase of own share sales

Although the relevant' qualifying period for entrepreneurs'' relief ('ER') is just TWO years (one-year for pre-5 April 2019 POS deals) before the disposal, the seller must have owned the relevant shareholding for at least five years to bring themselves into the CGT regime.

Thus, the qualifying period of share ownership for a POS would normally be five years, although the strict ER conditions will also need to be satisfied in the year before the POS.

In this context, make sure that any resignation as a director occurs on or shortly after the POS, otherwise HMRC are likely to deny ER on the grounds that the 'director' condition had not been fulfilled throughout the one year leading up to the POS! (see case of J K Moore v HMRC [2016] UKFTT 115 (TC)).

Financing a purchase of own share and the use of 'multiple completion' structures

Financing a purchase of own shares is not always easy. Company law demands that the purchase price for the shares bought back by the company is paid immediately (S691 (2), Companies Act 2006). It is not therefore possible for a company to buy-back its own shares for a deferred consideration.

However, because of the (often) substantial sums involved for the POS consideration, many owner managers have used the 'multiple completion' mechanism. Broadly speaking, a multiple completion POS agreement involves the owner manager contracting to sell their shares back to the company, but with the legal completion of the buy-back subsequently taking place in tranches.

A multiple completion contract enables the company to finance the purchase price over a number of years out of its (surplus) trading cash flows. Provided it is properly structured and implemented, this mimics a 'deferred consideration' deal whilst remaining compliant with company law.

In carrying out multiple completion deals, tax advisers still place reliance on the (then) Inland Revenue ruling in 1989.

In a statement the Inland Revenue confirmed its agreement to a purchase of own shares being made in instalments, as reported in the ICAEW technical release 745 issued in April 1989. Para 10 (b) of the release states:

> ''They [the Inland Revenue] take the view that as the beneficial ownership of the shares is regarded as passed at the date of the contract, a disposal for capital gains tax purposes will have taken place by the vendor at that time notwithstanding payments at later dates.''

Practical experience has also shown that HMRC has generally given purchase of own shares tax clearances under s1044, CTA 2010 for properly structured purchase of own shares multiple completion deals.

Hitherto, tax advisers and HMRC has accepted the following technical analysis for a multiple completion purchase of own shares:

- For CGT purposes, the disposal of the entire beneficial interest in the shareholding takes place at the date of the contract (s28, TCGA 1992). Importantly, this means that if the seller shareholder qualifies for the ('no distribution') 'CGT' treatment and also ER, the full amount of the purchase of own shares proceeds should attract the beneficial 10% rate.

- Under the multiple completion route, the selling-shareholder gives up their beneficial interest in the repurchased shares on entering into the contract and therefore the 'substantial reduction' test does not apply. Thus, the seller cannot subsequently take dividends or exercise voting rights over the shares. Thus, since the 'seller' loses beneficial ownership of all the shares on entering into the contract, the various 'connection' tests imposed by s1042 and s1062, CTA 2010 are not in point.

- However, HMRC has always insisted that it is not legally possible to give up voting rights via the POS contract. If a shareholder still legally holds the shares, HMRC consider that they are still able to exercise their voting rights at a company meeting.

Assuming this view is correct, the selling shareholder would be ‘connected’ with the company under CTA 2010, s 1062(2)(c) where the voting rights on the ‘non-completed’ purchase of own shares exceed the 30% limit.

However, if this is likely to be a potential issue, HMRC also accept that the problem can be corrected by converting the relevant ‘non-completed’ element of the shares into a separate class of non-voting shares.

- The subsequent ‘multiple completion’ of the purchase of own shares of the remaining tranches of shares is simply a legal process and normally has no bearing for tax purposes.

Although there had been some anecdotal evidence in 2017 that HMRC had changed its view on the tax analysis of a multiple completion purchase of own shares – which may restrict the availability of entrepreneurs’ relief – it appears this is no longer a concern. HMRC published an update to its CG manuals (CG 58655) on 11 December 2018 that dealt with some of the technical points relating to multiple completion purchase of own shares – the potential entrepreneurs’ relief issue was not mentioned.

Multiple Completion Purchase of Own Shares *Case Study – Ravi & Daughter Ltd*

Ravi currently holds 75% of the issue share capital of Ravi & Daughter Ltd, which has a 100% trading subsidiary, Sunrise Ltd.

Ravi & Son Ltd was the vehicle used to buy-out Ravi’s business ‘partner’ in 1998, so that it became the holding company of Sunrise Ltd. Ravi gifted his daughter a 25% shareholding in 2014.

He now wishes to hand-over the shares in Ravi & Daughter Ltd to his daughter, whilst taking out a reasonable value for his shares. Ravi has asked his advisers how this can be achieved in a tax efficient way.

His advisers have proposed a company purchase of own shares.

Ravi has indicated that he would be happy with (say) £3 million for his shares. Although this valuation probably ‘undervalues’ the company, it considers the affordability of the buy-back from the group’s viewpoint.

The group has been recently been making trading pre-tax profits of around £800,000.

Structuring a multiple completion purchase of own shares

Given the cash flow constraints, Ravi (see ‘case study’ above) was advised to use the multiple completion route to buy-back his shares (as ‘blessed’ by HMRC – see ICEAW Technical Release 745). Broadly, this involves the seller contracting to sell their shares back to the company, but with the legal completion of the buy-back subsequently taking place in tranches.

Under the multiple completion route, Ravi would have to give up his beneficial interest in the repurchased shares on entering into the contract and therefore the ‘substantial reduction’ test does not apply. Thus, the seller cannot subsequently take dividends or exercise voting rights over the shares. However, for CGT purposes, the disposal of the entire beneficial interest in the shareholding takes place at the date of the contract (s 28 TCGA 1992).

Experience suggests that HMRC are normally prepared to grant tax clearances for multiple completion purchase of own shares cases. Multiple completion transactions are invariably implemented to ensure that the financing of the purchase of own shares is Companies Act compliant - there is no tax avoidance involved.

Contributed by Peter Rayney

Administration

Directors filing SA returns (Lecture P1116 – 21.27 minutes)

Historically, HMRC has claimed that company directors have a statutory obligation to notify HMRC of their requirement to complete a self-assessment tax return. In reality, there is no legal obligation. However, back in April 2018, we reported on a First Tier Tribunal case that challenged this point (*Karen Symes v HMRC: TC06320).* Here the judge said "there is a statutory obligation on every person to notify liability if they are chargeable to tax and their income and gains do not fall within at least one of the exceptions in s7(4) to (7) TMA 1970". In 2015/16, her dividends fell into her basic rate band and so they were not chargeable to tax as they were covered by the 10% tax credit that was available at that time.

Agent Update 69 has brought some good news. It states that:

> "Many company directors are taxed under PAYE and so will not need to give notice of liability to tax provided they have no other untaxed income.
>
> HMRC can choose to issue a notice to file a SA return (under section 8 Taxes Management Act 1970) to any individual. Anyone receiving a notice to file a tax return must do so by the required deadline, or they may be liable to a late filing and/ or a late payment penalty.
>
> If an individual has received a notice to file and has no other taxable income to report, they can ask for the notice to file to be withdrawn. However, HMRC may decide that they still require a return and if so, the return must be submitted, otherwise penalties may be incurred."

The Government tool at https://www.gov.uk/check-if-you-need-tax-return still makes reference to individuals being a company director but confirms that as long as their income is below £50,000 and they have no other taxable income, they do not need to file a tax return.

Remember, from 6 April 2016 there is a tax liability arising from dividends in excess of £5,000 falling with the basic rate band and so there would be a liability to notify if dividends were in excess of this amount in 2016/17. This allowance fell to £2,000 for 2017/18 onwards. It is important to check that individuals receiving dividends above the allowance register for self-assessment.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/763042/Agent_Update_-_issue_69.pdf

Excuses for late returns, or not!

On 31st January 2019, the BBC News website reported that last year almost ¾ million people faced a fine of £100 by filing their self-assessment return late. They stated that:

> “Some of those had imaginative (and unsuccessful) excuses for their tardiness. HM Revenue and Customs (HMRC) has revealed some of the "outlandish" reasons they heard last year:
>
> - My mother-in-law is a witch and put a curse on me
> - I'm too short to reach the post box
> - I was just too busy - my first maid left, my second maid stole from me, and my third maid was very slow to learn
> - Our junior member of staff registered our client in self assessment by mistake because they were not wearing their glasses
> - My boiler had broken and my fingers were too cold to type”

If your clients file their returns late, hopefully they will have a ‘valid’ reasonable excuse.

https://www.bbc.co.uk/news/uk-47065721

Employees submitting SA returns **(Lecture P1116 – 21.27 minutes)**

Summary – The taxpayer’s appeal against late filing penalties imposed by HMRC failed as she had successfully filed tax returns up to and including 2014/15 and should have been aware of the filing procedures and deadlines for 2015/16.

HMRC’s records showed that Margaret Mcdonnell:

- was set up for self-assessment on 19 June 2007, as her expenses exceeded £2,500 in her employment;
- had been successfully filing her tax returns from the 2006/07 to 2014/15 and claiming her expenses for the same period.

HMRC issued a notice to file her 2015/16 return on 6 April 2016. The filing date was 31 October 2016 for a non-electronic return or 31 January 2017 for an electronic return, but the return was not submitted until 21 June 2017 return by which time HMRC had issued penalty notices totalling £620.

On 4 July 2017 Margaret Mcdonnell’s agent appealed against the penalties, stating that she had visited her local tax office in Enniskillen in November 2013 approximately 2 weeks before the local tax office closed its services to the public. She gave her income details for the year ended 5th April 2016 to the staff member in the tax office and she assured our client that her tax return was now filed and that she had completed the necessary paperwork on her behalf. She could not then go back to the local tax office to query this.

Clearly this could not have been correct as in November 2013 she would not have known her income and expense details for 2015/16. When HMRC challenged on this point, the agent replied that in 2013 she had asked to be removed from the need to file a return, as she only had PAYE income and there was no need for her to be filing a return going forward. “She was under the impression and told by the local tax office at this point that this had been actioned, and going forward she would no longer need to file a return ...”

HMRC’s records show that she attended an appointment at the Enniskillen Enquiry Centre on 7 November 2013, but this was to complete her 2012/13 return. The note shows she requested her expenses to be removed from her tax code in the future, as this was creating underpayments of tax as her mileage expenses claimed varied. Her 2013/14 tax code was amended by removing her expenses. Each time she submitted a tax return, her tax code would have been changed to reflect the expenses claimed. HMRC therefore consider she would have been aware of the relationship between her completed tax return and her tax code changes.

Margaret Mcdonnell claimed that she was unaware that she needed to complete a return for 2015/16. However, HMRC’s records showed a Notice to File a Tax Return was issued on 6 April 2016, to the address on HMRC’s records at that time. There was no evidence that the tax return was returned to HMRC as undelivered, and therefore the return was deemed to have been served.

HMRC also contend that if she believed she did not need to complete a tax return after 2012/13, she would have contacted HMRC to see why later returns had been issued for 2013/14 and 2014/15 both of which she completed and submitted on time. It was HMRC’s view that the 2015/16 SA short tax return was issued correctly.

Decision

The First Tier Tribunal stated that when a person appeals against a penalty they are required to have a reasonable excuse for the whole period of the default. A reasonable excuse is normally an unexpected or unusual event, either unforeseeable or beyond the person’s control, which prevents him or her from complying with an obligation which otherwise would have been complied with.

The Tribunal agreed with HMRC’s reasoning. Margaret Mcdonnell had successfully filed previous tax returns and should have been aware of the filing procedures and deadlines. The late filing penalties were charged in accordance with legislation and there was no reasonable excuse for Margaret Mcdonnell’s failure to file her tax return on time.

Interestingly, the Tribunal added that the fact that the taxpayer’s sister had had her case settled with a favourable outcome does not alter the fact that in this case the penalties were correctly imposed. None of the circumstances in that case was known whereas the circumstances in this case were known. This case was determined on its own merits.

Margaret Mcdonnell v HMRC (TC06838)

Reasonable excuse for late filing (Lecture P1116 – 21.27 minutes)

Summary – The fact the taxpayer had lost data from her computer, was caring for her mother and had her own eye problem requiring an operation were not a reasonable excuse for the late filing of her 2012/13 self-assessment return.

Gayle Ward had been within the self-assessment regime since 1996/97. Her 2012/13 return was issued on 6 April 2013.

She failed to file her return by 31 January 2014 and was issued with a £100 late filing notice, daily penalties of £10 per day for 90 days were imposed under Schedule 55 as well as 6 month penalty of £300.

She finally filed her return on 12 August 2014. On 13 August 2014, her agent appealed against the penalties, on the grounds that:

- Her computer had a virus. She had to replace it and lost data in the process which had to be re-inputted;
- She underwent an eye operation on 6 June 2014;
- She was looking after her mother 24/7 who was suffering from the late stages of Alzheimer's and died on 14 November 2014

HMRC carried out a review and issued their review conclusion on 24 November 2014. The outcome of the review was that HMRC's decision should be upheld.

Decision

The Tribunal noted that she had been filing self-assessment tax returns since 1996/97 and so would be well aware of her obligations. However, HMRC said that she had been late filing her SA tax returns for the six years prior to 2012/13.

When HMRC first sent a late filing penalty to Gayle Ward this should have acted as a prompt to her that her return was due and had not been submitted. The £100 penalty notice would have also advised her that if her return was more than three months late HMRC would begin charging her a penalty of £10 for each day it remained outstanding for a maximum of 90 days. The penalty notices would have also warned about the six month £300 penalty.

The Tribunal concluded that the reasons given by Gayle Ward for the delay in filing her 2012/13 return did not amount to a reasonable excuse. They sympathised that she lost data from her computer and had to arrange for it to be inputted, was caring for her mother, and was also suffering eye problems.

However, being aware of the 31 January 2014 deadline she should have prepared for this and could have appointed an agent to deal with the return, which is what she did eventually in any event.

The late filing penalties have therefore been charged in accordance with legislation and there is no reasonable excuse for her failure to file her tax return on time.

Gayle Ward v HMRC (TC06867)

Reasonable excuse for late payment of tax (Lecture P1116 – 21.27 minutes)

Summary – The Upper Tribunal held that the taxpayer did not have a reasonable excuse for his late payments as he failed to make provisions tax and chose to buy a house rather than renting a property at a time when he was short of cash.

Mr Raggatt had been in professional practice as a barrister for 40 years, during which time there had never been any suggestion of his not attempting to pay his tax liabilities. However, from 2008 Mr Raggatt's practice had been to make occasional tax payments as and when his professional income permitted, but without any particular discipline as to the due dates. A schedule in evidence before the First Tier Tribunal showed the payment history back to 2008, revealing multiple late payments.

In 2010, Mr Raggatt had concluded a divorce settlement with a large lump sum and annual maintenance. The amounts had been agreed by reference to his past earnings. The government's cuts to criminal legal aid had severely affected his professional practice, resulting in cashflow problems.

Mr Raggatt agreed a time-to-pay instalment plan with HMRC for the tax year 2011/12. His monthly instalment obligations were met by Mr Raggatt's bank until he exhausted his £200,000 overdraft facility, and the bank declined to extend it, in August 2012. Mr Raggatt made a significant payment in November 2012 – again, following his usual practice, out of his professional income as it became available – and HMRC accepted that as not incurring any liability to penalties for 2010/11 and 2011/12. However, the breach of the time-to-pay agreement meant that HMRC were not prepared to extend a similar facility for 2012/13.

He had no investments apart from his house and his pension plan. His house sale had not completed until early 2016, due to the sluggish market. Access to his pension plan was not possible until he was 65 in 2015. When access had become possible he had drawn out such sums as he was able without triggering a tax charge.

Mr Raggatt argued that he had a reasonable excuse for late payments of income tax that resulted in late payment penalties as follows:

(1) Tax year 2012/2013 – penalties totalling £9,795; and

(2) Tax year 2013/2014 – penalties totalling £3,640.

The First Tier Tribunal were not satisfied that in all the circumstances Mr Raggatt had exhibited the exercise of reasonable foresight and of due diligence and a proper regard to the fact that the tax liabilities concerned would become due on particular dates and accordingly concluded that there was not a reasonable excuse. The First Tier Tribunal found that Mr Raggatt "has really just continued his long-established practice of paying irregular lump sum instalments to HMRC as and when he can afford to do so out of his professional income".

Mr Raggatt appealed to the Upper Tribunal submitting that the First Tier Tribunal made an error of law in that its decision was against the evidence before it.

Decision

The Upper Tribunal observed that the schedule of Mr Raggatt’s income over the three tax years preceding the two tax years in respect of which the penalties were charged, and the first year thereafter show, Mr Raggatt earned an average annual income of £190,788, giving rise to an average annual tax payment of £70,342. His highest total income was £310,776, in respect of 2010/11, at a time when the legal aid cuts were beginning to bite significantly and his lowest was £123,308 in 2011/2012. In the year following that his total income rose to £245,981. It was therefore not clear to the Upper Tribunal why if Mr Raggatt had made prudent reservations for tax out of moneys he received in respect of those years when he was receiving higher levels of earnings, he would not have been in a position to have funds available to supplement the tax payments he was able to make out of the lower amounts of income that he was receiving in the years in which the payments fell due. By not making any provisions, which was consistent with his practice in the years before the legal aid cuts began to bite Mr Raggatt was taking a commercial risk that he would not have sums available to meet his tax liabilities when they fell due.

Additionally, the Upper Tribunal noted that Mr Raggatt had funds available to buy a house in 2011 following his divorce, at a time when his income appeared to have dropped considerably but he would have been aware at that time of significant tax liabilities to come. In those circumstances, he might have made a different choice and provided accommodation for himself by renting a property or purchasing a property subject to a mortgage, at least until his financial position improved.

The appeal was dismissed

Timothy Raggatt QC v HMRC (UT/2016/0163)

Deadlines

1 February 2019

- £100 penalty /extended enquiry window 2018 SA returns not filed by 31 January 2018
- Corporation tax due for SME accounting periods ended 30 April 2018

2 February 2019

- Due date of filing for P46(Car) for quarter ended 5 January 2018

7 February 2019

- Filing date for VAT returns and electronic payment for 31 December 2018 quarter

14 February 2019

- Quarterly corporation tax instalment for large companies due, depending on year end
- Filing date for monthly EC sales list if paper return used
- Application deadline to defer Class 1 NICs for 2018/19; deferral applications up 5 April 2019 considered only with employer(s) approval.

19 February 2019

- Due date to pay PAYE, National Insurance, construction industry scheme and student loan liabilities for month ended 5 February 2019 if not paying electronically
- Due date to file monthly construction industry scheme return

21 February 2019

- File online monthly EC sales list by this date.
- Submit supplementary Intrastat declarations for January 2019 by this date

22 February 2019

- PAYE, National Insurance, construction industry scheme and student loan liabilities should have cleared HMRC's bank account by this date

28 February 2019

- Payment of 2018/19 SA liabilities after this date will be subject to a 5% surcharge
- Private company filing deadline for those with 31 May 2018 year end
- Public limited company filing deadline for those with 31 August 2018 year end
- Corporation tax SA returns for companies with periods ended 28 February 2018

News

2017/18 self assessment

The ICAEW's Tax Faculty has reported 2017/18 self-assessment return problems that have been reported by some members. These include:

- Payments on account for 2018-19 not being generated but HMRC has advised that interest will not be charged;
- Late filing penalties were being issued incorrectly for some trust returns filed in early January but HMRC has advised that all such cases have now been identified and corrected;
- Incorrect calculations for Scottish taxpayers being issued;
- Paper returns being processed with whole pages being omitted and exclusion cases not being identified;
- In-year coding adjustments being incorrectly amended.

https://ion.icaew.com/taxfaculty/b/weblog/posts/2017-18-self-assessment-problems

Spring statement

The chancellor of the exchequer, Philip Hammond, has announced that the government will respond to the forecast from the Office for Budget Responsibility (OBR) in a Spring statement on Wednesday 13 March 2019.

www.gov.uk/government/news/spring-statement-2019-date-confirmed

Spotlight 46: Rewarding Using Contrived Loan Arrangements

In our December 2018 notes, we summarised two cases on which the GAAR Advisory Panel had recently given their opinion., one involved a contractor, and the other a company and its employee. Both involved employee rewards using loans and the transfer of creditor rights into an Employer Financed Retirement Benefits Scheme (EFRBS). The panel said that entering into and carrying out these arrangements was not a reasonable course of action.

How these types of arrangements work

In both cases an individual became employed by a trust that paid them a small wage along with much larger loans. The loans were claimed not to be taxable as income.

- In the contractor case, the trust provided the employee's services to an unconnected third party.

- In the company and employee case, the trust provided the employee's services back to the company they had been employed by at the start of these arrangements. The employee's company claimed 100% of the invoiced amounts as an expense for Corporation Tax purposes.

Under both of these arrangements, the individuals received about 82% of the amounts invoiced by the trust to the unconnected third party or previous employer.

In each case the trust transferred its right to receive repayment of the loans to an EFRBS. Both individuals were beneficiaries of the EFRBS.

The panel thought that there was no reason for the arrangements to be structured in this artificial and complex way, other than to seek a tax advantage in a contrived and abnormal.

What are HMRC likely to do?

In similar cases, an HMRC officer may issue a counteraction notice without going back to the panel for a new opinion, with taxpayers receiving an accelerated payment notice requiring the disputed tax to be paid upfront while HMRC continues its investigations.

Such transactions may also be subject to a 60% GAAR penalty, where the GAAR applies.

Unsurprisingly, HMRC strongly advises that any taxpayers using such schemes to withdraw from them and settle their tax affairs promptly.

www.gov.uk/guidance/rewarding-employees-and-contractors-using-contrived-loan-arrangements-spotlight-46

Illegal state aid in Gibraltar

In Gibraltar, companies should pay corporate taxes on income accrued in or derived from Gibraltar. However, the EC's investigation found that certain companies in receipt of interests or royalties were exempted from taxation in Gibraltar without a valid justification. The EC concluded that the exemption was designed to attract multinational companies to Gibraltar and that it effectively reduced the corporate income tax of a limited number of companies belonging to multinational groups.

This selective tax treatment in favour of multinational companies granted these companies an advantage distorting competition within the EU's Single Market, in breach of EU State aid rules. The EC concluded that the tax exemption for companies in receipt of interest and royalties, as applied in Gibraltar between 2011 and 2013, is illegal under EU State aid rules and must be recovered from the companies.

After carefully reviewing 165 tax rulings granted by Gibraltar, the EC concluded that five of these tax rulings granted by the tax authorities of Gibraltar to large multinational companies in 2011 and 2012 involved illegal State aid.

The five contested tax rulings concern the tax treatment in Gibraltar of certain income generated by Dutch limited partnerships. According to the tax legislation applicable in both Gibraltar and the Netherlands, the profits made by a limited partnership in the Netherlands should be taxed at the level of the partners. In the five cases at hand, the partners of the Dutch partnerships were resident for tax purposes in Gibraltar and should have been taxed there. However, under the five contested tax rulings, the companies were not taxed on the royalty and interest income generated at the level of the Dutch partnerships, contrary to other companies in receipt of other type of income.

These rulings continued to apply and to exempt interest and royalties from taxation even after Gibraltar adopted legislative amendments to bring this income within the scope of taxation in 2013 (passive interest) and 2014 (royalties).

Since the exemptions in question gave their beneficiaries an undue and selective advantage, the Commission concluded that the five tax rulings concerned were illegal under EU State aid rules and that this advantage must be recovered.

During the Commission's investigation, Gibraltar amended its tax rules to enhance its tax ruling procedure, reinforce its transfer pricing rules, enhance taxpayers' obligations (e.g. filing of annual returns, providing meaningful information in applications for rulings) and improve transparency on how it implements its territorial system of taxation. The Commission welcomes these improved rules, which entered into effect in October 2018.

europa.eu/rapid/press-release_IP-18-6889_en.htm

Business Taxation

Temporary increase in AIA (Lecture B1117 – 11.00 minutes)

At the October 2018 Budget, the Chancellor announced a large, temporary increase in the Annual Investment Allowance (AIA). It rose from £200,000 p.a. to £1m p.a. on 1 January 2019 but will revert back to £200,000 on 1 January 2021.

This change has clearly been made to encourage investment in what are uncertain economic times but, as with previous changes in the AIA limit, businesses will have to be careful of the transitional rules (unless they have a December year-end).

Example 1

A business has a 30 April 2019 year-end. The maximum AIA for this period would be:

The proportion of the period from 1 May 2018 to 31 December 2018

i.e. 8/12 x £200,000 = £133,333 and

The proportion of the period from 1 January 2019 to 30 April 2019

i.e. 4/12 x £1,000,000 = £333,333

This gives a total of £466,666 (£133,333 + £333,333) but no more than a maximum of £200,000 of the company's actual expenditure in the first period to 31 December 2018 can qualify for AIA.

Example 2

A company with a 31 March 2021 year end would calculate its maximum AIA entitlement based on:

The proportion of the period from 1 April 2020 to 31 December 2020

i.e. 9/12 x £1,000,000 = £750,000; and

The proportion of the period from 1 January 2021 to 31 March 2021

i.e. 3/12 x £200,000 = £50,000

The company's maximum AIA for this transitional chargeable period would therefore be the total of £800,000 (£750,000 + £50,000 = £800,000).

However, in relation to the latter period, no more than £50,000 of the business's actual expenditure in that part period would be covered by its transitional AIA entitlement.

Contributed by Kevin Read

Overstated profits and reduced penalties (Lecture B1116 – 28.17 minutes)

Summary – The taxpayer's uninvoiced work was cancelled by bad debts and so the appeal was allowed in part; by contrast the appeal against the deduction for home office costs and capital allowances was dismissed but with penalties charged at lower rtes.

Sandra Carter submitted her 2013/14 self-assessment tax return on 18 December 2014 consisting of the following:

- Self-employment pages for a child minding business: turnover of £21,154, allowable expenses of £20,579 and capital allowances of £5,834;
- Self-employment pages for a business giving tax advice and filing tax returns: turnover of £45,219, expenses of £39,673 and capital allowances of £1,200; business closed on 12 February 2014 as HMRC told her that they would no longer allow her to act as an authorised agent; her existing clients were subsequently transferred to another firm, called Candid Accountants.
- Property pages: income from rents of £15,900 and net profits of £1,173.

Following an enquiry into her 2013/14, during which time Sandra Carter co-operated fully, HMRC increased her assessment to reflect the following:

- Just over £36,000 of uninvoiced work resulting in an increase in profit of £22,915.17, after having allowed for VAT and certain expenses;
- Adjustment of £7,851.17 to disallow 4/5 of her deduction for home as office costs;
- Adjustment of £336 to correct her car capital allowance claim.

In addition, HMRC raised penalty assessments on the basis of a prompted disclosure where behaviour had been deliberate but not concealed. These were charged at rate of 45.5%, so below the maximum of 70% but above the minimum of 30%.

Sandra Carter appealed. She asked the Tribunal to reverse HMRC's amendments and allow a deduction for the £380,554.98. She claimed that the additional deduction was for costs that she was now seeking to claim that related to the £36,000 of uninvoiced client work.

Decision

The First Tier Tribunal dismissed the claim for the additional expense deduction saying that if Mrs Carter had genuinely incurred these costs in the 2013/14 tax year, she would have included them in the detailed schedules provided to HMRC; no credible evidence was supplied.

The Tribunal concluded that HMRC were correct:

- to increase turnover by £36,000 but should have made an identical adjustment countering this amount to reflect the fact that this amount would never be collected and so was deductible as a bad debt;

- that Sandra Carter's claim for "home as office" was too high; they agreed with HMRC and allowed a claim for expenses relating to one room in her house rather than the five rooms that she had claimed;

- that she also over-claimed her car capital allowances as she had calculated these on a straight line basis rather than using the rules prescribed in legislation.

HMRC were instructed to recalculate the penalties, based on the adjusted lower starting point but also using a lower percentage.

The maximum penalty for a prompted disclosure where the behaviour is deliberate but not concealed is 70% of the "potential lost revenue". HMRC mitigated this maximum penalty to 45.5%, having taken into account "quality of the disclosure". In assessing the "quality of the disclosure" HMRC said that Mrs Carter had "failed to admit the error" in her turnover figure and "failed to produce the original invoices or evidence of the bad debt."

The Tribunal instructed HMRC to recalculate the penalties using lower percentages. HMRC made no reference Sandra Carter acting "deliberately" in relation to the home as office claim or the car claim, but nevertheless calculated the penalty on the basis of the total figure by which Mrs Carter's assessment was increased. The Tribunal concluded that the penalties should be reduced and calculated as follows:

- Home as office: Mrs Carter must have known that she did not use five of her eight rooms entirely for her "assisting and consulting" business. Her actions were deliberate but she co-operated fully with HMRC and so this penalty should be charged at 35%
- Car capital allowances: The Tribunal said that It was clear from the correspondence that Mrs Carter did not understand the rules. She was not acting deliberately; she simply got the calculation wrong. However, as someone giving tax advice she should have checked the calculations. She was careless. Prompted disclosure with full cooperation resulted in a penalty of 15%, rather than the maximum that could have been charged of 30%.

A carelessness penalty can be suspended if compliance with a condition of suspension would help the person to avoid becoming liable to further penalties under for careless inaccuracies. The Tribunal concluded that it was clear from the correspondence that Mrs Carter considered herself capable of running her own tax affairs and that it was very unlikely that she would comply with a suspension condition. As a result, the penalty was not suspended. However, the Tribunal left it for HMRC to decide whether the carelessness penalty should be disregarded as below their assessing tolerance, stating that they did not have the discretionary power to make that decision.

Sandra Annette Carter v HMRC (TC06862)

Contractor engaged in construction contract (Lecture B1116 – 28.17 minutes)

Summary – Thornton Heath LLP was not a contractor engaged in a construction contract and so was not required to file monthly CIS returns.

On 27th July 2007, Thornton Heath LLP acquired property in West Norwood, London that was let to two tenants:

- Iceland Foods (ground floor convenience store); and
- Norwood Leisure Ltd (first and second floors as a snooker club).

Following the expiry of the lease to Norwood Leisure on 8th August 2014, these floors were re-developed into nine residential apartments. Thornton Heath LLP signed a contract with ARJ Construction Ltd on 9 February 2015 to carry out the work. Practical completion of the scheme occurred on April 2016. Thornton Heath LLP retained the freehold interest in the property and continued to operate as an investment vehicle with the residential units having been sold under long leases and the tenants paying ground rent to Thornton Heath LLP, as landlord.

Thornton Heath LLP did not consider it necessary to register the partnership for CIS as it did not consider itself to be 'a developer'; its primary activity being property investment. The partnership said that it held no other property and that this was the only development it had undertaken.

On 26th April 2016 HMRC advised Thornton Heath LLP to register itself for the CIS as a contractor and operate within the CIS legislation because it was considered that:

> "The Conversion from office space to residential units is not considered to be a minor refurbishment to bring the properties up to a suitable standard to be able to let them. It is a substantial development required to change the building to its new use. ...we would regard your property investment business as having taken on the mantle of a mainstream contractor as its business activity is now that of construction operations".

Thornton Heath LLP appealed arguing that it acquired the Property as an investment and it continued to be an investment. The nine residential units were a one- off development and no further developments were intended. Thornton Heath LLP was not a 'contractor' within the meaning of s 59 FA 2004. ARJ Construction Ltd was the contractor. Thornton Heath LLP was the principal. ARJ Construction Ltd was contracted to undertake the Property alterations with Thornton Heath LLP continuing to a property investment business. It is not a property developer and did not engage in 'construction operations' within the meaning of s57 FA 2004.

The issue to be decided was whether Thornton Heath LLP was a 'contractor' and carrying on a 'business which includes construction operations'. If so, the second issue was whether HMRC had correctly raised the CIS penalties and whether those penalties had been correctly calculated.

Decision

The First Tier Tribunal said that Thornton Heath LLP was carrying on an investment business prior to conversion of the Property and that this was not in dispute. The issue was whether it's usual business changed when it undertook the conversion of the Property so that it was a contractor carrying on a business which includes construction operations.

The First Tier Tribunal concluded that Thornton Heath LLP was, as owner of the Property, acting as a principal and appointed ARJ Construction Ltd, as the main contractor. Thornton Heath LLP did not itself act as a contractor. ARJ probably engaged subcontractors. The contract between Thornton Heath LLP and ARJ Construction Ltd was therefore not a 'construction contract'. Consequently, Thornton Heath LLP was not obliged make monthly returns under the CIS for the period March 2015 to April 2016 inclusive. The appeal was allowed and the penalties are discharged.

Thornton Heath LLP v HMRC (TC06831)

Subcontractor's expenses claim (Lecture B1116 – 28.17 minutes)

Summary - No deduction was allowed in respect of management services, translation fees or the substantial claim for home office expenses. A small deduction for accountancy fees was allowed.

Mr Rohac was Romanian/Moldovan and spoke very little English when he arrived in the UK. He was employed from 2010 in the construction industry.

In March 2014 he decided to become self-employed and registered as a 'subcontractor' within the Construction Industry Scheme on 9 April 2014. He received a notice to file a self-assessment return for 2014/15 that he filed on 23 May 2015. The return showed a claim for the deduction of £45,704 expenses.

On 8 June 2015 HMRC notified Mr Rohac that they intended to check his 2014/15 tax return and opened an enquiry. On 19 January 2016 HMRC closed the enquiry and issued a closure notice. HMRC disallowed £39,294 of expenses of the total of £45,704 expenses claimed.

HMRC allowed the deduction for £5,760 car expenses and £660 phone expenses. However, a number of expenses were disallowed, including:

- £25,000 for management services to Positive Response. According to the engagement letter this included, among other things, negotiating with contractors, searching for new clients and all administration and record keeping.
- £9,400 for translation services; Mr Rohac required translation services in order to allow Positive Response to advise him on technical issues and regulations given his limited English.
- £4,006 home office expenses. The claim was made on the basis that Mr Rohac used one of the three bedrooms in his house for the purposes of his business for an average of 36 hours per week, usually 3 hours per day. The total of his rent, council tax, water and power expense for the year was £13,291, and he claimed one third business use figure.
- £288 for accountancy services.

It was these expenses that were appealed. He claimed that he had paid the management expenses by transferring amounts of between £100 to £1,000 to a separate bank account and then paid this over as larger cash amounts to settle the expenses due. It was claimed that the translation services were paid in a similar way from Mr Rohac's personal bank account.

Mr Rohac died on 16 March 2017 and so the appeal was made by his personal representative on behalf of his estate.

Decision

The First Tribunal found that, while a schedule had been prepared showing bank transfers, the Tribunal was not convinced that Mr Rohac had proved, on the balance of probabilities that cash payments were made for the management services. The cash arrangements explained did not appear to be consistent with an engagement with a professional services provider. There is no record of the cash payments being made to or received by Positive Response and the payments were not made to Positive Response's bank account as required by the engagement letter. These expenses were disallowed.

The invoice relating to the translation services was drafted as an invoice for future services stating it was for "Assistance provided, and to be provided, to you during the period April 2014 to end March 2015". There was no record of the payments being made and the Tribunal concluded that it was not credible that nearly all of the cash withdrawals made from Mr Rohac's personal account over the tax year were cash payments for these services. These expenses were disallowed.

Despite claiming that his house was used mainly by "other people/labour", there was no evidence as to who these people were as he employed no staff and he was onsite labouring. The Tribunal were not satisfied that there was evidence of any exclusive business use of part of Mr Rohac's family home. The Tribunal considered that HMRC's amount of a £120 allowance for more limited home office use was reasonable in the circumstances.

The £288 for accountancy services was allowed.

PRs of Veaceslav Rohac v HMRC (TC06869)

Low salary, high dividend profit extraction (Lecture B1118 – 14.50 minutes)

Small family companies will nearly always agree a salary to family members within the personal allowance (PA) with dividends on top. If the salary is commensurate with duties performed and made for the purposes of the business, a corporation tax deduction can be taken without creating a corresponding income tax liability. Where both spouses are directors of the company a personal allowance salary should be easily justified.

Some care must be taken as to not trigger an NIC charge for either the company or the employee as the primary earnings threshold for NIC is lower than the PA (the earnings threshold for 2018/19 is £8,424). A payment of earnings between the lower earnings limit of £6,032 and £8,424 will therefore avoid an NIC charge while also creating an entitlement to retirement benefits (as earnings in this band will count toward the employee's contribution record).

If the £3,000 employers national insurance allowance is available it would be advantageous to have a salary of £11,850 pa. A small amount of employees national insurance at 12% will be due BUT the corporation tax relief of 19% on the additional salary will be greater. The employers national insurance allowance will be available unless there is only one individual creating an employers national insurance liability and that individual is a director. Husband and wife companies will therefore be entitled to the employers allowance where both their salaries exceed £8,424.

Regular dividends can be paid to supplement the owner managers salaries. As long as the paperwork supports the fact that dividends are being paid (minutes and dividend vouchers) then there is little chance of regular dividends being reclassified as salary.

With an increasing move to digitalisation the practice of low salary, high dividend will become even stronger. All businesses should have more timely information available to them and this is key to a low salary, high dividend extraction route.

Illustration 1 – Client with software

Mr and Mrs Hobbs each own 50% of their consultancy company OMB Limited. They are both directors of the company and each draw a monthly salary of £987.50. Mr Hobbs works full time in the business and Mrs Hobbs works around 3 days per week. There are no other employees in the company.

The employers NIC holiday of £3,000 pa ensures that no employers NIC is paid on their salaries.

They each pay employees national insurance of £376pa through the PAYE system of OMB Limited. They appreciate that a salary of £705 per month would secure the same state pension and avoid any employees national insurance but the corporation tax relief on a salary of £11,850 rather than £8,460 is worth an extra £644. This exceeds their employee national insurance bill so a personal allowance salary is their chosen remuneration level.

Mr Hobbs is the main client contact within OMB Limited whilst Mrs Hobbs provides the administrative support. Mr and Mrs Hobbs do not have formal employment contracts with the company so the company will not be bound to pay the national minimum wage to either of them. This would be important for Mr Hobbs who could easily work in excess of 40 hours a week.

Mrs Hobb's salary might be considered high for three days per week but it should be justifiable give that she is a director of the company. Mr and Mrs Hobbs often discuss key contracts, direction of the company etc. A salary of £11,850 is perfectly reasonable for the role Mrs Hobbs performs.

Mrs Hobbs keeps OMBs records on Xero and as such their monthly numbers are available within a week of the month end.

Every month Mr and Mrs Hobbs look at their results for the previous month and pay dividends based on what they feel is affordable. They consider the monthly profit, the retained reserves in the Balance Sheet and most importantly the available cash.

Their accountants drafted pro forma minutes that Mr and Mrs Hobbs complete for each monthly dividend. A Dividend voucher is prepared at the end of the year.

Mrs Hobbs posts the dividends drawn to dividends in the Xero software.

Their mix of salary and dividends is a sound method of tax efficient extraction and HMRC will have no grounds to challenge their extraction method.

Illustration 2 – Client without software!

Assume I have a small limited company with minimal retained reserves – essentially a make and take company i.e. whatever they make they extract…

They want a director/shareholder salary of £11,850pa with balance as monthly dividends - but they only know their numbers when their accountants prepare their annual accounts.

How could they ensure that their monthly dividends are "legal"? Given the recent Court of Appeal decision in Global Corporate Limited v Hale we must be sure to avoid the possibility of illegal dividends.

Two options:

1. Post the monthly draws to directors loan account. When the numbers are available the accountants prepare paperwork for an interim (or final) dividend to clear loan account.

   - Problem with this is you only have one dividend date so you may have abnormal dividends in a particular tax year.

   - And if the loan ever exceeds £10,000 during the tax year you have a beneficial loan interest charge whilst the loan is outstanding. If numbers were available quarterly then the £10,000 balance may not be exceeded as the loan account is being cleared once a quarter. So monthly draws of £3,000 cleared by a quarterly dividend of £9,000 would avoid a loan interest benefit.

2. Prepare monthly dividend minutes but make specific mention that the levels of profit have been considered. Something like "The directors have considered the levels of cash, debtors and creditors at this point in time and consider a dividend of £10,000 justifiable".

If you have strong retained reserves it does not matter whether you have timely information available as the retained reserves can cover the dividend draws.

I have come across a practice of preparing paperwork at the start of the year e.g. "Monthly dividends of £2,000 will be payable through the year where directors are satisfied that the profit levels justify such a dividend." I am not a fan of this route and would suggest they change their practice to Option 2 above.

Article prepared by Dean Wootten

Profit diversion compliance facility

On the 10 January 2019, HMRC launched a new disclosure facility for companies subject to the diverted profits tax (DPT).

By way of background, DPT was introduced in 2015 and seeks to ensure that the profits taxed in the UK reflect the economic activity in the UK.

A charge to DPT may be applied to the taxable diverted profits of a company for an accounting period if one or more of the three situations summarised below arises:

1. charge on a UK company where entities or transactions lack economic substance;
2. charge on a non-UK company where entities or transactions lack economic substance;
3. charge on a non-UK company avoiding a UK taxable presence.

There is an exception from a charge arising under DPT if the UK-related sales are below £10 million or the UK-related expenses are below £1 million.

The amount of tax charged is the sum of:

- 25% of the amount of taxable diverted profits specified in the charging notice;
- interest charged (if any) for the period beginning six months after the end of the accounting period to which the charge relates, and ending on the day the charging notice is issued .

HMRC note that businesses would not be at risk to a charge to DPT if they do not enter into tax driven arrangements, have in place appropriate transfer pricing policies applied to the actual business operations and do not seek to artificially avoid a permanent establishment in the UK. The UK profits reported for corporation tax purposes would then reflect the economic substance of the activity that is undertaken both in the UK and with the UK.

The guidance highlights that during the course of HMRC's enquiries into profit diversion there have been misconceptions about how DPT operates and the tests required to confirm whether a business was within the scope of DPT. Therefore, the intention of the disclosure facility, HMRC state, is to encourage businesses with arrangements that might fall within its scope to review both the design and implementation of their transfer pricing policies, change them if appropriate, and use the facility to put forward a report with proposals to pay any additional tax, interest and where applicable, penalties due.

The facility disclosures should cover all prior accounting periods for the disclosed arrangements that are within time limits to assess (excluding discovery assessments). The initial step is to register an intention to disclose and then HMRC will acknowledge this within 14 days by arranging a Registration meeting that will allow the business to explain their proposals and timetable for completing the report.

A report must then be submitted within six months of registration, this can be done by one UK company on behalf of all UK entities involved. Payment of any tax due is required when the report is submitted. HMRC will respond to the proposal within three months and either accept or request additional information.

Acceptance does not mean that future arrangements will not be subject to enquiry – this can only be achieved by entering into an advance pricing agreement.

The report consists of six separate sections for which the guidance gives detailed explanation:

1. a description of the relevant facts referenced to the evidence from which they are derived;
2. an analysis of the application of the tax law to the facts and the conclusions reached;
3. an analysis of the behaviours investigated and the conclusions reached on the application of penalty provisions;
4. the proposal being made to settle all outstanding liabilities;
5. a signed declaration by a senior responsible officer within the group on behalf of the entity or entities certifying that to the best of their knowledge and belief it is a full and accurate disclosure of the facts;
6. an annex listing the evidence that supports the facts referred to in the report.

The proposals can be made on a without prejudice basis.

For a non-deliberate DPT failure to notify where DPT is treated as first becoming unpaid by reason of the failure to notify before 1 January 2019 if a full and accurate disclosure is made by 31 December 2019 for all impacted accounting periods and full co-operation is provided to HMRC, then the DPT FTN penalty will be reduced to nil.

Contributed by Joanne Houghton

Accounting for corporate partnership profits

HMRC v Investec Asset Finance Plc & Investec Bank Plc [2018] UKUT 0413 is a follow up to a previous decision by the Upper Tribunal where there were several issues under consideration but the last one was undetermined pending further submissions ([2018] UKUT 0069).

The basic facts of the case were that Investec had acquired an interest in a partnership entitled to lease receivables, and become a partner in that partnership, with a view to the partnership realising the receivables and making distributions to Investec.

HMRC had disallowed expenditure claimed by Investec in relation to its acquisition of the partnership interests on the grounds that:

- it was capital expenditure not revenue expenditure; and, alternatively,
- that even if it was revenue expenditure, it was not incurred wholly and exclusively for the purposes of Investec's trades (as opposed to the trades carried on by the leasing partnerships).

In summary the decisions in this initial Upper Tribunal hearing were as follows:

Issue 1: was the expenditure by the Investec companies for the acquisition of the partnerships capital or revenue?

It was found that although the transactions involved the acquisition of partnership interests and making capital contributions, they were short-term, recurrent transactions that had the character of trading transactions and the lease receivables were quickly extracted in distributions and sales proceeds.

Issue 2: was the expenditure incurred wholly and exclusively for the purposes of Investec's trades?

It was found that the expenditure was not incurred solely for the purpose of the Investec companies' financial trades but partly for the partnerships' trades so HMRC appeal was allowed.

The last issue that was undetermined was whether the partnership profits should be subject to two tax assessments. The First Tier Tribunal had decided that profits that were taxed in the hands of the leasing partnerships did not fall again to be taxed in the Investec companies. HMRC appealed this decision.

The Upper Tribunal, however, found that they could still not resolve this issue although they could limit it to just one of the partnerships.

It was noted there appeared to be conflict of the facts that was not addressed by the First Tier Tribunal. On the one hand the Investec companies calculated their share of the partnership profits by looking through the partnerships and accounting for the leases directly in their own accounts, essentially reflecting one trade. On the other hand, the statement of agreed facts confirmed that there were actually two trades – the Investec companies' own trades and that of the partnerships. This is borne out by the deductible expenses in the companies' accounts referred to in the previously decided issues being the costs of acquiring the partnership interests rather than the direct costs of the lease receivables.

The case was referred back to the First Tier Tribunal to look at the facts again.

Contributed by Joanne Houghton

Leasing under IFRS 16 (Lecture B1119 – 15.38 minutes)

Entities applying IFRS or FRS 101 will be required to adopt IFRS 16 for periods of account beginning on or after 1 January 2019 which will change the accounting treatment for leases. The main change will affect the treatment for the lessee.

Currently, lessees and lessors are required to make a distinction between finance and operating leases. Where the lessee has substantially all the risks and rewards incidental to the ownership of an asset (a finance lease) it recognises a finance lease asset and liability on its balance sheet. Where the lessee does not have substantially all the risks and rewards incidental to the ownership of the asset (an operating lease) it recognises lease payments as an expense over the lease term. This treatment will continue under the Financial Reporting Standard 102 (FRS 102), the main Financial Reporting Standard applicable in the UK and Republic of Ireland.

The new accounting standard will remove the distinction between finance leases and operating leases for a lessee. Going forward under IFRS 16 a lessee will recognise all leases on its balance sheet other than certain exempted leases which are of low value or are short term.

Lessors will still need to distinguish between operating and finance leases in establishing how to account for the lease in their books – there should be no substantive change to the way they recognise the lease when converting to IFRS 16.

This measure introduces legislative changes to ensure that certain rules which relied upon the distinction between finance and operating leases for lessees will continue to operate as intended to ensure that taxation of lessees is broadly consistent regardless of which accounting framework is adopted.

S53 FA 2011 was introduced in anticipation of these accounting changes but before the new accounting standard was settled. S53 has the effect of disregarding for tax purposes most changes in the accounting treatment for leases after 1 January 2011 (unless the new method was similar to existing UK GAAP). That legislation is now repealed. This removes the requirement that a lessee, adopting IFRS 16 recalculate for tax purposes its lease accounting using the frozen accounting policy.

Changes to long funding leases

The long funding lease rules in Part 2 of CAA 2001 provide that where a plant or machinery lease is in substance a funding lease for the lessee (because the effect of the lease is substantially equivalent to the lessee having borrowed funds to acquire the asset) the lessee is entitled to claim capital allowances on the asset even though they are not the legal owner. The changes ensure that those rules will continue to apply as intended for an IFRS 16 lessee. This is achieved through a lessee using IFRS16 having to determine if they would have accounted for the lease as a finance lease had they been required under GAAP to determine if it was a finance lease or not (ie if the distinction had existed).

The legislation is amended so that there is no deemed disposal and reacquisition where a long funding lease is reclassified upon the mandatory adoption of a new accounting standard. The following example is given in the explanatory notes:

A lessee uses IFRS or FRS 101 and has a long funding operating lease which has three years left to run as at the 31 December 2019. In its accounts for the year to 31 December 2019 it is required to adopt IFRS 16 and moves from accounting for the long funding operating lease as an operating lease to accounting for the lease under IFRS 16, recognising a right-of-use asset and a lease liability. Section 70YA does not apply and the lease will continue to be taxed using the rules for a long funding operating lease without any deemed disposal or reacquisition.

A lessee of plant and machinery using IFRS 16 will have a long funding finance lease if the lease is not short and it meets either the lease payments test or the useful economic life test. There is no need to distinguish between long funding operating leases and long funding finance leases for a lessee using IFRS 16 because all leases will be accounted for in the same way. Furthermore, this measure will ensure that a lessee using IFRS 16 with a long funding finance lease will be able to adjust the deduction claimed in certain circumstances where the rentals increase or decrease.

The schedule makes several simplifications to the tests to identify a long funding lease which are not connected to the accounting standard changes. A short lease is a lease with a term of less than 7 years (before it was a lease with a term of less than 5 years with some leases of terms between 5 and 7 years being caught too). The lease payments test is met if the present value of the minimum lease payments is equal to 80% or more of the fair value of the leased plant or machinery with the present value of the minimum lease payments being calculated by using the interest rate implicit in the lease (being the interest rate that would apply accordance with normal commercial criteria). A new amendment states that if the interest rate cannot be determined then it is taken to be 1% above LIBOR. For completeness, a lease meets the useful economic life test if the term of the lease is more than 65% of the useful economic life of the leased plant and machinery.

Interaction with corporate interest restriction

The CIR rules operate to limit interest and other financing costs that are deductible for corporation tax purposes. For leases classified as finance leases for tax purposes, any finance charges in the accounts are tax-interest amounts for CIR. For leases classified as operating leases for tax purposes, any finance charges in the accounts are not tax-interest amounts for CIR.

In particular, where a lessee has a right-of-use asset under IFRS 16, the legislation will require the company to determine whether they would have accounted for the lease as a finance lease if they were required to determine whether the lease was a finance lease or not for accounting purposes.

Therefore, lessees will not suffer any interest restriction on amounts paid in respect of operating leases. This means effectively that this change in the legislation will not have any impact for the purposes of CIR. Any adjustments on change of accounting policy will also be excluded from the CIR provisions.

Transition from IAS 17 to IFRS 16

The transitional provisions on change of accounting treatment are amended for these provisions. The transitional provisions apply where a lessee treats a lease as a right-of-use asset under IFRS 16 and had not previously accounted for the lease as a finance lease. These will have effect for a period of account beginning on or after 1 January 2019.

There are three methods permitted to transition from IAS 17 to IFRS 16 where the lease is an operating lease under IAS 17:

1. Prospective application (simple method) – the lease liability is recognised on 1 January 2019 (for a calendar year-end company) as the present value of the lease payments to be made from that date. The lease asset will be set equal to the liability, but is then adjusted for any accrual or prepayment relating to the lease at 31 December 2018 (which would be perhaps where rent had been paid in advance, or there was a rent-free period which is being spread over the lease term).

2. Prospective application (complex method) – the lease liability is the same as in 1. above. The asset is calculated using a retrospective approach but using the interest rate on 1 January 2019.

3. Full retrospective application – each lease is recalculated from its start date on the presumption that IFRS 16 had always existed.

2. and 3. will result in a debit or credit to retained earnings and this debit or credit will be recognised for tax purposes using a spreading approach as described below.

The calculation steps result in a lessee spreading all adjustments recognised in consequence of adopting IFRS 16 across the average length of the leases which have given rise to those adjustments.

- Step 1 requires the lessee to calculate the net debits and credits brought into account for each lease. The legislation ensures that the net amount includes only amounts recognised in retained earnings which are in consequence of the transition to IFRS 16.

- Step 2 requires the lessee to calculate a percentage for each lease ("the relevant percentage") by dividing the amount under Step 1 for that lease by the total amounts for the lessee for all leases found under Step 1.

- Step 3 requires the lessee to multiply the relevant percentage found under Step 2 by the remaining period outstanding in days of the lease as at the date of transition. The term of a lease is determined in accordance with generally accepted accounting practice.

- Step 4 requires the lessee to calculate the mean of all periods under Step 3. This will be done by adding together all of the amounts calculated under Step 3.

- Step 5 sets out that the spreading period is the number of days found under Step 4 beginning with the day on which the first period of account begins.

The following table illustrates these steps through an example, assume that the table below sets out details of four leases held by a lessee who adopts IFRS 16 on 1 January 2019. This is taken from the explanatory notes to the FB2019 provisions:

	Step 1	**Step 2**	**Step 3**	**Step 4**
Lease	**Transitional debit/(credit) to retained earnings**	**Weighting percentage A/SUM (A1-An)**	**Remaining lease term on IFRS 16 adoption**	**Mean lease period**
Lease 1	£(10,000,000)	26.32% (10m ÷ 38m)	1,826 days	481 (=1826 × 26.32%)
Lease 2	£ 8,000,000	21.05% (8m ÷ 38m)	730 days	154 (=730 × 21.05%)
Lease 3	Nil	Excluded	1,826 days	Excluded
Lease portfolio	£ 20,000,000	52.63% (20m ÷ 38m)	1,461 days	769 (=1461 × 52.63%)
Overall	**£18,000,000 debit**			**1,404 days**

Step 1 – Calculate the net debits and credits

Calculation included in the table gives the figure of £18,000,000.

Step 2 – Calculate the relevant percentage – each amount is calculated by dividing the net amount by the total (treating the debits and credits as if they were added together not netted off)

Step 3 – Calculate the remaining lease term

Step 4 – Calculate the mean of all periods

Step 5 – Calculate the spreading period.

The spreading period is 1,404 days. If the lessee had a period of account which ran from 1 January 2019 to 31 December 2019 they would claim as a deduction £4,679,487 (=365 ÷ 1,404 × £18,000,000).

Note that if the lessee ceases activities, it can bring in any amounts not already relieved on cessation.

Article prepared by Malcolm Greenbaum

VAT

Reasonable grounds for zero rating (Lecture B1116 – 28.17 minutes)

Summary – The First Tier Tribunal had failed to give adequate reasons for its finding that the intended use of a clubhouse was use by a charity "as a village hall or..." and they had erred in concluding that GFC was not carrying out a business. However, they had correctly concluded that GFC had a reasonable excuse for believing that the works should be zero- rated.

The appeal to the First Tier Tribunal related to the liability of Greenisland Football Club (GFC) to pay VAT on the cost of the construction of a new clubhouse at Greenisland. The project was commenced in 2010 by GFC who hoped to construct a multipurpose facility for use by its members and the local community. The facilities at the clubhouse were available for booking on a first come first served basis and open to anyone in the local community. At the time of the original hearing there were five other bodies who had keys to the clubhouse. There were at least 15 other groups that used the facilities including 12 charities. The First Tier Tribunal recorded that GFC did not have any priority over any other body when it came to reserving facilities nor could it block book a particular facility for, by way of example, the whole of the football season, at the start of that season.

GFC had successfully appealed to the First Tier Tribunal against the penalty issued by HMRC under s62(1) VATA 1994 for £53,101 arising out of the construction works where GFC had issued a zero rated certificate under Item 2 Group 5 Schedule 8 VATA 1994 which provides for zero-rating to apply if:

> "The supply in the course of the construction of—
>
> (a) a building ... intended for use solely for a ... relevant charitable purpose."

Note 6 to Group 5 ("Note 6") explains what is meant by a "relevant charitable purpose":

> "Use for a relevant charitable purpose means use by a charity in either or both the following ways, namely—
>
> (a) otherwise than in the course or furtherance of a business;
>
> (b) as a village hall or similarly in providing social or recreational facilities for a local community."

HMRC obtained leave to appeal on three different grounds arguing that the First Tier Tribunal:

1. Failed to give adequate reasons for its finding that the intended use of the clubhouse was use by a charity "as a village hall or similarly ...".
2. Erred in concluding that GFC was not carrying out a business;
3. Had incorrectly concluded that GFC had a reasonable excuse for believing that the works should be zero rated.

Decision

The Upper Tribunal concluded that there was no satisfactory explanation either in the decision or in the trial bundles as to why the First Tier Tribunal was able to conclude that the use of the clubhouse was a qualifying use within Note 6(b). There had been no attempt to analyse either the intended or actual use of the clubhouse and whether its intended use or actual use was similar to that of a village hall. Although the First Tier Tribunal recorded that both the local community and GFC used the clubhouse, it made no attempt to try and quantify or analyse the nature of their respective uses.

The Upper Tribunal noted that nowhere in the decision does the First Tier Tribunal explain why it has seen fit to ignore the deeming provision of Section 94(2) VATA 1994:

> “(2) Without prejudice the generality of anything else in this Act, the following are deemed to be the carrying on of business –
>
> (a) the provision by a club, association or organisation (for a subscription or other consideration) the facilities or advantages available to its members.”

However, there was no dispute that that the club provided facilities for a subscription from members or for a consideration to junior, associate or affiliated members. They questioned why the judgment contained no detailed discussion of:

- The substantial income in respect of dues from junior members for use of the clubhouse and for defraying other expenses;
- The After School’s Club which generates £10,000 per annum, that is approximately £200 per week and presumably represents a rent or licence fee;
- A tuck shop selling goods which realise an income of £4,000 per annum.

The Upper Tribunal were satisfied that the First Tier Tribunal had erred in law in concluding that GFC was not operating a business at the clubhouse or did not intend to operate a business at the clubhouse.

Despite the appeal being over turned on points 1 and 2, HMRC failed on point 3. GFC had told the First Tier Tribunal that they had relied upon HMRC’s guidance set out at VAT Notice 708 that explains when building work/materials can be zero/reduced rated. They had checked the position with their professional advisers and so confirmed their view. HMRC argued that a reasonable taxpayer should have checked the position with HMRC by way of a non-statutory clearance before issuing a zero rated certificate. The Upper Tribunal noted that there was no mention in HMRC’s VAT Notice 708 advising a taxpayer to seek advice direct from HMRC. As GFC had provided the First Tier Tribunal with a reasonable excuse for having given a zero rated certificate, there were no grounds for the Upper Tribunal to interfere with that decision.

HMRC v Greenisland Football Club (UT/2018/0043)

Charitable building zero rating certificate (Lecture B1116 – 28.17 minutes)

Summary – As a sub-contractor, their supplies could not be zero-rated. Failing to issue a standard rated invoice to the main contractor in time resulted in them suffering a loss of revenue.

J & B Hopkins Ltd (subcontractor) entered into a construction contract with Rok Building Limited (main contractor) to install equipment for a charity.

The charity provided Rok Building Limited with a certificate under VATA 1994, Sch 8 group 5 note (12)(b) stating the building was for charitable use only and that the work was zero rated. Note (12)(a) provides that the supplies by the main contractor can be zero rated.

However, Rok Building Limited gave the certificate to J & B Hopkins Ltd who in turn issued invoices to Rok Building Limited incorrectly treating the supplies as zero rated. Rok Building Limited paid these but in November 2012 went into liquidation

HMRC assessed J & B Hopkins Ltd at the standard rate on the supplies. This should not have caused a problem since Rok Building Limited's supplies to the charity were zero rated, it should have been able to recover any VAT charged to it by J & B Hopkins Ltd. Due to the liquidation, J & B Hopkins Ltd had not raised a revised invoice using standard rate. J & B Hopkins Ltd said that the HMRC assessments were contrary to EU law because HMRC would be unjustly enriched by the VAT since Rok Building Limited could no longer recover this VAT.

The First-tier Tribunal dismissed the taxpayer's appeal.

Decision

The Upper Tribunal agreed with the First Tier Tribunal that, to the extent that HMRC would be enriched, this would not be at J & B Hopkins Ltd's expense, but rather Rok Building Limited.

The only sense in which J & B Hopkins Ltd's was out of pocket was because Rok Building Limited had not paid the full price as J & B Hopkins Ltd had not invoiced at standard rate and that was their mistake. J & B Hopkins Ltd made an error which it did not discover until it was too late to pursue a contractual remedy against Rok Building Limited for the balance of the price.'

The J & B Hopkins Ltd 's appeal was dismissed.

J & B Hopkins Ltd v HMRC [2018] UKUT 0382 (TCC)
Adapted from case summary in Taxation (10 January 2019)

Refund under DIY builders scheme (Lecture B1116 – 28.17 minutes)

Summary – The taxpayer was allowed to recover all of the VAT suffered when they demolished an interconnecting Annexe and replaced it with a new dwelling.

Roy Tabb and his wife owned a Barn that was converted into their original house and associated out buildings. One of those out buildings was a single storey cowshed that shared a short common wall with the Barn. Initially the couple converted the cowshed into a games room that had no direct access to the barn, but later the Games Room was converted into a self-contained Annexe for his mother-in-law. The annexe had an external access but also internal access to the Tabb's Barn at the common wall.

In 2009 following the mother-in-law's death, the couple decided that they would demolish the Annexe, build a new house on its footprint ("the New House") and sell the Barn. The construction works involved the complete demolition of the Annexe including the replacement of the foundations so that there was no trace of any of the pre-existing walls.

The New House is free standing in that no part of it joins the Barn but instead abuts it at the location of what was previously the common wall. The internal access to the Barn has been blocked up, although the shape of the previous internal door is visible from inside the New House in that the internal rendering where the door was is inset against the profit of the rest of the internal wall around it.

Mr and Mrs Tabb moved into the New House in January 2017 and sold the Barn in 2018. On 11 April 2017 Roy Tabb made an application under the DIY Builders Scheme for the refund of £31,381.46 of VAT incurred in constructing the New House. On 21 April 2017 HMRC rejected the claim that was upheld on review. Roy Tabb appealed that decision on 26 June 2017.

The sole issue in this appeal was whether the works carried out to build the New House consisted of "the construction of a building designed as a dwelling" within s.35(1A) VATA 1994. Roy Tabb has two arguments based on the application of Notes 16 and 18 to Group 5 of Schedule 8 for the purposes of construing Section 35.

Argument 1: 'Existing buildings' only qualify under s35 if they satisfy Note 18. Roy Tabb argued that the New House is a new building under Note 18 as it ceased to be an 'existing building' when the Annexe was demolished to below ground level, the New House was then separately constructed. HMRC argued that under Note 18 the 'existing building' was the Barn and Annexe, and that only the Annexe had been demolished to below ground level, not the Barn.

Argument 2: Even if Note 18 did not apply, Roy Tabb argued that Note 16(b) allows 'existing buildings' to be included under s35 if they are reconstructed, enlarged or extended to create an <u>additional dwelling</u> or dwellings which was the case here. HMRC said that the New House was not wholly, but rather substantially within the area of the Annexe (being part of the existing building) and so Note 16(b) does not apply.

A supplemental point raised by HMRC in the context of this second argument was whether if Note 16(b) applied, the legislation requires an apportionment of the VAT recovery between that incurred on the existing building and on the new building.

Decision

The First Tier Tribunal took the view that the test in Note 18 as to whether the building has been demolished should be determined by reference to the building before and after the works had been carried out. Accordingly, while the New House is a new dwelling, it has been built from an existing building constituting the Barn and the Annexe that were physically connected and had an internal connection. The existing building had not been demolished completely to ground level as required by Note 18.

The Tribunal concluded that Note 16(b) requires two elements to be present, an "enlargement or extension" and that the enlargement or extension "creates an additional dwelling or dwellings".

They concluded that both elements were present as:

1. the New House was an extension or enlargement of the prior building in that an additional floor was added to make a two storey building and the footprint was extended by the lean-to kitchen;

2. the extension or enlargement created a new dwelling, the old Annexe previously being interconnected to and forming a single dwelling with the Barn and the New House now being a new dwelling with no internal access to the Barn.

As for the need to apportion input VAT recovery, the Tribunal held that there was no need. The Tribunal found that the works carried out in this appeal were entirely focused on and attributable to constructing the New House. Even if an apportionment were required under Note 16(b), it was not relevant here.

Roy Tabb v HMRC (TC06870)

Buying essays online **(Lecture B1116 – 28.17 minutes)**

Summary – The taxpayer should have accounted for output tax on the full value received from their clients as they were acting as principal who subcontracted out the production of the coursework that was being supplied.

All Answers Ltd's supplied students with essays, coursework and dissertations produced by academic experts with the buyer specifying the grade they wished to achieve in their coursework.

All Answers Ltd argued that output tax was only payable on the commission that they retained as it was acting as an agent in bringing together the coursework writer and the student.

HMRC argued that All Answers Ltd acted as principal to the students by supplying them with essays with output tax due on the full payment received from the students. All Answers Ltd then subcontracted the production of the essays to the writers who worked for them.

Decision

The First-tier Tribunal concluded that the commercial reality indicated there was a single, contractual arrangement between the student and All Answers Ltd for the supply of a written document, for which the student paid a single price to All Answers Ltd.

The agency idea was wholly artificial and was intended to disguise the reality that the company engaged subcontractors to produce each piece of writing that it has contracted to supply.

The Tribunal listed several factors that showed that All Answers Ltd was acting as a principal:

- the student and author did not know each other's identity;

- customer perception from the company website was that the students thought they were dealing with the company, not the author;

- the author invoiced the company and was paid from the company's bank account;
- it was supplying to the student a completed essay which it acquired from an expert it had hired as a subcontractor.

The taxpayer's appeal was dismissed.

All Answers Ltd v HMRC (TC06845)

Apportionment of management fees

Summary – The financial technology services provided to portfolio managers could 'in principle' benefit from exemption in Art 135.1(g) that applies to the management of special investment funds (SIFs), but referred the possibility of apportionment between SIFs and non-SIFs to the CJEU for guidance.

BlackRock is the representative member of a VAT group that includes a number of fund management companies. BlackRock receives supplies of services, performed by and through a platform known as Aladdin, and uses those supplies in order to manage both SIFs and other investment funds ("non-SIFs").

Article 135 of the Principal VAT Directive sets out a number of categories of transactions which Member States are obliged to exempt from VAT. Amongst those is Article 135.1(g):

> "the management of special investment funds as defined by Member States"

While the management of SIFs is treated as an exempt supply, by contrast the management of non SIFs represent a standard rated taxable supply. But what happens in the case where the management is of both SIFs and Non SIFs?

It was common ground that:

1. The supply of Aladdin Services was a single supply;
2. Unless apportionment was allowed, the supply would be taxed according to its principal element, which in this case would make the supply taxable as the management was predominantly of non-SIFs.

BlackRock argued that the:

- Supplies of Aladdin Services received by it were exempt from VAT under Article 135.1(g) of the Directive, in so far as those services were used in the management of SIFs.
- Single supply, which would otherwise be wholly standard-rated, may be apportioned under Article 135.1(g) into exempt and taxable elements, based on use, so that the Aladdin Services are exempt to the extent that they are used in the management of the SIFs.

Agreeing that the management of SIFs was an exempt supply, the First Tier Tribunal had gone on to reject BlackRock's apportionment argument. Agreeing with HMRC, it found that if apportionment were to be allowed in this case, it would also have to be allowed in relation to other composite supplies where the ancillary element was, viewed in isolation, an exempt supply. That they regarded was a startling and novel proposition that would be contrary to the aim of the law on composite supplies.

Decision

To fall within the meaning of the term “management of special investment funds” in Article 135.1(g), the services in question must form a distinct whole and be specific to, and essential for, the management of SIFs.

The Upper Tribunal said that Article 135.1(g) lacked any express wording regarding apportionment but accepted that there was nothing in the Article that precluded such an apportionment. They concluded that it was arguable that Article 135.1(g) could permit an apportionment but it was equally arguable that such an apportionment may not apply, and that the single supply should be taxed according to its predominant or principal use.

To help reach a decision, the case was referred to the CJEU for interpretation of Article 135.1(g). The appeal was stayed pending receipt of the CJEU’s guidance.

Blackrock Investment Management (UK) Limited v HMRC [2018] UKUT 0415 (TCC)

Meals replaced by juices Lecture (B1116 – 28.17 minutes)

Summary - Products sold as part of a 'juice cleanse programme' were food rather than beverages and so fell within the zero-rated food provisions in Sch 8 Group 1 VATA 1994.

The Core is a health café in Swindon’s old town supplying a range of juice and food plans. Juice Cleansing Plans are programmes that enable individuals to super charge nutrient intake and supply their body with raw, nutrient-rich juices and smoothies in place of meals, four times a day over a period of days.

The issue was whether the Juice Cleansing Plans were zero rated as food or standard rated beverages as excepted item 4 of Sch 8 Group 1.

Decision

The First Tier Tribunal found that buyers were using the Juice Cleansing Plans as meal replacements. They were not bought as beverages and they drink water in addition to consuming the juices. The products are not unpleasant to drink, but they are not consumed for pleasure.

Applying the test in Bioconcepts (1993) Decision no. 11287, which decides whether a drinkable liquid is a beverage, the Tribunal noted that the juices and smoothies sold by The Core were not bought to increase bodily fluid, to quench thirst, to fortify or to give pleasure.

In addition, the product would not be offered as a drink to a visitor as we might tea, coffee or a cold drink such as a fruit juice. They were therefore not beverages.

The Core (Swindon) Ltd v HRC TC06874)

Raw choc brownies Lecture (B1116 – 28.17 minutes)

Summary – All four variants of the "Raw Choc Brownies" were correctly classified as cakes which made them zero rated and so the claims to overpaid VAT were repayable

This case concerned the classification for VAT purposes of "Raw Choc Brownies" produced in four flavours.

Pulsin' Ltd sought to claim repayment of output tax for its brownie sales, originally treated as standard rated but subsequently considered to be properly taxed as zero rated cakes. HMRC considered that the Products were not eligible to be zero rated on the basis, in summary, that they did not display enough characteristics of a cake to so qualify.

The Raw Choc Brownies are individually wrapped bars produced by cold compression of predominantly: dates, cashews, cacao, various syrups, concentrated grape juice and brown rice bran. All ingredients used are intended to be as natural, unprocessed, hypoallergenic and as nutritionally beneficial as possible. Cacao is the predominant flavour of all four variants. They are all very dark brown and of a dense texture.

The Tribunal was shown a number of other products some of which were more closely examined than others.

- Closely examined products: Morrisons bakery brownies, Mr Kipling brownies, Mr Kipling gluten free brownies, Pret brownie bar, Morrisons own gluten and dairy free brownies, Kent & Fraser double chocolate vegan brownie.

- Other products available to the Tribunal: Mr Kipling French Fancies, whole Victoria sponge cake, Tunnock Tea Cakes, Mr Kipling Battenberg Bars.

The relevant legislation is contained in Schedule 8, Group 1 but is complicated.

- Item 1 provides for the zero rating of "Food of the kind used for human consumption";

- Excepted item 2 excludes from zero rating "Confectionary, not including cakes or biscuits other than biscuits wholly or partly covered with chocolate or some products similar in taste or appearance";

- Note 5 provides "for the purposes of item 2 of the excepted items 'confectionary' includes chocolates, sweets and biscuits; drained glace or crystallised fruits; and any item of sweetened prepared food which is normally eaten with the fingers".

Both parties referred to the case of Lees of Scotland Ltd & Thomas Tunnock Ltd v HMRC [2014] UKFTT 630. This case considered whether a snowball was a cake and looked at whether it displayed "enough of the characteristics of a cake that it should be classified as such". The Tribunal said that the test is the view of the ordinary person, informed as to:

- Ingredients;

- Process of manufacture;

- Unpackaged appearance (including size);

- Taste and texture;
- Time, place and manner of consumption);
- Packaging;
- Marketing.

Decision

In the Tribunal's view, the brownies fell under the definition of confectionary (standard rated) subject to the statutory exception for cakes (zero rated). However, the Tribunal concluded that the current state of the law on the taxation of food items is not fit for purpose and will necessarily present apparently anomalous results as tastes and attitudes to eating change. They highlighted the VAT treatment of zero-rated flapjacks as cakes versus standard rated cereal bars, the main distinction being that the former only contained oats while the latter contained several cereals. They concluded that the 'test' for whether the brownies were to be classified as cakes was a matter of informed impression.

The Tribunal referred to HMRC's internal guidance on cakes which says that cakes includes sponge cakes, fruit cakes, pastries, eclairs, meringues and jaffa cakes, normally marketed as cakes, displayed with cakes rather than the confectionary section and packaged with a number of individual portions cellophane wrapped so contents are revealed. Examples included Flapjacks, Caramel shortcake and Marshmallow teacakes. The Tribunal pointed out at there was no similarity between the ingredients, manufacturing process, size, appearance, taste or texture of the products.

The First Tier Tribunal said that they needed to decide whether the brownies were cakes and their classification should be "a practical question calling for a practical answer" and not an "over-elaborate, almost mind-numbing, legal analysis" (Proctor & Gamble UK v HMRC [2009] EWCA Civ 407).

The Tribunal considered the factors identified in the Lees case outlined above as well as the products name and description and shelf life. On balance the Tribunal formed the view that the brownies did show enough characteristics of cakes to be zero rated. Put alongside a slice of traditional Victoria sponge, a French Fancie and a vanilla slice or chocolate éclair the products may look out of place. However, brownies are generally considered to be cakes. Put alongside a plate of brownies, or, for instance, at a cricket or sporting tea where it is more likely that bought and individually wrapped cakes will be served on a plate the products would absolutely not stand out as unusual

The appeal was allowed and the output VAT being reclaimed was repayable.

Pulsin' Ltd v HMRC (TC06909)

MTD and completing VAT returns (Lecture B1120 – 11.52 minutes)

In previous sessions, we have considered the basic rules of MTD (when it is being introduced, who it affects etc) and also the record keeping requirements in relation to e.g. sales and purchase invoices. This session considers the final stage of the process i.e. completing and submitting VAT returns.

Journals

Many businesses need to make VAT adjustments on either a quarterly or annual basis – think of partial exemption, capital goods scheme adjustments and even some retail schemes require an annual adjustment as well. The calculations can be done outside of MTD e.g. a handwritten sheet of paper is fine, but then the amount being adjusted needs to be posted into the digital software (usually by journal) or entered on the spreadsheet kept by the business if this option is used rather than a full accounting system. The posting of journals presents a possible risk that clients using accounting software might post them the wrong way around i.e. because of debit and credit confusion. There is also a risk that they could post the wrong date and miss the VAT return completely – think of a business doing a year end partial exemption adjustment on 5 May but which relates to the period and VAT quarter ending 31 March 2019 – it needs to ensure the journal is dated 31 March and not 5 May otherwise it will miss the March VAT return.

Join the pilot scheme

The compulsory introduction date for MTD is still a few months away (VAT periods beginning on or after 1 April 2019 for most businesses trading over the £85,000 registration threshold) but it is worth encouraging clients to be ahead of the game and register for the pilot scheme as soon as possible, almost as a dress rehearsal to the main MTD show. This will also guide the client through the initial registration process i.e. so that returns will be submitted through HMRC's API enabled software rather than the current government gateway. However, it is important to recognise that not all businesses can join the pilot scheme and their MTD start date has been put back to a later date. This delay applies to those entities which:

- Are a trust or charity
- Are part of a VAT group or VAT Division
- Currently trade with, or have traded with the EU
- Are based overseas
- Are a partnership
- Submit annual returns
- Make VAT payments on account i.e. larger businesses
- Use the flat rate scheme
- Are a business that is newly registered for VAT and has not previously used its online VAT account to submit a return.

As a separate delay, those business with more complex VAT issues (3.5% of total VAT registrations so definitely a minority) will have a mandation date of 1 October 2019 i.e. the first VAT return beginning on or after this date will fall within MTD.

Deferral applies to:

- Trusts

- Not for profit organisations not set up as a company
- VAT groups or VAT divisions
- Public sector entities required to provide additional information on their VAT return (Government departments, NHS Trusts)
- Local authorities
- Public corporations
- Businesses based overseas
- Payments on account businesses
- Annual accounting scheme users

Note – the soft-landing period for these businesses, with regard to digital links being necessary between software or separate parts of the accounting system, will still end on 31 March 2020 as with other businesses, i.e. they won't get an extension beyond this date.

VAT return options

There are three ways for clients to submit returns with MTD, and the chosen route will depend on the VAT complexity of the business and the client's own level of accounting skill and tax knowledge:

1) Client input only – a direct submission is made using their own accounting software (or bridging software with spreadsheets) i.e. no agent involvement;

2) Client and agent share software – e.g. a cloud-based arrangement, and the agent checks the VAT return before the client submits it. This is the crucial opportunity to ensure that any important VAT journals or other adjustments and important transactions have been done correctly;

3) Clients transmits data to agent via digital link – and the agent checks the return and submits it via his own software and his agent account with HMRC (VAT Notice 700/22, section 6).

MTD strategy

It is important that advisers have a clear MTD strategy in place for each client, which takes account of the client's computer skills, ability to deal with major software changes and also their technical VAT knowledge. Many advisers will choose option (2) above because it means they will be able to check major transactions where there is a risk of error, such as the journal postings I considered above.

Contributed by Neil Warren

Latest on MTD pilot and go live

Joining the pilot

HMRC has now opened up the MTD for VAT pilot to all remaining businesses that will be required to join the system for their first VAT accounting period starting on or after 1 April 2019. In addition, groups can join the MTD for VAT pilot although the mandatory start date for group registrations is not until 1 October 2019. Other businesses where their mandatory start has been deferred until 1 October 2019 are expected to be able to join the pilot in the Spring.

Signing up for MTD for VAT

By early February, HMRC will have written to all businesses mandated to join from the April 2019 deadline.

Businesses must sign up after filing all non-MTD VAT returns and once they have acquired MTD compatible software. HMRC has a useful step-by-step guide on how to go about signing up which can be found by following the link below. Businesses that pay by Direct Debit must sign up at least 15 working days before they need to submit to allow the payment to be taken.

https://www.gov.uk/government/publications/making-tax-digital-for-business-stakeholder-communications-pack/making-tax-digital-for-business-stakeholder-communications-pack