Tolley®CPD

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Personal tax

Furloughing staff to look after children

With schools closed, the challenge of trying to work while looking after children has reared its ugly head once more.

Remember, employees are eligible to be furloughed under the Coronavirus Job Retention Scheme if they are unable to work or are working reduced hours because they have caring responsibilities resulting from COVID-19. HMRC's latest guidance clarifies that this includes caring for children who are at home as a result of school and childcare facilities closing.

https://www.gov.uk/guidance/check-which-employees-you-can-put-on-furlough-to-use-the-coronavirus-job-retention-scheme

Cycle to work scheme impacted by COVID-19

Many employers offer the cycle-to-work scheme but, for the benefit exemption to apply, one of the conditions is that the cycling equipment provided should be used mainly for qualifying journeys (to or from work or in the course of work).

With so many employees working from home due to COVID-19, many users of the scheme are not travelling to work, meaning that this benefit becomes taxable.

The Government has announced that it will introduce a time limited easement for employees who have joined such a scheme on or before 20 December 2020 and will run until 5 April 2022, after which the normal rules of the exemption will apply.

It appears that employees who join a scheme from 21 December 2020 will need to meet all the normal conditions of the exemption.

https://questions-statements.parliament.uk/written-statements/detail/2020-12-17/hcws676

Cross-border UK/EU social security rules (Lecture P1236 – 11.04 minutes)

These notes will provide a general overview about how mobile workers are liable to National Insurance/social security contributions and in particular, how this has been affected by Brexit.

While these notes will concentrate on liability for the mobile worker, it should be assumed in these notes that where an employed worker has a liability to UK Class 1 primary NICs, the UK employer will face a secondary charge.

NIC and the Mobile Workforce – General Principles

Workers move around. Well, they used to before the pandemic and will hopefully do so again once our bodies are replete with vaccine.

Most countries have some sort of social security system. Ours is called National Insurance. Most social security systems link the payment of contributions to the provision of state-provided welfare benefits. But in essence we are dealing with tax.

For mobile workers, the key question is where social security contributions should be paid. Does the worker pay in the “host” country in which the work is carried out, or does the worker continue to pay into their “home” system despite them living and working in another state? Or could the worker be liable for contributions in either both states or (very exceptionally and improbably) neither?

The default position

The default position is that workers generally pay social security/NI contributions in the country where the work is carried out and/or where the duties are performed.

Therefore, if a UK employee is sent by his employer to work in (say) France, unless there are rules which say otherwise, the assumption is that he will be subject to the social security rules of France rather than paying NICs in the UK. Paying contributions in France could therefore (in principle) give the individual some entitlement to certain welfare benefits from the French Government (for example, pension on retirement). Whether this is actually the case depends on the rules of the country in question. Some countries are more generous than others. Some indeed are “contribution only” and give nothing in return. Caveat emptor.

However, where an employee is only working in a country for a temporary period, the two countries could mutually agree that social security contributions be paid only in the “home” country with no contributions being paid in the country in which the work is carried out. So, a UK worker who is sent on a short secondment to France could instead continue to pay UK NICs on his earnings for work performed in France and would not pay any French social security contributions.

Note here that the income tax rules which apply to the assignment are irrelevant. There is no “Statutory Residence Test” for NIC and no assumption that just because earnings are taxable (or not) in the UK that they should similarly be liable to NICs (or not) in the UK. It is not unknown for a worker to be subject to overseas income tax on his non-UK earnings but for those same earnings to be subject to NICs in the UK only.

Payroll operators beware. This is a difficult area and specialist advice is usually recommended.

The “World” for NIC purposes

To help determine social security liabilities for mobile workers, the “world” for NIC purposes has traditionally been split into three areas (“NIC-zones” for simplicity). These are:

- Zone 1: The European Economic Area (EEA) being the EU member states plus Norway, Iceland and Liechtenstein. Switzerland joined Zone 1 for NIC in 2012;

- Zone 2: Non-EEA countries with which the UK has a “reciprocal agreement on social security” (which is basically a double tax treaty for NIC). These include the USA, Canada, Japan, the Channel Islands and the Isle of Man. See gov.uk for a complete list.

- Zone 3: The rest of the world (being non-EEA countries with whom the UK has no bilateral social security agreement). There are too many here to list but include major trading partners such as China, Australia and India. [While the UK's double tax agreements cover most of the world, the same cannot be said for NIC.]

I will deal with these zones in reverse order.

Zone 3: Non-reciprocal countries

Where a worker is sent by his home employer to work in a non-reciprocal country, the default position is that liability to UK NICs will cease and the non-UK earnings will be subject to the social security regime of the host country. A UK employee sent on secondment to India for example will be subject to Indian social security contributions instead of UK NICs. In such cases there is an option for the worker to then pay voluntary NICs in the UK to preserve entitlement to UK benefits which is always worth considering as contributions are generally quite cheap.

However, there are situations where UK NICs will continue for the first 52 weeks of the overseas assignment. This will be the cases if the employer has a place of business in the UK and the assignment is such that the worker remains ordinarily resident in the UK. A worker who spends (say) 3 months on secondment to the firm's office in Mumbai would then remain liable to UK NICs in that period and would not pay into the Indian system.

If the overseas posting extends beyond 52 weeks, contributions will then be made to the foreign social security system from week 53.

You may have thought (and indeed hoped) that "ordinary residence" died with IR20, but the term still lives and breathes in NIC-land where it applies to workers who normally live in the UK, have a settled and regular mode of life in the UK but are temporarily absent from the UK. Keeping a home in the UK while working abroad is a typical indicator of ordinary residence.

Where a worker is coming to the UK from a non-reciprocal country, the earnings will normally be liable to UK NICs (although again there is a 52-week NIC-free period if the worker does not become ordinarily resident in the UK and his employment is mainly outside the UK for a non-UK employer). Short term secondments to the UK would therefore fit the bill. UK NICs will then kick in if that worker stays beyond 52 weeks.

Zone 2: Reciprocal countries

Where a worker is sent by his home employer to work in a "reciprocal" country, liability is determined by reference to the specific bilateral agreement between those countries. These agreements are also called Double Contributions Conventions or Totalisation Agreements.

For example, assume ABC plc (a UK company) sends Andrew, an employee, to work in its New York office. The UK/USA social security agreement allows Andrew to remain in the UK system (and not pay US social security contributions) where the posting is for five years or less. Note that the income tax position here is irrelevant, so Andrew will probably pay income taxes in the US but NICs in the UK. The payroll operator in the UK would therefore still have a job to do here.

The UK employer will apply to HMRC for a certificate of continuing liability. This will prevent the overseas authorities making demands for payment of social security contributions in the country of posting.

Note here that the reciprocal rules will only apply where the employee is posted by his home country employer to work in a reciprocal country. If an employee simply leaves his job in the UK to work for a different employer in the USA, overseas contributions will apply from day one with no UK NIC liability.

The Zone 2 and Zone 3 rules are (unsurprisingly) unchanged post Brexit.

Zone 1: Workers moving between the UK and the EU/EEA

Until 31 December 2020, the UK was covered by UK/EU Social Security Regulations (these having continued until the end of the transitional period after the EU Withdrawal Agreement).

Under the EU principles of free movement of persons, the EU Regulations had always ensured that a worker of an EU/EEA member state should only be subject to the social security legislation of a single member state/EEA country at any given time.

The pre-Brexit social security regulations provided that:

Where a “detached worker” spent a short period of time working outside their home EU country and the home country employment contract remained in place, the employee remained in the home country social security scheme. A short assignment was one which was not expected to exceed 24 months. If these conditions were met, the employer applied to the relevant authorities for a coverage certificate (an “A1 certificate” in the UK) to confirm that it was the home social security contributions legislation that applied in respect of the employee whilst he was working abroad.

For longer postings of up to five years, it was possible to remain in the home country scheme if the relevant authorities agreed.

In the absence of an A1 certificate (or once one had expired), social security contributions were paid in the country in which the work was carried out.

The impact of Brexit

All this was thrown up in the air by Brexit.

In the absence of a Brexit deal, liability to social security contributions would depend on whether the UK had negotiated reciprocal agreements with the 27 individual EU member states. If so, the Zone 2 rules would apply to workers moving between those countries.

In the absence of any reciprocal agreements, the Zone 3 rules would apply, and liability would be determined by the worker’s ordinary residence status and the place in which the work was carried out. Double liability to social security contributions could not then be ruled out.

To guard against a possible “no deal “scenario, in 2019 the UK and Ireland entered into a bilateral social security agreement under which employed and self-employed workers would continue to pay NICs/social security contributions in their home country where they are

assigned / posted to the host state for up to 2 years. This mirrored the arrangements already in existence.

The post-Brexit deal

After what seemed like an eternity of wrangling between the ever-present Monsieur Barnier in the blue corner and the phalanx of different UK sacrificial lambs in the red-white-and-blue corner, the UK and the 27 EU Member States finally shook hands on a Brexit deal on Christmas Eve 2020. The “UK-EU Trade and Co-operation Agreement” was born and became effective from 1 January 2021.

At the time of writing, the Bill implementing the Agreement has been passed in the House of Commons and it is expected to be passed by the House of Lords. The European Parliament will formally vote on the Brexit Deal sometime in January 2021. However, ambassadors from all remaining EU member states have unanimously approved it in advance, so barring something catastrophic, we’re finally there.

The new Agreement contains a protocol on social security co-ordination between the UK and the EU.

These new social security co-ordination arrangements deal with workers moving between the UK and the EU from 1 January 2021. In simple terms, the Agreement tells us which State should collect social security contributions in cases where a “detached worker” is temporarily seconded/assigned/posted from the UK to work in an EU Member State or vice versa. The rules also apply to the self-employed and to “multi-state workers” who whizz about working in several EU states at the same time.

The rules apply broadly as they did before Brexit in that an employee who is sent on a temporary posting to another EU state will continue to be subject to the social security legislation of their home country. “Temporary” means that the duration of the posting does not exceed 24 months and the detached worker is not replacing another detached worker.

Under pre-Brexit rules, the 24-month period could be extended (for up to 5 years). This is no longer possible from January 2021. Once the 24-month period has expired, contributions will be payable under the system of the country where the work is carried out.

What is unclear at the moment, is that if a worker is sent on a 24-month secondment to an EU state (after which he returns to the UK), can that worker remain in the UK system if he accepts another posting to either the same or a different EU state?

Opting out

Each EU member state (except Ireland which is now bound by the reciprocal convention) has the ability to “opt-out” of the detached worker rules.

Each EU country must individually agree to apply the detached worker rules by 1 February 2021 in order for these rules to apply (and for the previous regime to be retained). A failure to do so is effectively an opt-out (in which case the Zone 2 or Zone 3 rules for inward and outwards assignments will apply).

There is therefore no guarantee that the new detached worker rules will apply for all postings and we will need to wait for the individual EU member states to formally confirm their respective agreement or non-agreement. As I write this (staring at Google), Austria,

Belgium, Hungary, Portugal and Sweden have already opted in and it is reasonable to assume that most (if not) all of the others will follow.

Switzerland, Norway, Iceland and Liechtenstein

The new detached worker rules do not cover Norway, Iceland, Liechtenstein and Switzerland.

- Switzerland: Employees will remain within their home country legislation for temporary postings of up to 2 years;

- Norway: Employees will remain within their home country legislation for temporary postings of up to 3 years;

- Iceland: Employees can remain within their home country legislation for temporary postings of up to 1 year but only if they are non-UK and non-EEA nationals. This can be extended by agreement for a further 12 months. Otherwise, contributions will be paid in the country is which the work is carried out (subject to the 52-week rule);

- Liechtenstein: There are no special rules (thus making Liechtenstein a Zone 3 country for NIC). Contributions will be paid in the country is which the work is carried out, subject to the 52-week rule.

Employer responsibilities

Employees will require a certificate of coverage (or similar document) in order to carry on paying social security contributions only in their home country. Whether this will be the old A1 or a new form remains to be seen.

A failure to obtain the required documentation will mean that contributions should be charged in the country in which the work is carried out.

One telling little snippet from the new protocols is that:

> "An employer who is not established in a state whose legislation for social security applies must comply with the legislation in that state as if the employer was established there".

So, UK companies who send their staff to an EU State need to know the social security rules for that state even if they have no tax presence in that country. Ignorance would appear to be no excuse.

Working abroad pre-January 2021

Some workers will be working in the EU/EEA on a posting which straddles 1 January 2021.

Assignments that began before 31 December 2020 are covered by the transitional arrangement in the EU Withdrawal Agreement.

Workers who had been posted between the UK and the EU/EEA (including Norway, Switzerland, Iceland and Liechtenstein) before 1 January 2021 are protected by the

Withdrawal Agreement which states that individuals "shall be covered for as long as they continue without interruption to be in one of the situations …. involving both a Member State and the United Kingdom".

This means that a posted worker with a valid A1 certificate who remains on their posting will continue to be covered by that A1 certificate, so NICs / social security contributions will remain payable in their home country (and not the host country).

The existing A1 will also cover pre-January 2021 postings to and from any EU State that decides to opt out of the new detached worker rules.

Contributed by Steve Sanders

MTD for income tax – trading and property income (Lecture P1237 – 9.02 minutes)

Self-employed individuals and landlords with annual business or property income above £10,000 will fall within MTD for Income Tax from their next accounting period starting on or after 6 April 2023.

Start date

It is important to appreciate that it is the source of income that is mandated under MTD for Income Tax, not the individual taxpayer. This means that individuals who are self-employed and also rent out property could have two separate mandated start dates.

Individuals with property income have a compulsory accounting year of 5 April. Landlords will therefore have to start meeting their MTD obligations for their rental income from 6th April 2023, i.e. their first accounting period starting on or after 6 April 2023. From the start of 2023/24, property information will be submitted quarterly and then finalised via an annual upload.

If the same individual is self-employed and trades to 5th April each year, then their trade and property MTD obligations would start at the same point in time, i.e. 6 April 2023. However, if their trading year was to 31 July (say), their quarterly MTD obligations for their trading income would start later on 1st August 2023. This is their first accounting period for trading income starting on or after 6 April 2023.

Submitting returns

There will be separate submission obligations for each source of income for quarterly updates and an end of period statement. Software developers are expected to make the end of period statement a single process.

This end of period statement needs some thought. Let's return to our trader with a 31 July year end who will join MTD for Income Tax in respect of their trading income from 1 August 2023. If the trader also has rental income, they must start quarterly reporting of the rental income from 6 April 2023. Two different start dates for quarterly reporting but what about the end of period statement?

Whilst there is no official guidance on how two mandated start dates will work, we have received comment from an HMRC spokesperson on how they see it working.

It appears that the trader will still need to submit their trading information for the year to 31 July 2023 as part of the end of period statement for 2023/24, even though their year to 31 July 2023 would have had no quarterly uploads. This is simply because their rental income created an obligation to submit an end of period statement.

What about individuals who trade to 31 March 2024? Such traders will fall with MTD for Income Tax from 1 April 2024, i.e. their first accounting period starting on or after 6 April 2023.

If they also have property income, HMRC will be expecting an annual upload of:

- rental income - to supplement the quarterly uploads submitted through the 2023/24 tax year; and

- trading income for the year to 31 March 2024- without any quarterly uploads during the tax year.

Jointly owned property

Partnerships will be able to submit one report for the partnership, with the MTD system allocating the profits according to a statement about how the income is split between the relevant partners. Where property owners have formed a partnership, they should be able to adopt this approach.

Where individuals own property jointly rather than in partnership, both individuals will be responsible for keeping digital records and making their quarterly and year end submissions. However, HMRC believe that software developers will create products with functionality that allows them to keep one combined set of digital records. The software should then be able to upload the required information into both individuals tax accounts.

Corporate non-UK resident landlords filing final income tax return

From 6 April 2020, non-UK resident companies carrying on a UK property business are now liable to corporation tax rather than income tax. This means that the last year that they will need to report property income on income tax returns was for 2019/20 so up to 5 April 2020.

Rather than preparing accounts to 5 April each year, many property businesses prepare their accounts to 31 March. They have filed income tax returns on that basis, with the five days from 1 to 5 April being included in the tax return for the following tax year.

In its Property Income Manual, HMRC has stated that this method is still acceptable for the 2019/20 tax returns provided that the company has consistently used this basis, and the difference in adjusting for the 5 days is not substantial. The final five days from 1 April to 5 April 2020 should then be included in the first Corporation Tax return.

https://www.gov.uk/hmrc-internal-manuals/property-income-manual/pim1010

Capital Taxes

Furnished holiday property and business relief? (Lecture P1239 – 28.42 minutes)

The question for determination in the First-Tier Tribunal hearing of Cox v HMRC (2020) was whether furnished holiday accommodation known as Crail House, situated in Fife, was eligible for 100% business relief on the death of the owner of four of the five flats into which the property had been divided. The owner was Sheriff Principal Graham Cox QC (C).

C died on 27 December 2014 at the age of 81. Crail House was built in 1871, with a two-storey wing being added in 1937. The property contained five apartments:

- Flat 1 which had been purchased by C in 1989 and which then became his main residence;
- Flat 2 which C purchased in 1996;
- Flat 3 which C purchased in 1991;
- Flat 4 which C purchased as a second home in 1971 where he lived during the summer months until 1989 when, after his acquisition of Flat 1, he started his holiday letting business with Flat 4. Flats 2 and 3 were added to C's rental portfolio following their acquisition in the 1990s;
- Flat 5 was owned by a third party.

On C's death, Flats 2, 3 and 4 were valued at £562,040 and business relief of this amount was claimed by his personal representatives. The IHT saved by this claim – were it to be successful – was £224,816.

The situation of the flats within Crail House is as follows:

- Flat 1 is on the ground floor of the property, together with the basement of the original house;
- Flat 3 is immediately above Flat 1;
- Flats 2 and 4 are in the newer wing, on the ground and upper floors, respectively;
- Flat 2, being the ground floor flat, has its own garden area;
- Each flat has its own front door, but they share a communal main entrance through a glass porch which gives access to the four flats;
- Each flat has its own dedicated parking space within the grounds.

The gardens and grounds of Crail House extend to more than one acre (= 0.405 of a hectare) and are in an elevated position overlooking the harbour in the village of Crail, the Isle of May and the Firth of Forth.

As mentioned above, the furnished holiday letting business was started in 1989. C operated as a sole trader and employed his wife to assist him in the business. She had no stake in the rental properties.

The personal representatives' claim for business relief as part of C's death estate was refused by HMRC on the ground that the business consisted mainly of the making or holding of investments. They cited S105(3) IHTA 1984. Any additional services or facilities provided were insufficient, in HMRC's view, to change the nature of the business. As a result, the personal representatives appealed, and it was one of the deceased's three daughters (Mrs T) who represented the appellants before the First Tier Tribunal. Mrs T is a chartered accountant as well as being one of her late father's personal representatives.

The question of whether furnished holiday accommodation can be relevant business property for IHT purposes has been the subject of litigation in a number of recent cases:

- HMRC v Pawson (2013) where the Upper Tribunal overturned the First-Tier Tribunal's decision in favour of the taxpayer;
- Green v HMRC (2015) where the First Tier Tribunal rejected the taxpayer's contention that the difference in rent between a holiday letting and an assured shorthold tenancy represented the value of the services provided under the holiday letting arrangements;
- Ross v HMRC (2017) which was decided in the same way as the two earlier cases, despite the fact that the lady owner provided an impressive list of services for her holidaymaker tenants; and
- Graham v HMRC (2018) where the First-Tier Tribunal judges held that the provision of many of the facilities for the tenants distinguished it from other more mainstream actively managed holiday letting businesses and found for the Graham family.

To date, the Graham case has been the only one where the taxpayer was successful. HMRC appealed the First Tier Tribunal's verdict, but, in March 2019, they withdrew their appeal just before the planned Upper Tribunal hearing.

It should be emphasised that, when the special furnished holiday accommodation legislation was put in place in FA 1984, it only extended the 'deemed trading' regime for qualifying properties to income tax and capital gains tax.

IHT and its predecessor (CTT) were never included. Initially, that did not seem to be a problem.

If the owner of residential property which satisfied the furnished holiday letting requirements died, the tax authorities did not deny a claim for the IHT relief. It was only after the turn of the century that HMRC started to impose a stricter interpretation, with the Pawson dispute being the first case law victim.

C advertised his holiday letting business in a number of national newspapers and through entries on websites such as 'VisitScotland'. Annual mailshots were sent to guests who subscribed to the mailing list and, in 2008, C launched his own website.

The case report states that the judge saw archived website pages from periods in 2008, 2009 and 2011 which were printed out shortly before the hearing and which 'provide a good description of the business as advertised to the public'.

From Mrs T's evidence, the activities of the letting business were held by the judge to fall into the following three categories:

1. Investment activities that included:
   - the provision of accommodation;
   - the provision of parking spaces;
   - the provision of communal laundry facilities;
   - repairs and maintenance of the buildings, gardens and grounds; and
   - all the administration dealing with bookings and advertisements.
2. Incidental or ancillary activities that included:
   - the provision of electricity and other utilities;
   - the provision of appliances, furniture, kitchen utensils and crockery;
   - the provision of kitchen basics such as tea and coffee;
   - the provision of consumables such as washing up liquid and toilet paper;
   - cleaning the apartments and the laundry of bed linen and towels between lets;
   - welcoming guests on arrival.
3. Non-investment activities that included:
   - the provision of books, DVDs and information leaflets;
   - the use of tennis or badminton racquets; and
   - the use of buckets and spades, crab lines and frisbees.

With regard to this categorisation, the judge said:

> 'The ancillary activities were an integral part of the provision of the accommodation and, as such, they are to be considered as part of the business of holding the property as an investment. The non-investment activities were so insignificant in scale as to be negligible.'

And there was no evidence that extra services such as dog sitting, child minding, transport, breakfast and supper were rendered to the guests with any degree of regularity. Indeed, they appeared to be ad hoc in nature.

While not taking issue with Mrs T's 'credibility', the judge said that her evidence was 'strained, anecdotal and, at times, contrived in the way that the generality of a state of affairs was suggested by implication from the particulars'.

The judge went on:

'(Her) description of staying in one of the apartments to be "the equivalent of having a suite in an exclusive country hotel with a concierge on site" is an overstatement.'

Another key quote is this:

> 'I find that the business was run to a high standard for furnished holiday lettings, but there was nothing exceptional about the business to elevate it to the level of the business found in Graham which qualified for business relief. The non-investment activities in Graham were extensive: swimming pool, games room, sauna, fresh produce from the herb garden, greenhouse and fruit trees, three or four barbecues in each holiday season, receipt of grocery deliveries for guests, fresh seafood at cost price, event and party planning (three or four a year) and prize-winning gardens.'

The First Tier Tribunal's conclusion was therefore that the Crail House letting business fell firmly on the investment side of the line. The business was mainly one of holding an investment. The appeal was dismissed.

Let the last comment be provided by the Editor-in-Chief of 'Taxation':

> 'Yet again a decision shows that there is no substitute for contemporaneous evidence of how an activity was actually carried out. The taxpayer's daughter did her best but could only make general assertions that could not be backed up. In these sorts of cases, where a dispute is likely to arise after death, it is essential that the best possible evidence is obtained and retained during the proprietor's lifetime. Whether this would have made any difference here is not clear, but, in other cases, it could certainly tip the balance in the taxpayer's favour and prevent a large IHT bill.'

Contributed by Robert Jamieson

Business asset disposal relief anti-forestalling (Lecture P1240 – 24.40 minutes)

The cumulative lifetime limit for the relief which has been renamed business asset disposal relief was reduced from £10,000,000 to £1,000,000 for transactions taking place on or after 11 March 2020 (Paras 1 and 2 Sch 3 FA 2020).

The FA 2020 legislation contains a number of anti-forestalling rules to counter arrangements which sought to lock in entitlement to the higher level in anticipation of the abolition or restriction of the relief. Planning of this sort typically required the making of an election under S169Q TCGA 1992 and is addressed by Paras 4 and 5 Sch 3 FA 2020.

S169Q TCGA 1992 allows an election to be made which displaces the operation of S127 TCGA 1992, i.e. that a share reorganisation is not regarded as a disposal of the original shares. Reorganisations include share-for-share exchanges and company reconstructions. This chapter considers the position with regards to share-for-share exchanges.

The aim of the election is to allow a disposal to be triggered upfront, so as to create a gain against which relief can be set, given that business asset disposal relief may not be available on the sale of the new shares.

If a S169Q TCGA 1992 election is made on or after 11 March 2020 in relation to a share-for-share exchange under S135 TCGA 1992 which took place between 6 April 2019 and 10 March 2020 (inclusive), relief will still be available but subject to the reduced limit of £1,000,000. The detailed provisions for this anti-forestalling rule are found in Para 5 Sch 3 FA 2020.

The rule applies where there is an exchange of shares or securities within the meaning of S135 TCGA 1992 and either of two conditions are met (note the references to 'company A' and 'company B'):

1. those holding shares or securities in company B immediately after the exchange are substantially the same as those who held shares or securities in company A; or

2. those having control of company B immediately after the exchange are substantially the same as those who had control of company A.

Various permutations are examined in the examples which follow. Unless otherwise specified, they all involve trading companies.

Example 1

Chris and Dick each hold 50% of the shares in company A. Prior to 11 March 2020, they incorporate company B which issues them with new shares in exchange for their shares in company A. This is regarded as a share reorganisation and so Chris and Dick are not treated as disposing of their shares in company A.

Following the reduction in the lifetime limit, Chris and Dick could elect under S169Q TCGA 1992 to crystallise a gain which would theoretically qualify for relief under the £10,000,000 limit, even though they would still be eligible for business asset disposal relief (subject to the new limit) when they sell their shares in company B.

The two parties (Chris and Dick) are exactly the same individuals and so the condition set out in 2. above is met. The reduced limit is therefore in point.

Example 2

Richard and Sheila are a married couple. They each own 50% of company A. Together with their two adult children, Timothy and Rupert, they set up company B and exchange their shares in company A for an issue of shares in company B, with the parents having an 80% stake and the sons a 20% stake. Assume that they use the same time frame as Chris and Dick.

Because FA 2020 treats connected persons (as defined in S286 TCGA 1992) as the same person for this purpose, the shareholders in each company are treated as being the same and so the condition set out in 1. above is met. Again, the lower limit is in point.

Example 3

Nigel and Cindy are a married couple. They each own 50% of company A. A third party wishes to invest in the business via company B. Nigel and Cindy exchange their company A shares for an issue of shares in company B so that together the couple hold a 60% stake in company B. Assume that they use the same time frame as Chris and Dick.

Taking into account the extent of the third party's holding the shareholders would not in this instance be considered to be substantially the same. The anti-forestalling legislation dealing with the holding of shares should not apply. HMRC are a little less specific, as is evidenced by their statement:

> 'Whether the shareholders would be regarded as being substantially the same will depend on the facts. Where, say, there are two original shareholders in company A but a third in company B who is not connected and holds a substantial (but not majority) proportion of the shares in that company, then the rule *may* (emphasis added) not apply.'

But see below.

The second condition above deals with the situation where the parties involved do not hold shares in the respective companies but are classified as 'associates' under the close company legislation.

Example 4

Owen owns 100% of company A. The XYZ trust was settled by Owen's late father and the trust beneficiaries comprise Owen's children and grandchildren. The XYZ trust holds all the shares in company B, a long-established family investment company.

In December 2019, Owen exchanged his company A shares in return for:

- cash of £1,500,000; and
- an issue of shares in company B.

The shares in companies A and B are not held by persons who are connected with each other under S286(3) TCGA 1992 – see Para CG14590 of the Capital Gains Manual. However, Owen and the trustees of the XYZ trust are associates by virtue of S448 CTA 2010, given that the settlor of the trust was a relative of his. Companies A and B are therefore treated as being under the same control.

Owen will be taxed on the cash element at the time of the share-for-share exchange and will be able to claim relief based on the 'old' limit of £10,000,000. If Owen makes a S169Q TCGA 1992 election, the gain attributable to the consideration which he received in the form of shares in company B will attract relief at the reduced level of £1,000,000 (less any relief which he previously enjoyed).

The rule explained in Example 4 could also apply to the situation described Example 3 because Nigel and Cindy are associates who together control company B through their 60% shareholding. However, it would not apply if the outside third party's shareholding meant that Nigel and Cindy did not control company B.

Finally, there is an additional provision which applies where a share-for-share exchange takes place on the departure of a shareholder. If the remaining shareholders have a greater shareholding in company B than they did in company A, they are subject to the reduced limit where they still meet the qualifying conditions for relief in respect of their shares in company B on 11 March 2020 (Para 5(3) Sch 3 FA 2020).

Example 5

Donald, Edward and Francis have had equal shareholdings in company A for several years, but Donald wishes to retire from the business. Edward and Francis therefore set up company B and, in October 2019, they exchanged their shares in company A for an issue of shares in company B. Contrast their position with that of Donald who received cash and loan notes in company B (but no shares).

Donald would not meet the relief conditions in respect of company B on 11 March 2020 because the company is not his personal company and he is no longer an officer or employee. Therefore, Donald can make an election under S169Q TCGA 1992 and the 'old' limit of £10,000,000 will be available. If Edward or Francis make a similar election, their gain will be subject to the £1,000,000 limit.

Contributed by Robert Jamieson

Preference shares and ordinary share capital

Summary – The Upper Tribunal confirmed that 10% cumulative preference shares with right to dividend were ordinary share capital for entrepreneurs' relief purposes.

Stephen Warshaw was chairman of a UK-based company known as Cambridge Education Group Limited (CEG) and held 44,183 ordinary shares and 396,000 preference shares in that company.

In 2012, following a reorganisation of the Group, Stephen Warshaw exchanged all of his shares in CEG for new shares, replicating his original shareholding in CEG. On 26 March 2012, he subscribed for 24,660 B ordinary shares in the Company. He became a director of the Company on 26 October 2012.

On 4 December 2013, he disposed of his entire shareholding for cash and ceased to be a director and chairman of CEG as of that date. His 2013/14 Self Assessment tax return included a total gain of £6,438,419, and a claim for entrepreneurs' relief relating to the disposal of his ordinary shares, ordinary B shares and preference shares, on the basis that he held 5.77% of the company.

However, if his preference shares were excluded, he only held 3.5%. These shares carried the right to a fixed cumulative 10% preferential dividend per annum based on the total of their subscription price and the amount of any compounded preference dividends which had not yet been paid.

HMRC denied the entrepreneurs' relief arguing that the company was not his personal company as the preference shares were not ordinary share capital. Ordinary share did not include shares with a right to a dividend at a fixed rate but no other right to share in the company's profits.

Stephen Warshaw was successful at the First Tier Tribunal. The shares had no right to a dividend at a fixed rate because the Articles of Association stated that the computation of the dividend amounts must include any cumulative compounded unpaid preference dividends. This could be a varying amount depending on the level of the company's distributable reserves.

Decision

The Upper Tribunal agreed with the First tier Tribunal and dismissed HMRC's appeal.

Any dividends paid relating to the preference shares were not fixed rate. The 10% rate applied to an amount which may vary and cannot be determined at the date of issue of the shares.

The Upper Tribunal stated that:

> "if the dividends had all been paid when due, then 5 years after the date of issue the rate of dividend would be 10% of the nominal value of the shares. However, if no dividends had been paid when due, then after 5 years the dividend right would equal 14.6% of the nominal value. If at any stage the arrears of dividend had been paid, the dividend right would again have become 10% of the nominal value. We do not consider that that is a right to a dividend "at a fixed rate"."

The Upper Tribunal concluded that the preference shares were "ordinary share capital", the company was therefore Stephen Warshaw's "personal company", and he was entitled to entrepreneurs' relief on a disposal of his shares.

HMRC v Stephen Warshaw [2020] UKUT 0366 (TCC)

SDLT clawback but no penalties

Summary –HMRC were unable to prove that the company deliberately submitted an inaccurate SDLT return and so no penalties were due.

In June 2016, Forest Commercial Services Limited bought a property, with the intention to redevelop the 'Holwell' plot. Simon Smith, the sole director of the company, was aware that there could be objections through planning, as the site was in a conservation zone and had some interest from Historic England.

As a high value residential property, SDLT would have been charged at 15% on the acquisition. However, as the property had been purchased by a company for redevelopment, para. 5AA Sch. 4A FA 2003, permitted relief from this higher rate. The company filed their SDLT return on this basis.

Simon Smith confirmed that around the time he was purchasing this property, he was moving home himself, into a property that was still under construction. In need of a short-term let, Simon Smith and his wife could not find a suitable property available and so temporarily moved into Holwell for about four months.

The relief from the 15% is subject to a claw back, if within three years of the effective date of the transaction the property is no longer used for the purpose for which relief was available when purchased, or the property is used personally or for family occupation. Following an SDLT enquiry notice, HMRC sought to clawback the 15% SDLT that they argued was due. Further, HMRC imposed a penalty for a deliberate inaccuracy in the return.

The company accepted that the 15% SDLT was now due but appealed the penalties. Simon Smith argued that when the return was submitted, it was correct because at that time, he had no intention to live there with his wife.

Decision

The First Tier Tribunal stated that the issue to decide was whether the property had been acquired “exclusively for development or redevelopment and resale in the course of a property development trade' at the time of completion.

The Tribunal stated that the company bought the plot on:

> “a speculative basis and with an open mind, to develop it in one way or another. Had property development not been his trade, we may have concluded differently. It may have been in his mind that he and his family could, possibly several years later, move into the property, but it would be wrong to say that could be regarded as an established intention to do so.”

The Tribunal concluded that it was clear from an architect's letter dated a couple of months after completion that the initial intentions were to redevelop and sell the property and so the SDLT return was correct and no penalty payable.

This was a somewhat surprising outcome as Simon Smith, a property developer, had claimed to have no knowledge of the SDLT rules. In addition, he had initially denied that he had ever lived in the property with his wife, despite using the property as their postal address and being registered at the property on the electoral register. Further, Council Tax records showed that he had paid the council tax due on Holwell from 14 June 2016 until the end of that year and this was paid *before* the SDLT return had been submitted. It seemed very unlikely that he was not aware that he would be occupying the property on completion but HMRC could not prove, even on a balance of probabilities, that occupying either the old or new Holwell property was Simon Smith’s real and true intention from the outset.

Forest Commercial Services Limited v HMRC (TC07944)

Changes to Welsh land transaction tax

In the draft December Budget the Welsh Government announced that:

- the higher residential rates would increase by 1% across all tax bands, effective for property transactions completing on or after 22 December 2020;
- the non-residential zero-rate bands, for freeholds and leases, would increase from £150,000 to £225,000 on 22 December 2020;
- they intend to increase the 'relevant rent' amount for the annual rent element of non-residential rents from £9,000 to £13,500 in February 2021;

- the temporary increase to the nil rate band of LTT for residential property transactions will end on 31 March 2021.

https://gov.wales/changes-rates-and-bands-land-transaction-tax-december-2020

Failure to pay Land Transaction Tax due to COVID-19

Summary – The penalty appeal on the grounds that there was no reasonable excuse attributable to COVID-19 was dismissed.

In December 2019, Prime Aesthetics Limited bought a hotel at that was subject to the Land Transaction Tax. The company's solicitors filed a land transaction return on time, confirming that just over £171,000 was payable by 5 January 2020.

The Welsh Revenue Authority issued a late payment penalty on 4 February 2020, and the taxpayer appealed in April following reviews.

This tax was not paid and was still outstanding at the date of the hearing.

Prime Aesthetics Limited argued that the reason for non-payment was due to COVID-19. The company had applied for a loan to be able to settle the 'stamp duty', but the bank had put the application on hold due to the lockdown. Further, a director was unable to transfer funds due to lockdown, as he was in India at the time. Finally, due to lockdown, the hotel had been forced to close meaning that no money was coming in as the leaseholder had suspended all rent payments.

Decision

The First Tier Tribunal noted that each of the company's reasons for the failing to pay the tax due referred to the COVID-19 lockdown that started in March 2020.

However, the tax was due in January 2020, so prior to the COVID-19 pandemic taking effect. The delays regarding the coronavirus pandemic only delayed payment from March 2020.

The Tribunal stated that the company should have ensured that funds were in place before purchasing the property.

The company did not have a reasonable excuse and could not argue special circumstances as insufficient funds was not a valid reason.

The company's appeal was dismissed.

Prime Aesthetics Limited v The Welsh Revenue Authority (TC07948)

Administration

Soft Drinks Industry Levy returns filed late

Summary –Filing requirements relating to the Soft Drinks Industry Levy was clearly stated in the regulations; ignorance of the law was not a reasonable excuse for late filing.

Fortune Foods UK Limited was registered for the Soft Drinks Industry Levy since 1 March 2019.

Under the Soft Drinks Industry Levy Regulations 2018, registered companies must submit online quarterly returns for periods ending 31 March, 30 June, 30 September and 31 December each year within 30 days of the period end.

The company was late filing its first three returns and so HMRC imposed penalties. The company appealed claiming that:

- they had never received any information from HMRC on the filing of a Soft Drinks Industry Levy return; and
- it is not fair to penalize honest small businesses who are not able to check as frequently as big companies what their requirements are.

Decision

The First Tier Tribunal reminded us that:

- when a person appeals against a penalty, they must have a reasonable excuse which existed 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 the taxpayer from complying with an obligation.

The Tribunal concluded that ignorance of the law can only exceptionally be a reasonable excuse. In this case, there was no reason why the company could not have checked their obligations under the Soft Drinks Industry Levy legislation.

With no reasonable excuse, the appeal was dismissed.

Fortune Foods UK Limited (TC07952)

Deadlines

1 February 2021

- SME CT due for periods ended 30 April 2020 when instalments not payable

2 February 2021

- Form P46(Car) for quarter ended 5 January 2021

5 February 2021

- Employment intermediaries report for quarter to 5 January 2021

7 February 2021

- VAT returns and payment for 31 December 2020 quarter (electronic payment)

10th February 2021

- register date for the non-union mini one stop shop scheme for UK business making relevant supplies into the EU during January 2021

14 February 2021

- Quarterly CT instalment for large companies (depending on accounting year end)
- Monthly EC sales list if paper return used
- Application to defer class 1 NICs (leaflet CA72A) for 2020/21

19 February 2021

- PAYE, NIC, CIS, student loans for month to 5 February 2021 if not paying electronically
- File monthly construction industry scheme return

21 February 2021

- File online monthly EC sales list
- Submit supplementary Intrastat declarations for January 2021

22 February 2021

- PAYE, NIC, CIS, student loans should have cleared HMRC's bank account

28 February 2021

- Submission of CTSA returns for companies with periods ended 28 February 2020

- Deferred online deadline to file individuals' Self Assessment tax return

HMRC News

2019/20 filing deferred but payment date unchanged

In a press release dated 25th January 2021, HMRC announced that:

> "Self Assessment customers who cannot file their tax return by the 31 January 2021 deadline will not receive a late filing penalty if they file online by 28 February."

However, the payment date is unchanged:

- Any tax due must still be paid by 31 January 2021;
- Interest will be charged on any outstanding liabilities from 1 February 2021;
- Late payment penalties do not apply until the payment has been outstanding for 30 days.

Individuals who cannot afford to pay their tax bill on time can apply online to spread their bill over up to 12 months. However, to set up a time to pay arrangement, they must have already filed their 2019/20 tax return.

According to the CIOT, HMRC has now also confirmed that the easement will also apply to:

- forms SA700 (Non-resident Company Income Tax Return) and SA970 (Tax Return for Trustees of Registered Pension Schemes) – note these can only be filed on paper as there is no online alternative
- forms SA800 (Partnership Tax Return) and SA900 (Trust and Estate Tax Return) if the return is filed online. Paper versions of these forms do not benefit from the easement (as they should have been filed on 31 October)

https://www.gov.uk/government/news/no-self-assessment-late-filing-penalty-for-those-who-file-online-by-28-february

SEISS 4 amount and eligibility

The fourth Self Assessment Income Support (SEISS) grant covers February to April 2021. HMRC has confirmed that details about the amount and eligibility criteria for this grant will be included in the Spring Budget on 3 March 2021.

It is unclear why this information is being delayed until the Budget. Some are speculating that it could mean that information from 2019/20 returns will be taken into account when calculating the grants and it could also mean that more people will be eligible for SEISS 4 as HMRC will now have 2019/20 tax return information easily available them.

Brexit checker

On 1 January 2021 we entered the brave new Brexit world, with so many new rules now applying to travel and business when dealing with Europe.

The Government's Brexit checker can be used by individuals to obtain a list of actions relating to their personal and business circumstances.

It can be found at https://www.gov.uk/transition.

https://www.gov.uk/transition

Employer Bulletin: UK Transition Special Edition

On 22 January 2021, HMRC published a special edition of Employer Bulletin looking at the new rules that now apply following the of the Brexit transition covering:

- Trading with Europe;
- Business travel
- Social security coordination. I

https://www.gov.uk/government/publications/employer-bulletin-uk-transition-special-edition/employer-bulletin-uk-transition-special-edition

New lockdown grants

On 5th January 2021, the Chancellor announced one-off top up grants for retail, hospitality and leisure businesses worth up to £9,000 per property.

The one-off top-ups will be granted to closed businesses as follows:

- £4,000 for businesses with a rateable value of £15,000 or under;
- £6,000 for businesses with a rateable value between £15,000 and £51,000;
- £9,000 for businesses with a rateable value of over £51,000.

A further £594 million is also being made available for Local Authorities and the Devolved Administrations to support other businesses not eligible for the grants, that might be affected by the restrictions. Businesses should apply to their Local Authorities.

https://www.gov.uk/government/news/46-billion-in-new-lockdown-grants-to-support-businesses-and-protect-jobs?

Repaying business rates relief

With several businesses choosing to repay the business rates relief given during the pandemic, the Government has confirmed that repaid business rates relief is deductible for

tax purposes in the same period the original payment of business rates would have related to.

Their guidance states:

> "The government intends to legislate to provide clarity that the repayments of business rates relief should be treated as if they were business rates payments and so should be deductible for tax purposes. The government also intends to specify the timing of the deduction as the same period the original payment of business rates would have related to."

The guidance states that the Government will introduce legislation to clarify this point in due course.

https://www.gov.uk/government/publications/repaying-your-business-rates-relief/repaying-your-business-rates-relief

DAC 6 regulations replaced with OECD Mandatory Disclosure Rules

HMRC has confirmed that the government intends to repeal the EU disclosable cross-border arrangements rules, which implement DAC 6 in the UK, and replace them with new legislation to implement the OECD Mandatory Disclosure Rules (MDR). By doing this the UK will transition from EU to international standards on tax transparency.

Under OECD MDR, the only arrangements that need to be reported are those falling within Category D of DAC 6. As a temporary measure, amending UK regulations which took effect from 31 December 2020, have been enacted. These regulations effectively repealed most of DAC 6 in the UK from that date, by removing all the hallmarks other than those in Category D (on automatic exchange of information and beneficial ownership).

HMRC has confirmed that this change applies retrospectively, meaning that no disclosures will need to be made for any arrangements that fall into one of the other hallmarks set out in DAC 6.

https://www.icaew.com/insights/tax-news/2020/dec-2020/dac-6-to-be-replaced-by-oecd-rules-for-uk-intermediaries-from-2021?

Business Taxation

Cash basis for calculating taxable profits (Lecture P1238 – 10.28 minutes)

Normally, a business (both an unincorporated trader or a limited company) must prepare accounts under the 'going concern' accruals basis, as detailed in the accounting standards. This takes account of amounts paid and received, as well as future amounts payable and receivable by the business which relate to the current year.

However, eligible unincorporated businesses can also elect to use the 'cash basis' to calculate their taxable trading profits. Limited companies may not use the cash basis.

Eligibility and making of election

Individuals working as unincorporated businesses can elect to use the cash basis if their total business receipts for that tax year do not exceed £150,000 or £300,000 for Universal Credit recipients. In a year in which your tax basis period is less than 12 months long e.g. the year in which you start to trade, this limit is proportionately reduced. If you therefore commence trading on 1 January, the limit will be reduced to £37,500 (being 3/12th of £150,000).

It is necessary to consider all self-employed income of an individual to see if they are eligible to enter the cash basis. If you are considering partnerships, if there is a controlling partner, then the partnership receipts must be added to the receipts of any other businesses carried on by the controlling partner to see if the limit is exceeded.

Once an election is made, it will apply for the tax year for which it is made and all subsequent tax years, until such times as the business receipts exceed £300,000.

In order to make an election to use the cash basis, the relevant box must be ticked on the self-assessment return.

Certain persons cannot elect to use the cash basis (called by the legislation 'excluded persons':

- Partnership which has a partner who is not an individual
- An LLP
- An individual who is a Lloyd's underwriter
- A person who has made a herd basis election
- A person who has made a claim for profit averaging
- A person who has within the previous seven years obtained a BPRA
- A person who carries on a mineral extraction trade
- A person who has at any time obtained a research and development allowance

Effect of making the election

If an election is made for the cash basis to apply, it applies for income tax and Class 4 NIC purposes.

The profits of the trade for an accounting period are then calculated simply as income actually received, less allowable expenses actually paid.

The tax treatment of costs is generally governed by the same rules as applying to those businesses not using the cash basis, however there are some exceptions.

Capital allowances – the only assets which qualify for capital allowances are cars purchased by the business. All other plant and machinery is treated as deductible in full in the year it is paid, if used wholly for business purposes. Any private usage will reduce the allowances given. If the private proportion increases, then a notional receipt must be brought in when calculating the profit. Sales proceeds will also be brought into the tax computation in full when received. For assets being acquired under hire purchase, a deduction would be allowed for each payment as it falls to be paid.

No deduction is permitted for capital expenditure:

- to acquire or dispose of a business or part of a business or
- in connection with education or training
- or on the acquisition, alteration or disposal of an asset which is not a depreciating asset, is not used in the trade, is a car, is land, is an intangible asset or a financial asset.

Goods taken for own use – if goods are removed for your own use, the cost of the goods is disallowed in the tax computation, rather than making an adjustment to include the sales price of the goods.

Interest costs – a maximum of £500 of loan/overdraft interest and related costs can be deducted each period for any loans obtained. The limit also includes the incidental costs of obtaining loan finance. This does not impact hire purchase interest.

Car leasing costs – all car leasing costs are deductible without any restriction based on emissions.

It is possible to claim simplified expenses as part of a cash basis calculation but it is not obligatory. There are restrictions though as motoring expenses under the cash basis cannot be calculated using the simplified expenses mileage rates if the vehicle has been subject of a capital allowances claim before entering the cash basis.

If the business makes losses, these losses may only be carried forward against future trading income. They cannot be used against other income in the same way as non-cash basis trading losses can be.

Entering the cash basis

Where a person enters the cash basis, there are various rules to ensure that there is no advantage or disadvantage accruing:

if income has already been taxed as accrued income it is not taxed again when it is received

If expenses have already been allowed on an accrued basis, they will not be allowed again when paid

any expenditure that is unrelieved qualifying expenditure for capital allowances purposes at the start of the period in which the cash basis election is made (other than cars) is allowable as a deduction in the first year of using the cash basis.

For assets being purchased on hire purchase, it is necessary to check the amount on which capital allowances have been claimed as against the amount of payments made. If capital allowances claimed exceed payments (for example because the entire cost has been covered by annual investment allowance) then there will need to be a receipt of the amount by which the AIA exceeds payments. If it is the other way around, then a deduction is allowed in the first cash basis period for the excess payments.

Leaving the cash basis

Where a person leaves the cash basis, there are various rules to ensure that there is no advantage or disadvantage accruing as well. So income which has earned but not received would have to be brought into account when received and costs which have been accrued but not paid would be allowed when paid. If there is any adjustment income on leaving the cash basis, it can be spread evenly over the following six tax years although the individual can elect to accelerate that charge if they wished to do so.

For capital expenditure, there is unlikely to be a significant number of adjustments since capital costs are deductible as incurred. The most obvious exception is where assets are being purchased under hire purchase agreements. Any amount unpaid at the time of leaving the cash basis would be allocated to a capital allowance pool in the first chargeable period the person used the accruals basis.

Property businesses

The default for property businesses is that they will calculated on the cash basis unless any of the five conditions below are met:

Condition A: the business is carried on at any time in the tax year by:

(a) a company,

(b) a limited liability partnership,

(c) a partnership with a non-individual member,

(d) the trustees of a trust.

Condition B: the cash basis receipts for the tax year exceed £150,000 (or pro-rata amount thereof if the property business is carried on for only part of the tax year).

Condition C: that:

(a) the business is carried on by an individual (‘P’),

(b) a share of joint property income (see below) is brought into account in calculating the profits of the business for the tax year,

(c) a share of that joint property income is brought into account in calculating the profits of the business for the tax year of a property business carried on by another individual (‘Q's property business’), and

(d) the profits of Q’s property business for the tax year are calculated in accordance with GAAP.

Condition D: that:

(a) an allowance under the BPRA rules has been made in calculating the profits of the property business, and

(b) if the profits of the business were to be calculated on a GAAP basis, there is a day in the tax year on which the occurrence of a balancing event under the BPRA rules would give rise to a balancing adjustment for the tax year

Condition E: that a valid election is made to disapply the cash basis. An election must be made on or before the first anniversary of the normal self-assessment filing date for the tax year for which it is made.

Contributed by Ros Martin

Brexit and Withholding Taxes (Lecture B1236 – 22.55 minutes)

The end of the transition period for the UK leaving the EU means that it can no longer benefit from two directives that meant no withholding tax was suffered on certain payments made by EU companies to ‘associated companies’:

1. **The parent-subsidiary directive** – an EU company making payments of dividends to another company in the EU cannot withhold local tax if the investing company owns at least 10% of the paying company;

2. **The interest and royalties directive** – an EU company making payments of interest and royalties to another EU company cannot withhold local tax if the recipient company owns at least 25% of the paying company or vice-versa.

Dividends

UK companies receiving dividends from companies resident in the EU in which they own at least 10% of the share capital and voting power may suffer withholding tax at source for dividends received on or after 1 January 2021.

Dividends received by UK companies are usually exempt from corporation tax, so the withholding tax would represent a real tax cost which previously would not have arisen. The taxation of dividend income is covered in more detail below.

The rate of withholding tax will depend on the local legislation in the country where the payer is resident and the terms of the double tax treaty between that country and the UK.

For example, the following countries would require local companies to withhold tax on dividends:

Austria	5%
Germany	5%
Italy	5%
Luxembourg	5%

It may be possible for the UK investing company to restructure their EU operations to minimise the impact of this withholding tax.

For example, a company with trading subsidiaries in Germany and (say) Poland (which would not levy WHT on dividends), could transfer its shares in the German company to the Polish company. This would mean that any dividends paid by the German company would be paid to Poland and still covered by the parent-subsidiary directive.

The Polish company could then pay this dividend on to the UK parent company and no WHT would be deducted.

There is a risk, however, that the Polish company could make losses and this would trap the dividends in the Polish company as it would have insufficient profits to pay a dividend to its UK parent.

This could be overcome by inserting an intermediate holding company in Poland, which would hold the shares in the German and Polish subsidiaries.

It should be noted that clearance would need to be obtained to ensure that no adverse tax charges would arise from this re-organisation and that Germany might be able to invoke the 'anti-avoidance' Article of the UK-Germany double tax agreement as this type of re-organisation could be seen as 'treaty shopping'.

If there are commercial justifications for the re-organisation, then this could provide a robust defence, if needed.

The UK does not impose withholding taxes on payments of dividends, so a UK subsidiary of an EU parent would continue to make those dividend payments free of WHT.

Royalties and interest

The UK has not repealed the effect of the interest and royalties directive in UK law (ss757 – 767 ITTOIA 2007), so a UK company paying these to an EU associated company would not deduct income tax at source.

Note that this relief from WHT is not automatic and relief needs to be claimed by filing the appropriate form with HMRC.

(https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/694817/eu-claim-form.pdf)

UK companies receiving interest and royalties from EU associated companies will no longer be covered by the directive and therefore, either under the domestic law of the paying country, or where more beneficial, the terms of the double tax agreement between the UK and the paying country, withholding tax may be suffered at source.

For example, double tax treaties with various EU countries provide for the following maximum rates of withholding tax:

Country	**Interest**	**Royalties**
Austria	0%	10%
Germany	0%	0%
Italy	10%	8%
Luxembourg	0%	5%
Poland	5%	5%
Portugal	10%	5%

As interest and royalty income will be taxable on a UK company (unless it has losses that can be used against them), the deduction of withholding tax at source will usually only be a cash flow disadvantage.

The foreign tax suffered will be credited against the UK tax payable on the grossed up amount of foreign interest or royalties received.

Taxation of dividend income for UK companies

The law states that dividends received by a company are taxable unless an exemption applies.

If exempt, the company must add the dividends received to its taxable profit to determine if quarterly instalment payments are payable.

The exemptions can depend on whether the company is:

1. Small (less than 50 employees and either turnover or total assets not exceeding €10 million);

2. Non-small.

The small company limits include linked/partner enterprises

- Linked = part of same control group
- Partner = is held 25%+ of shares or votes (unless held by certain investors such as venture capitalists, public investment corporations if total investment of these entities < €1.25 million, universities, non-profit research centres, institutional investors, small local authorities)

Small company dividend exemption

Dividends received will be exempt if all of 1 – 4 below apply:

1. The payer is a resident only of the UK or a qualifying territory - a country with which the UK has a double taxation treaty (DTT) containing an appropriate non-discrimination article – Channel Islands is non-qualifying
2. No deduction is allowed to any resident of a non-UK territory under the laws of that territory in respect of the dividend;
3. The dividend does not fall within CTA 2010 s 1001 para E or F
    - E: distributions from non-commercial securities (paying a higher than commercial return)
    - F: Special securities, and
4. The dividend is not made as part of a tax advantage scheme (broadly, a scheme a main purpose of which is to obtain a more than negligible tax advantage)

Dividends from a controlled foreign company are exempt if paid out of profits subject to a UK CFC charge (which is rare).

Special securities (s1001E CTA 2009)

1. Issued other than for new consideration, or
2. Convertible into shares or have a right to shares or securities in the company and not listed and terms not reasonably comparable with listed securities, or
3. Return based on results of the company (or part of it), or
4. Securities are connected with shares in the company or the securities are equity noted held by an associated or funded company
    - Connected = necessary/advantageous for a person to hold a proportionate part of the shares because of the rights attached to the securities or shares
    - Funded = holder put in funds by the issuing company or an associate (75% group companies) of the issuer

As a result of the above, small companies receiving dividends (whether from UK or foreign payers) are likely to be taxable on them where

1. They are received from dual-resident payers

2. The payers are denied benefits under the terms of a DTA

   – E.g. a company established under Luxembourg 1929 Act – even though the UK-Lux DTA has a non-discrimination article

3. Dividends are received from Channel Islands companies

Large company exemption

Dividends received by large companies will be exempt if:

1. The dividend falls into an exempt class (see below);

2. The dividend does not fall within CTA 2010 s 1000(1) para E or F; and

3. No deduction is allowed to any resident of a non-UK territory under the laws of that territory in respect of the dividend.

There is no ‘payer residence in qualifying territory’ requirement, so dividends received from Channel Islands companies would be exempt if meeting the 3 conditions above.

There is also no general disapplication if the dividend is received as part of a tax advantage scheme.

Exempt classes

1. From controlled companies (defined per UK CFC rules)

2. On non-redeemable ordinary shares

3. From portfolio holdings (broadly own < 10% interest in share capital, assets and profits);

4. Out of profits available for distribution that do not result from transactions, the effect and a main purpose of which is to achieve a more than negligible UK tax reduction; and

5. On shares accounted for as liabilities and taxable as loan relationships

Dividends received in most commercial arrangements will usually fall within an exempt class.

Election to tax

The dividend exemption may have unintended adverse consequences, particularly for groups. An exemption may restrict access to reduced withholding tax rates on dividends under a DTT if the rates are conditioned on a ‘subject to tax’ requirement (e.g. UK-Russia DTT)

Depending on factors such as foreign tax rates and UK rate, may be more efficient overall to incur UK CT (at 19%) on the dividend than be subject to WHT at rates exceeding 19%.

An election must be made within 2 years of end of the chargeable accounting period when the dividend was received.

Contributed by Malcolm Greenbaum

New R&D claim requirement

From 1 April 2021, in addition to the existing R&D entries in the CT return, a supplementary page, the CT600L, will also be required by:

- Large companies claiming Research and Development expenditure credit (RDEC);
- Small or medium-sized enterprises (SME) who have been subcontracted to do R&D work by a large company or have received a grant or subsidy for a R&D project and want to make an RDEC claim;
- SMEs claiming R&D tax relief for SMEs.

The ATT has provided a link to a draft copy and current guidance provided by HMRC.

https://www.att.org.uk/sites/default/files/CT600L%202021%20v0.8.pdf

https://www.att.org.uk/sites/default/files/CT600L_Guide.pdf

Corporate interest restriction – Part 2 (Lecture B1237 – 27.01 minutes)

Meaning of worldwide-group

The ultimate parent company ("Topco") and its consolidated subsidiaries make up the worldwide group. If there are no consolidated subsidiaries, then the company itself will be considered to be a worldwide group.

Subsidiaries are those defined by IFRS. This is based on the concept of control. IFRS 10 has an exception for investment entities owned by a parent. The parent can choose to fair value the investment entity rather than consolidating it.

If it takes advantage of this exemption, the investment entity will not form part of the worldwide group for this purpose.

Companies which are excluded from consolidation for other reasons (e.g. materiality, held for sale) are considered to be a consolidated subsidiary for CIR purposes.

The law also considers 'stapled' entities to be part of the same group. This is where investors acquire stock in two or more separate companies at the same time where the two companies are interdependent (e.g. an SPV and a management company running the SPV).

Aggregate net-tax interest expense

Net tax-interest expense amount of each company in the group minus net tax-interest income amount of each company in the group.

This consists of

- Relevant loan relationship debits and credits;
- Relevant derivative contracts debits and credits (those linked to interest rates, income or price indices, currency or corporate debt);
- Implicit finance costs/income in amounts payable under a relevant arrangement or transaction (lease interest expense, debt factoring charges, service concession arrangements where a financial liability is recognised under IFRIC 12);
- Consideration received for provision of a guarantee'.

Exchange gains and losses included in interest expense or income are ignored.

Impairment losses and reversals are also ignored

Impact of DTR on interest income - Example

A Ltd earns interest of £10m in a foreign country with tax of £1.2m levied on this by the tax authorities there in the year ended 31 March 2020.

A Ltd pays UK corporation tax at 19% but a credit for the foreign tax of £1.2m is given.

The notional untaxed income amount will be £6.3m.

This is arrived at by dividing the double tax credit (£1.2m) by the rate of corporation tax payable (19%) giving £6.3m which is the amount of the interest effectively not being taxed in the UK at 19%.

The interest income to include in the calculation of aggregate net tax-interest expense is therefore (£10m - £6.3m) £3.7m.

Capitalised interest

Net group-interest expense does not include amounts of capitalised interest and other financing amounts at the time they are capitalised in an asset or liability, because the calculation is based on amounts recognised in profit or loss.

There are special rules to deal with capitalised interest and other financing amounts that are subsequently recognised in profit or loss, for example by way of depreciation or part of a cost of sale of an asset.

But, so long as the asset is not a relevant asset (i.e. not plant, property and equipment, an investment property, an intangible asset, goodwill, shares in a company, nor an interest in an entity which entitles the holder to a share of the profits of the entity) an amount will be included in net group-interest expense in a period if it is:

1) recognised as an item of profit or loss in the group's financial statements; and

2) as a result of writing down the carrying value of the asset; and

3) relates to interest expense that had been capitalised.

Interest capitalised on property, plant and equipment (which is required by FRS 101/IFRS and US GAAP) would be expensed as part of the depreciation charge and, as such, would fall to be excluded from net group-interest expense.

When interest capitalised into inventory, this creates an issue. Inventory is not a 'relevant asset' and the capitalised interest is charged to P&L when the inventory is sold as part of EBITDA. In this case, NGIE is increased by capitalised interest which is subsequently charged as part of EBITDA.

Preference dividends payable and receivable

Because net group-interest expense is based on the financial statement, preference dividends payable and receivable which are treated as interest for accounting purposes are included in the figure.

Adjusted net group-interest expense ("ANGIE")

This takes the amount of net total group-interest and makes certain adjustments.

ANGIE is the absolute limit that is used for the fixed ratio debt cap as part of the fixed ratio method.

ANGIE is the net group-interest expense plus

- Capitalised interest in the period, minus
- Capitalised interest from previous periods, expensed as part of NGIE this period (rare), minus
- Preference dividends payable where the preference shares are recognised as a liability

Capitalised interest election

Groups can make an election to calculate ANGIE on a different basis which is more closely aligned to the UK tax treatment of capitalised interest.

Capitalised interest included in assets which are taxed according to their accounting treatment in accordance with qualifying GAAP (IFRS/FRS 101 and FRS 102) would be treated differently under the election.

This will therefore principally affect intangible fixed assets and inventory.

Example – capitalisation of interest into a tangible fixed asset

ABC plc prepares accounts to 31 December each year. It builds a factory for £40m as new premises for its trade.

It capitalises interest of £4m incurred during the year ended 31 December 2020 during the construction of the factory, increasing the cost to £44m.

The factory is completed on 2 January 2021 and is subsequently depreciated over 10 years on a straight-line basis.

The company has relevant interest expense amounts of £100m each year on other loans.

Solution

The £4m capitalised is not included in profit or loss for 2020, and so is not included in NGIE.

Depreciation expense for the following year will include (£4m ÷ 10) £400,000 of interest, so does not feature in NGIE either (as it is not presented as an interest item).

In calculating ANGIE, £4m is added to the NGIE giving a total of £104m in 2020.

No other adjustments are made to ANGIE in the future for this.

The outcome would not be affected by any election.

Example – capitalisation of interest into inventory

XYZ plc is a property development company with a December year end.

In 2020 the company builds a new development property as part of its trading stock.

The actual construction cost of the building is £100m, and the associated interest that is capitalised is £10m.

In 2021, the company manages to sell the property for £150m.

There are relevant interest expense amounts of £100m each year on other loans.

Solution

In 2020 the interest of £10m is capitalised so does not form part of NGIE.

In calculating ANGIE we add the interest capitalised in the period so NGIE is £100m, and ANGIE is £110m.

In 2021, the interest is recognised in profit or loss as part of the inventory cost (as part of accounting EBITDA).

As inventory is not a relevant asset for capitalised interest, the £10m interest is added to NGIE in 2021 (and excluded from tax-EBITDA for consistency), so that:

- NGIE is £110m, and
- ANGIE is £100m

If a ‘capitalised interest election’ was made, the tax treatment would follow the accounts treatment.

No adjustment would be made to ANGIE in 2020 and both NGIE and ANGIE would be £100m. Instead, the interest element of £10m is added to NGIE in 2021 when it is charged to profit or loss and is therefore included as part of ANGIE in 2021:

- NGIE is £110m
- ANGIE is £110m

Qualifying net group-interest expense (“QNGIE”)

This restricts the ANGIE by excluding certain amounts.

QNGIE is used in the numerator in the calculation of the group ratio percentage as part of the group ratio method. It is also the absolute limit that is used for the group ratio debt cap as part of the group ratio method.

Certain elections can be made to modify the calculations which will be discussed below.

The starting point for calculating QNGIE is the ANGIE. This is principally adjusted to exclude amounts where the loans or other financial liabilities owed to a related party.

Related party interest

Although, in general, a debt that is subject to a guarantee, indemnity or other form of financial assistance from a related party will be a treated as related party debt, this is subject to a number of exclusions.

For example, a debt will not be regarded as related party debt for the purposes of the group ratio method where the financial assistance:

- existed before 1 April 2017;
- is provided by another member of the group;
- simply pledges shares or loans in the group; or
- is a performance guarantee.

This is excluded from the calculation of QNGIE (used in the group ratio calculation) but not ANGIE (used in the fixed ratio calculation).

The general rule is that a person A will be related to person B on a particular day where any one of the following conditions is met:

The consolidated condition

- The results of A and B are, or are required to be consolidated, or would be but for an exemption from consolidation

The participation condition

- Either A or B directly or indirectly participates in the management, control or capital of the other, or
- The same person or persons directly or indirectly participates in the management, control or capital of both A and B.
- Based on definitions used for transfer pricing
- If the condition is met, it lasts for 6 months after it ceases to apply

The 25% investment condition

- Either A or B has a 25% investment (including connected parties, and parties acting together) in the other, or
- A third person has a 25% investment in both A and B
- 25% of voting power, entitlement to disposal proceeds, income from a distribution, or assets from a winding up

The following would all be considered to be related party financial liabilities:

- liabilities guaranteed by a related party;
- liabilities where a related party indirectly stands as a creditor;
- liabilities held in the same proportion as equity.

The following are excluded from the related party interest rules:

- loans where more than 50% is held by unrelated parties;
- loans following a corporate rescue;
- ordinary independent financing arrangements by banks and others;
- loans made by relevant public bodies;
- finance leases granted before 1 April 2017.

Sometimes the inclusions and exclusions can overlap. In most cases, the exclusions take priority.

Example 1

A parent company has ten shareholders, each holding a 10% interest. The company has issued debt of £100 million, of which each investor holds £1 million in proportion to their shareholdings.

The remainder of the £90 million debt is held by third party lenders. The debt held by the shareholders carries exactly the same rights as the debt held by the third-party lenders.

In this case, all of the debt is treated as unrelated debt. The exclusion for loans where more than 50% is held by unrelated parties has priority over the inclusion for loans held in the same proportion as equity.

Example 2

A Ltd borrows £20 million from Y Ltd and £80 million from Z Ltd on the same terms.

G Ltd provides a guarantee for all of A Ltd.'s liability.

Assume that Y Ltd and G Ltd are both related parties of A Ltd under the general participation condition whereas Z Ltd is not related to A Ltd under any of the general rules.

Section 466 (liabilities guaranteed by a related party) and section 468 (loans where at least 50% is held by unrelated parties) are both in point.

Under the priority rule, section 468 could potentially take priority over section 466 so that the loan from Y Ltd to A Ltd would be treated as if it were not between related parties.

However, the first step in applying these rules is to apply section 466 to the loan from Z Ltd to A Ltd.

Because of the guarantee provided by G Ltd this is treated as if it were a related party loan. In particular, this loan is treated as if between related parties.

Aggregate UK Tax-EBIDTA

This is the total of tax adjusted-EBITDA of each company that was a member of the group at any point in the period of account, so adjustments may be needed where companies join and leave the group during the relevant period.

Tax-EBITDA can be negative for some companies, but if the aggregate tax-EBITDA is negative, it is taken to be zero.

In arriving at the figure, make the normal tax adjustments (e.g. for disallowed expenses such as entertainment, capital expenditure included in P&L etc.)

Add back depreciation (as this is not part of EBIDTA) but do NOT deduct capital allowances/ balancing charges.

Ignore intangible fixed asset debits and credits.

Capital gains are included net of capital losses (even losses brought forward from an earlier period).

Exclude losses from different accounting periods and other group company losses.

Ignore abnormal pension contributions that are required to be spread for tax purposes, to the extent they will be tax deductible in other periods.

Ignore the effects of certain tax reliefs (e.g. R&D enhancement and RDECs, patent box adjustments, cultural reliefs, corporate gift aid payments).

For example, if the company spends £1,000,000 on qualifying R&D and is entitled to claim RDEC it will have a tax credit (using the current rate of 13%) of £130,000. This is included in the company's accounting EBITDA, but we must reduce tax-EBITDA by £130,000 to exclude it.

Any income included in accounting EBITDA that has an available double tax credit should be adjusted for by calculating how much of that income is effectively exempted from UK corporation tax.

As seen in a similar example earlier, we gross up the foreign tax credit by the UK tax rate and exclude this income from tax-EBITDA.

Example

£100,000 foreign tax has been suffered on income included in EBITDA of £1,000,000 and is available for tax credit against the company's corporation tax liability in full.

The £100,000 represents corporation tax at 19% on profits of £526,316, in other words it is equivalent to £526,316 of the EBITDA being completely tax exempt.

Therefore £526,316 of income is deducted in arriving at tax-EBITDA.

Worldwide Group EBITDA

Group EBITDA is used in the calculation of group ratio method (denominator in calculation group ratio percentage).

Take group profit before tax, add back:

1) depreciation and amortisation (including any capital items expensed in profit or loss and any impairment losses and reversals, but do not add back depreciation on finance lease assets); and

2) net-group interest expense.

It is an accounting figure, generally deriving from the worldwide consolidated financial statements.

The following items are excluded from group-EBITDA:

1) Fair value movements on derivatives used for hedging purposes (to the extent that the hedged items have not affected profit or loss before tax)

2) R&D Expenditure credit (as seen above, this will have increased accounting profits before tax, so the adjustment is to reduce the group-EBITDA by the tax credits for the period)

3) Fair value movements on revaluation of relevant assets (property, primarily)

4) Grant income in profit or loss that funds capital expenditure

Capital disposal adjustment

A capital disposal adjustment is also required, adding back (or deducting) a loss (or profit) on disposal, and replacing it with the increase or decrease between the original cost and the sale proceeds.

Example 1

A group's financial statements show an asset at a cost of £10 million and a net book value of £6 million at the start of the period.

During the period the machine is sold for £7.5 million, giving a profit of £1.5 million.

The capital (disposals) adjustment will be (£1.5 million). This represents the removal of the profit on disposal recognised in the accounts.

There is no recalculated profit amount because the proceeds of £7.5 million are less than the original cost of £10 million.

Example 2

A group owns an investment property which is revalued each period through profit or loss. The original cost of the property was £9m.

Year ended 31 December 2019

At the start of the period the property is included in the group's financial statements at a value of £8 million.

During the period the group carried out a review of the property. They decide that due to deteriorating market conditions, the property should be revalued down to £5.5 million, an adjustment of £2.5m. A revaluation loss of £2.5m was expensed in calculating the group's profit before tax for the period.

The capital (fair value movement) adjustment in respect of the property will be (plus) £2.5 million.

Year ended 31 December 2020

During the period the market improves significantly, and the group disposes of the property for £7 million, recognising a profit on disposal of the asset of £1.5 million (7m – 5.5m).

The capital (disposals) adjustment in respect of the property will be:	£
Removal of profit on disposal in accounts	(1.5)m

Proceeds minus original cost (7 – 9) – a loss of	(2.0)m
	(3.5)m

Contributed by Malcolm Greenbaum

Central management and control – matter of fact

The *Development Securities* Court of Appeal case concerned the use of augmented capital losses, but the outcome was dependent on where certain Jersey incorporated companies were resident.

Lord Justice Newey neatly summed up the tax planning scheme that had been devised by PwC in 2004 as follows:

> "Development Securities plc ("DS plc") had a number of subsidiaries ("the L&R Companies") whose value was less than their acquisition cost while two other companies in the Development Securities group ("the Group") owned properties ("the Properties") which were not worth as much as had been spent on them. The Group wished to use the latent losses on the L&R Companies and Properties to offset gains elsewhere in the Group. Had, however, the L&R Companies and Properties simply been disposed of at their market value, the Group would not have had the benefit of the indexation relief that would have applied in the case of disposals at a profit, such relief being available to mitigate tax on gains but not to augment losses. The point of the PwC scheme was to enable the Group to take advantage of indexation relief.
>
> To achieve this, three companies, DS Jersey (No. 1) Limited ("DS1"), DS Jersey (No. 2) Limited ("DS2") and DS Jersey (No. 3) Limited ("DS3") (together "the Jersey companies") were incorporated in Jersey as subsidiaries of DS plc and granted call options entitling them to buy the L&R Companies and Properties if certain conditions were satisfied. The options were then exercised.
>
> As the First-tier Tribunal ("the FTT") explained in paragraph 6 of its decision, "the price payable by the Jersey companies on exercise of the option was an amount equal to the relevant [Group] company's historic base cost in the relevant asset for capital gains purposes (broadly, being the amount originally paid for the asset) plus indexation accrued to that time" so that "the price was considerably in excess of the then market value of the asset".
>
> The Jersey-based directors of the Jersey companies were then replaced by individuals who were resident in the UK, so that the companies would themselves be resident in the UK for tax purposes.
>
> Thereafter, the L&R Companies and Properties were transferred to other companies in the Group and steps were taken to crystallise the losses on them, the idea being that the losses should be calculated by reference to the sums which the Jersey companies had paid for them. The losses were treated as accruing to DS plc, where necessary by means of an election under section 179A of the Taxation of Chargeable Gains Act 1992 ("the TCGA"). That section allowed a loss to be treated as accruing to another company in the same group."

Crucial to the scheme's operation was that the companies were resident in Jersey from the date of their incorporation until 20 July 2004. The issue in dispute was whether the Jersey companies were UK tax resident in that period, as claimed by HMRC.

The First Tier Tribunal decided the companies were not resident in Jersey, but the Upper Tribunal overturned that decision, saying the central management and control was exercised in Jersey, so the companies were resident there. HMRC appealed to the Court of Appeal.

Decision

The Court of Appeal concluded that 'essentially' whether a company is resident is a question of fact. The 'overarching principle' was that a company is resident where its real business is carried out; it is the actual place of management that mattered.

The Court of Appeal concluded that the Upper Tribunal's analysis was not 'well founded' and did not recognise the significance of findings of fact which the lower tribunal had made.

In essence, the First Tier Tribunal had found, aside from reviewing the corporate law advice, there was 'no consideration or discussion on the merits (or otherwise) of the Jersey companies entering into the option arrangements whether from their own perspective or taking into account the wider benefit to the group'. The Jersey board administered a decision it was instructed to undertake by DS plc in checking the legality of the plan before handing over to the UK group.

It 'merely passed the formal relevant resolution for the Jersey companies to enter into the options and subsequently to exercise them on the basis of the instruction/certifications received without any engagement with the substantive decision albeit having checked … there was no legal bar to them carrying out the instruction'. Lord Justice Newey said it was clear that the First Tier Tribunal had decided that, while the Jersey directors knew, understood and considered the lawfulness of what they were doing, they had not engaged with the substantive decision. It was therefore not open to the Upper Tribunal to assert that the Jersey directors 'gave detailed consideration to the appropriateness of the scheme' and concluded that it was in the best interests of the shareholders and the Jersey companies.

HMRC's appeal was allowed.

CRC v Development Securities plc and others, Court of Appeal

Adapted from the case summary in Taxation (7 January 2021)

Transfer of assets between group members

Summary – The Upper Tribunal has requested a preliminary ruling from the CJEU in respect of two cross-border group gains transactions covering UK's 'group transfer rules' on intra-group disposals of assets under s 171 TCGA 1992 and, for intangible assets under s775/6 CTA 2009.

The appeals related to two disposals by a UK-resident company to members of its group in:

- 2011 - a disposal of some brands to a Swiss company;
- 2014 - a disposal of shares to the company's Dutch indirect parent company.

The group transfer rules provide that there is no immediate tax charge on an intra-group disposal, but only if the assets remain within the UK tax net. As the disposals were to a Swiss and a Dutch company, the reliefs were not available. Gallaher Limited argued that this was an unjustified restriction on the freedom of establishment and/or the free movement of capital, and that therefore the legislation imposing the tax charges should be disapplied.

2011 disposal - the First Tier Tribunal had rejected the company's argument that the Dutch parent company's freedom of establishment was restricted, because it would have been subject to the same provisions (regarding transfers to non-EU companies) even if it had been resident in the UK, and it was not possible to invoke the free movement of capital instead.

2014 disposal - the First Tier Tribunal found that the UK's rules were a restriction on the freedom of establishment, although the restriction would have been justified if the legislation had permitted the tax to be deferred. The First Tier Tribunal found that it could not adopt a conforming construction so as to read in a deferral option that did not appear in the legislation, and so considered that it had to disapply the provisions entirely.

Decision

The Upper Tribunal concluded that it should make a referral asking:

- whether the principle of free movement of capital can be relied upon in relation to legislation applicable to groups of companies;
- whether the freedom of establishment or to move capital can apply to a transfer of assets from an EU company to a non-EU company if both are owned by a third company resident in a different member state from the transferor; and
- if either freedom has been breached, whether domestic law should be construed as though the taxpayer had the right to defer payment of tax, even though the legislation did not contain this option.

Following the First tier Tribunal’s decision in this case, the disputed legislation was amended by FA 2020 for accounting periods ending on or after 10 October 2018. The amendments introduced an option for companies transferring assets to group companies within the EEA to pay any resulting corporation tax over five years. This was intended to make the rules EU-compliant, but it left open the issue of whether tax imposed under the previous rules could be reclaimed. The figures in this case make clear that there is a lot of money riding on the answer to this question (the consideration for the 2011 disposal alone was more than £2bn).

Gallaher Limited v HMRC [2020] UKUT 354 (TCC)

Adapted from the case summary in Tax Journal (8 January 2021)

VAT and Duties

CIS Domestic Reverse Charge Part 1 (Lecture B1238 – 19.11 minutes)

Introduction

From 1 March 2021, we have a domestic reverse charge (DRC) on the supply of specified building and construction services together with goods supplied with those services.

The DRC will affect standard and reduced rated supplies if payments are reported through the construction industry scheme (CIS). Whether the sub-contractor is a gross contractor, 20% contractor or 30% contractor is irrelevant – if they are subject to CIS reporting, the DRC needs to be considered.

If we have a CIS reportable service, the DRC will apply to supplies between VAT registered sub-contractors and VAT registered contractors - subject to a few exceptions.

Illustration

A VAT registered subcontractor invoices a VAT registered main contractor £10,000 on 31 March 2021 for commercial construction work. The invoice includes £7,000 CIS labour and £3,000 materials.

Under CIS, deductions will only apply to the £7,000 CIS labour but the DRC will apply to the total invoice where CIS labour is present.

The subcontractor must:

Raise as invoice for £10,000 (no VAT charged)

Include DRC narrative on their invoice such as "Reverse charge: Customer to pay the VAT to HMRC"

Make a Box 6 entry of £10,000 on their VAT return

The main contractor must make the following entries on their VAT return:

Box 1 £2,000,

Box 4 £2,000,

Box 7 £10,000

The Box 4 recovery may need to be adjusted if the main contractor is partially exempt. Most main contractors are however fully taxable so full Box 4 recovery is likely.

If the job is lower rated the Box 1 and 4 VAT would be £500 e.g. conversion work.

It is important that the DRC is applied to the invoice as any VAT charged will not be properly charged. Any customers paying VAT not properly charged will not be able to recover it as input tax. The main risk on the DRC is to the main contractor.

Software

Software packages such as Xero can deal with the DRC invoicing and accounting requirements.

In Xero you simply click on "Advanced" in the Accounting menu and then click on "Tax rates". You can then add "Domestic Reverse Charge Tax Rates" to your software.

The next time you raise a sales invoice you will see two new options:

Domestic reverse charge @ 20%

Domestic reverse charge @ 5%

You simply select the rate that is applicable to the supply in question. This can even be pre-populated if you set up the nominal code as a domestic reverse charge service. You will need two nominal codes if you provide 20% and 5% services for the pre-population option.

The same options will also appear when entering a purchase invoice which is subject to the DRC.

If you identify the sales or purchase invoice as DRC when selecting the VAT rate, the software will deal with <u>all</u> the required VAT return entries. So Box 6 for the subcontractor when entering a sales invoice and Box 1, 4 and 7 for the main contractor when entering a purchase invoice.

The Xero sales invoices will show *"DRC @ 20% (VAT on income) narrative"* on each supply. It will also have the following DRC narrative on the bottom left of the invoice.

"Reverse charge applies to the items marked with Domestic Reverse Charge. Customers need to account for VAT on these items to HMRC at the rate shown".

Software such as QuickBooks and SAGE will have similar DRC functions.

Flat rate scheme

DRC supplies are excluded from flat rate scheme so it would be advisable to revert to normal VAT accounting so clients can recover input tax. If they stay in the flat rate their Box 1 will still be zero BUT they are restricted from claiming input tax as a flat rate trader. If they come out of the flat rate scheme from 1 March 2021 their Box 1 will still be zero BUT they will be able to recover their input tax on business costs in Box 4.

Cash flow impact

One of the most significant issues of the DRC is the cash flow implications for sub-contractors. Many sub-contractors rely on the fact that they collect the output tax but do not pay it over to HMRC until a month or so later. This is normally embedded in their business model and they rely on the VAT as a form of short-term funding.

From 1 March 2021 they will not be charging VAT so access to this short-term funding will disappear. Many sub-contractors are likely to struggle with this and early awareness and planning is essential. It should also be noted that many will have deferred their VAT

payments for their February, March or April 2020 VAT quarters and the deferred amounts will fall due on 31 March 2021 .

Many sub-contractors are likely to become repayment traders after 1 March 2021 and as such they could apply to move to monthly returns with a view to improving their cash flow.

Applications are normally accepted from the start of the month of application so an early March 2021 application would be sensible.

If they apply early March 2021 the subcontractor will have a one, two or three month VAT period to finish off their quarterly reporting cycle, depending on their VAT stagger. They will then have monthly returns and repayments from 1 March 2021.

Labour only subcontractors will not benefit significantly from monthly returns so may choose to remain quarterly.

If the clients have reasonable records monthly returns will not be overly onerous and the cash flow advantage will be significant for some. It could be yet another reason for the subcontractor to start using cloud based software such as Xero, QuickBooks or SAGE. This software will deal with their MTD and DRC reporting and will facilitate the submission of monthly VAT returns.

Preparing for the domestic reverse charge

In the lead up to the introduction of the DRC, accountants and their clients need to:

- Understand which sales and/or purchases are within the DRC provisions
- Check that the client's accounting systems can deal with the DRC
- Ensure that the staff dealing with the accounting are properly trained
- Recognise the impact the DRC has on cash flow

If we can get on top of all four then the client will be well placed when the DRC is introduced in March 2021.

Services affected by the domestic reverse charge

The DRC covers specified supplies.

Specified supplies will be 20% and 5% building and construction services reported under the CIS. The DRC will cover services <u>and</u> materials provided with those services.

The DRC will therefore apply to subcontractors working for main contractors on commercial projects, construction of relevant residential or relevant charitable and domestic extensions or renovations. These are all currently 20% jobs for the subcontractor.

The DRC will also extend to subcontractors working for main contractors on the conversion of commercial properties to residential or converting houses into flats. These are currently 5% jobs for the subcontractor.

The DRC will <u>not</u> apply to zero rated services such as the construction of new dwellings.

The construction industry scheme

The DRC covers specified supplies reported under CIS – subject to a few exceptions. It is therefore important to understand which supplies are within the CIS from a direct tax perspective.

The CIS only applies to contractors.

A contractor is either:

Persons carrying on a business which includes construction operations, or

Other persons spending > £1m pa on construction operations

So what about a property investment company that buys, renovates, lets? This is the normal activities of a property investor so they will not be within CIS unless they spend >£1m pa on construction operations.

Same with retailers who will only be within CIS if they spend more than £1m pa on construction operations for their own retail units.

It should be noted that just because something is within CIS from a direct tax perspective it does not automatically mean they are within the DRC. There are exceptions for end-users under the DRC (see below).

Construction operations

Construction operations has a wide definition under CIS and includes:

- Construction, alteration, repair, extension, demolition or dismantling of buildings;
- The installation of heating, lighting, air-conditioning, power supply, drainage or sanitation systems; and
- Cleaning, painting, decorating and other operations integral to the construction process (such as excavation and site-preparation)

Professional work is exempt (architects, engineers) from CIS and consequently exempt from the DRC.

It should also be noted that CIS does not apply to individuals engaging subcontractors for work on their home.

Sub-contractors

Subcontractors are those carrying on construction operations for a contractor or those furnishing own labour or the labour of others in carrying out construction operations.

They could be sole traders, partnerships or companies.

Where a sole trader works exclusively for contractor there is a danger they may be regarded as an employee. In this case PAYE applies rather than CIS and the DRC. Contractors must declare on their monthly CIS return that their workers are not employees.

Mixed invoices

If any of the services on the invoice are subject to the DRC then the whole invoice will be subject to the DRC. This will include materials and non-CIS services.

Furthermore, if the contract has invoices which are subject to DRC the parties can agree that all subsequent invoices are subject to DRC even if they would not qualify in their own right. This is an administrative easement as HMRC appreciate that some contracts will have mixed supplies i.e. some within the DRC and some outside of the DRC.

HMRC guidance suggests that if you are ever in doubt you should always apply the DRC to construction services supplied to VAT registered businesses.

Contributed by Dean Wootten, Wootten Consultants

CIS Domestic Reverse Charge – Part 2 (Lecture B1239 – 12.02 minutes)

End user exception

The DRC will not apply when providing specified services to end-users (or intermediaries connected with end-users) where the end user confirms their status in writing.

End users are consumers or final customers of building and construction services. Essentially businesses that do not make onward supplies of construction services.

Property developers are end users as they intend to sell completed properties rather than make an onward supply of construction services.

The end user may be registered for CIS as a mainstream or deemed contractor BUT they are excepted from the DRC if they want to be. Many will want the DRC to apply for the cash flow benefits and will not confirm their status in writing. As such the DRC will apply.

Where an end user wants to confirm their status, HMRC guidance suggests something like:

"We are an end user for the purposes of section 55A VATA 1994 reverse charge for building and construction services. Please issue us with a normal VAT invoice, with VAT charged at the appropriate rate. We will not account for the reverse charge"

Examples of end users would include deemed contractors under the £1m rule such as:

Retailers,

Manufacturing businesses,

Utility companies,

Property investment companies

Property rental companies

End users would also cover property developers unless they are making onward supplies of construction services. If they are simply selling the completed or converted property, they are an end user and where they confirm their status the DRC will not be in point. Most developers would prefer the cash flow advantage of the DRC and will not confirm their end user status.

Checking VAT and CIS status

Under the DRC the customer must be VAT and CIS registered. It would therefore be prudent for the subcontractor to check the VAT and CIS status of any new customer once the DRC comes into force.

VAT status

Where the customer is not an end user the supplier should obtain and verify the customers VAT number. This can be done via www.gov.uk/check-uk-vat-number.

It would be advisable to keep evidence of the check but there is no need to include customer VAT number on the DRC invoice.

CIS status

If there is an existing CIS contract at 1 March 2021 there is no need to verify CIS status again.

New contracts commencing on or after 1 March 2021 should be validated using the free HMRC CIS online service or commercial software.

In some cases, status may change during a contract e.g. a property developer selling a partly completed property and then supplying construction services to the buyer. The property developer was an end user pre -ale but post sale they are not. In this case the developer should notify their supplier that they are no longer an end user. The DRC will apply at the point the developer's circumstances change.

If an invoice straddles end user status the supplier can apply DRC to all of the invoice or to none of it. The DRC must however be applied to any subsequent invoices.

Tax points

The tax point will determine whether the subcontractor charges VAT or whether they apply the DRC. There is no requirement apportion invoices around the 1 March 2021.

Building services are typically a continuous supply of services and as such the tax point is the earlier of:

Invoice date, or

Payment

If this falls before 1 March 2021 the supplier will charge VAT. Likewise if the tax point falls on or after 1 March 2021 the DRC will be in point.

For single payment contracts the basic tax point is the date the service is performed but this could be earlier if invoiced or paid. If not earlier then it could be later when invoiced < 14

days. Again, the tax point will determine whether the supplier charges VAT or applies the DRC.

Authenticated tax receipts and self-billed invoices

Authenticated receipts are used in the construction industry in place of VAT invoices for supplies of services, or of goods and services, made under contracts that provide for periodic payments to be made. This procedure is provided for by the VAT Regulations 1995, regulation 13(4).

This allows a supplier to authenticate a receipt for payment issued by the customer instead of issuing a normal VAT invoice, on condition that:

- the receipt contains all the particulars required on a VAT invoice
- no VAT invoice or similar document is issued

Self-billing is an arrangement between a supplier and a customer. Both customer and supplier must be VAT registered. The customer prepares the supplier's invoice and forwards a copy to the supplier with the payment.

The tax point for authenticated receipts and self-billing is normally the date the supplier receives payment.

Transitional rules apply where payments due are entered onto the accounting system pre 1 March 2021 but are paid on or after 1 March 2021.

If entered in accounting system before 1 March 2021:

paid on or before 31 May 2021 = normal VAT rules

paid on or after 1 June 2021 = DRC

If entered in accounting system on or after 1 March 2021 and paid on or after 1 March 2021 the DRC applies

Cash accounting

Cash accounting cannot be used for supplies subject to the DRC. Taxpayers can however use cash accounting for the remainder of their activities.

This is not expected to be a major complication as suppliers are not charging VAT under the DRC so these should move to invoice accounting anyways. Invoice accounting will accelerate their recovery of input VAT which will improve their cash flow.

From a customer perspective they will put the output VAT and input VAT recovery on the same return, so they are not disadvantaged.

If the customer is partially exempt, they will need to be careful with the tax point as there is a tax loss if they put it on a later VAT return and penalties are a risk. The tax loss (potential lost revenue) is only 5% pa so penalties on the 5% are normally very low. In the early days of the DRC HMRC are adopting a light touch on penalties in any event.

There is a timing impact for Box 6 for the supplier and Box 7 for the customer but there are no penalties for incorrect Boxes 6 and 7 if tax point errors arise.

Invoices

When supplying a DRC service the invoice must show all the information required on a VAT invoice.

Additionally, there must be a note on the invoice to make it clear that the domestic reverse charge applies and the customer is required to account for VAT. HMRC guidance suggests something like:

Reverse charge: VAT Act 1994 Section 55A applies

Reverse charge: S.55A VATA 1994 applies

Reverse charge: Customer to pay the VAT to HMRC

The invoice must also clearly state how much VAT is due under the DRC or the rate of VAT on the DRC where this is not possible. The invoice generated by Xero will just show the DRC rate rather than quantify the VAT.

Authenticated tax receipt and self-billing invoices

Authenticated tax receipts or self-billing invoices issued by the customer must:

- Show the suppliers name, address and VAT number
- Clearly mark the self-billed invoice with the reference self-billing
- Clearly state the amount of VAT due under the DRC or the rate of VAT under the DRC
- Clearly state that the DRC is in point. For example:
    - Reverse charge: we will account for and pay the output VAT to HMRC
    - Reverse charge: as the UK customer we will pay the VAT due to HMRC

Credit notes

If a supplier issues a credit to a customer who can reclaim all the tax on their supply, they do not have to adjust the original VAT charge as long as both parties agree. So a credit note for £3,000 (net) with no mention of VAT on the credit note would suffice.

The same can apply to any credit note under the DRC.

However, if the parties do not agree or the customer is partially exempt VAT adjustments are required.

Suppliers

Suppliers must issue a credit note to the customer with a note on it to show that the DRC applies and showing the reduction in the VAT the customer has to pay to HMRC.

HMRC suggested narrative is:

> Reverse charge: customer to account for the output tax adjustment of £x to HMRC
>
> Reverse charge: UK customer to account for the output tax adjustment of £x to HMRC
>
> Customer to account to HMRC for the adjustment to reverse charge output tax on the VAT exclusive price of items marked reverse charge

The supplier would need to reduce Box 6 in the period the credit note is issued.

Customers

Customers would need to adjust output tax in Box 1 and their input tax in in Box 4. The Box 4 recovery would be subject to any partial exemption adjustments.

The customer would also need to adjust the net value in Box 7.

Authenticated receipts or self-billing

The same process applies for supplier and customer under authenticated receipts or self-billing but the customer will be raising the credit note.

Contributed by Dean Wootten, Wootten Consultants

Freshers' events

Summary – A students' union failed to convince the First Tier Tribunal that freshers' events organised by them were exempt activities.

Leeds Beckett Students' Union ran a freshers' programme of events for new students including, as stated in their welcome flyer, "food and freebies galore, parties, gigs … and so much more". Further down in the flyer, they advertised that students could buy a fresher's wristband that entitled them to entry to all 4 official events (including the Freshers' ball), 25% off at both City and Headingly Bars between 10am - 4pm, during the Fresher's programme and a discounted NUS Extra card.

At the bottom of the document, in much smaller text, is stated:

> "Leeds Beckett Students Union is a charity and Freshers' events are organised in order to raise funds for our charitable purposes. All events are free unless otherwise stated."

Leeds Beckett Students' Union identified two of the four official events as fund-raising events with the Union claiming that:

- the income from these events was VAT exempt under Item 1, Group 12, Schedule 9 VATA 1994; or
- the ticket element of the income was exempt under Item 6, Group 6, Schedule 9 as the Union was a youth club providing facilities to its members.

HMRC refused the exemption and Students' Union appealed.

Decision

In order to be an exempt activity, the income received from a fundraising event organised by a charity or not-for-profit body must satisfy certain conditions. A key condition is that its primary purpose must be to raise funds and it must also be promoted as such a fundraiser.

The First Tier Tribunal concluded that no internal documentation had been produced explaining why only two of the four events were organised with the primary purpose of raising funds. This was not indicated on the flyer, in documents supplied to HMRC or explained in the witness statement on appeal. In fact, there was insufficient evidence to conclude, on the balance of probabilities, that any of the events organised by the Union were events organised with the primary purpose of fund-raising rather than with the primary purpose of providing events to welcome new students. The Tribunal stated that the onus was on the Students' Union to demonstrate that fundraising events took place and they had failed to do so. The events were not exempt fund-raising events within Group 12.

The Students' Union final ground of appeal was that the ticket income was exempt under item 6, Group 6, Schedule 9, VATA 1994 as it falls within the definition of a youth club, and the provision of facilities to its members includes the access to the venue for payment of a ticket.

To qualify as a youth club, one of the conditions is that its members must be mainly under 21 years of age. The Tribunal stated that there was no evidence before them to demonstrate that the members were mainly under 21 years of age. The Articles of Association made no reference to age and no statistical evidence was provided.

The appeal was dismissed.

Leeds Beckett Students' Union v HMRC (TC07907)

Buying residential property

Summary – The purchase of a residential flats should never have been standard rated and, even if it was, there was no valid VAT invoice to support the input tax claim.

In August 2016 Kang and Mand Limited bought a former public house, that had already been converted into residential flats for £315,000. The seller charged VAT at the standard rate of £63,000, which Kang and Mand Limited paid on completion and then claimed input tax in its September 2016 VAT return.

Unsurprisingly, HMRC disallowed the full claim on the basis that the sale of a residential dwelling is:

- exempt from VAT; or
- zero rated if it was a new build or converted from non-residential to residential.

Further, the seller had not issued a VAT invoice, which would be needed for a valid claim to be made.

Decision

At the hearing it was accepted that the VAT had been incorrectly charged. The company's accountant asked for an adjournment so that the incorrectly paid VAT could be recovered from the seller, repaid to HMRC and the appeal formally withdrawn.

However, nothing further was heard from the company or their accountant and the case was dismissed.

Kang and Mand Limited (TC07945)

Holding company and contingent consideration

Summary – A holding company was making supplies for consideration engaging in an economic activity. Consequently, the company was entitled to recover input VAT on its costs.

Bluejay Mining plc is a UK incorporated holding company that operates in the mineral exploration and mining industry.

The group acquires licences, held by local subsidiaries, to explore for minerals and then undertakes the work required to prepare for extracting those minerals. Bluejay Mining plc investigates whether or not the project might be commercially viable. Having done this, the company provides the advisory, consulting, marketing, accounting, financial services and technological support and development services needed for the successful delivery of a mineral resource by the subsidiary.

Further, to enable the subsidiary to pay for these services, Bluejay Mining plc loans funds to the local subsidiary. If and when the project is successful or the licences and relevant assets are sold to another company which is willing and able to take the project to exploitation, the intra-company debt is repaid.

The service agreements between Bluejay Mining plc and its subsidiaries stated that Bluejay Mining plc shall be paid for the services by the subsidiary at a fee equal to 115% of the costs and expenses incurred by the company, including an appropriate proportion of any overheads incurred by the company. Bluejay Mining plc would invoice the subsidiary on a quarterly basis and the subsidiary would pay the invoice within 30 days of the invoice being served.

Separate loan agreements stated that the loan is of an amount up to €10,000,000, that may be drawn down in instalments and on such dates as agreed in writing between the company and the subsidiary. These loans were described in the company's accounts as being repayable "when sufficient cash resources were available in the subsidiaries".

HMRC contended that the separate service and loan agreements should be treated as one agreement. Under that agreement, contingent consideration was to be paid to Bluejay Mining plc when a project was successful and only if it was successful.

Further, HMRC argued that the purpose of the provision of the services is not to generate income on a continuing basis but is to enhance the value of its investment in the subsidiary, and, as such, does not amount to an economic activity.

Decision

In order to be able to claim input tax in relation to supplies of the services to the subsidiaries, Bluejay Mining plc needed to be able to show that those services were supplied in return for a consideration and provided for the purpose of generating income on a continuing basis from the provision of those services, i.e., that it is carrying on an economic activity.

The First Tier Tribunal concluded that:

> "Bluejay was providing services to its subsidiaries for a specified consideration of 115% of the cost of providing those services.
>
> The loan agreements and service contracts were two separate contracts and therefore payment of the invoices for those services was not contingent on the successful outcome of the projects. The invoices should be considered to have been paid when they were added to the loan account.
>
> Even if the invoice payments were contingent on the successful outcome of the projects, on the basis that the loan agreements and the services contracts should be treated as single documents, then the fact that the payments were contingent on the successful outcome of the projects does not mean that the services were not provided for consideration.
>
> Bluejay was carrying on an economic activity when supplying technical services to its subsidiaries."

The appeal was allowed.

Tax Journal (4 December 2020) reported:

> "The decision contradicts HMRC's published position on contingent consideration and holding companies. In HMRC's VAT Input Tax Manual at VIT40600 (citing Norseman), HMRC states that where 'a holding company incurs input tax on costs in providing or intending to provide management services to subsidiaries on terms whereby any payment will be contingent upon the profitability of those subsidiaries, then the holding company is not engaged in economic activity. This is because where services are supplied for no consideration or there is no contractual expectation that consideration will be received there is no supply for VAT purposes.' However, the FTT here clearly indicated that even had payment been contingent, services would still be supplied for consideration. It remains to be seen if HMRC will appeal, but holding companies denied VAT recovery in similar circumstances may wish to consider their options."

Bluejay Mining plc v HMRC (TC07947)

R&C Brief 21(2020)

This brief confirms the withdrawal of the VAT Retail Export Scheme and the tax-free shopping concession from 31 December 2020.

Tax free shopping concession

ESC 9.1 that allows retailers of goods sold in ports and airports to zero rate sales to passengers departing for non-EU destinations is withdrawn with effect from 1 January 2021 throughout the UK.

Retail export scheme

Purchases made in Great Britain using the VAT retail export scheme on or before 31 December 2020 remain eligible for a refund under the terms and conditions that applied when the item was bought. Visitors should continue to lodge their claims for these purchases when they leave the EU.

The scheme will continue to be available in Northern Ireland with some special rules for goods purchased in Northern Ireland that are taken to Great Britain and some additional records that will need to be kept.

https://www.gov.uk/government/publications/revenue-and-customs-brief-21-2020-withdrawal-of-the-vat-retail-export-scheme-and-the-tax-free-shopping-concession

Duty guarantee waiver

Where businesses establish a Duty Deferment Account, they can delay paying most of their customs or tax charges when importing goods or releasing goods from an excise warehouse. A Duty Deferment Account allows the UK importer (or their agent) to make one payment a month via Direct Debit instead of paying for individual consignments.

As part of the application process traders can apply for a guarantee waiver to avoid the need to get a financial guarantee. Where a trader has already applied for a duty deferment account, they can apply to amend their account.

Who can apply?

Businesses established in the UK can apply for a waiver provided that they have:

- no serious or repeated infringements of customs or tax rules in the past 3 years;
- no record of serious criminal offences related to their business activities in the past 3 years;
- had held positive net assets (excluding goodwill) for the past 3 years or, shorter, if trading for a shorter period.

Types of guarantee waiver

There are two types of guarantee waiver approvals to defer customs duty, import VAT and excise up to:

1. £10,000 per month
2. a specified amount over £10,000 per month

Change of circumstances

If a business has a change in circumstances such that it ceases to be eligible for their guarantee waiver, it must notify HMRC and provide a guarantee for their duty deferment account or apply to close it

https://www.gov.uk/guidance/check-if-you-can-get-a-guarantee-waiver-for-a-duty-deferment-account-in-great-britain

Rules of origin post Brexit (Lecture B1240 – 23.35 minutes)

Introduction

Up to 31 December 2020, UK businesses could trade with the EU tariff free without the need for Customs Declarations or meeting rules of origin. From 1 January 2021 our trading with the EU is based on a new Free Trade Agreement (FTA) - the Trade and Cooperation Agreement (TCA). However, to continue with tariff free trading under this agreement, we must meet the new UK-EU preferential rules of origin, backed up by supporting documentation.

New rules of origin

The rules determine the origin of goods based on where the products or materials used in their production come from. The purpose of these rules is to ensure that preferential tariffs are only given to goods that originate in the UK or the EU.

Goods that do not meet the UK origin rules will have duty applied, which means that goods imported from China and then exported to Ireland, for example, are unlikely to meet the UK origin rules, unless they meet product specific rules of origin.

TCA Rules of origin

The rules are in split in to two parts:

1. General Provisions that apply to all products being traded under preference;
2. Product-specific rules of origin (PSRs), with specific rules for every product based on their Harmonized System (HS) code

ANNEX ORIG-2 of the TCA contains 97 Chapters that stipulate the PSRs for each HS code.

Originating products

There are two ways in which a product can be considered originating:

1. Wholly obtained, where the product is exclusively obtained or produced one country's territory, without using materials from any other country.

2. Substantially transformed in line with the relevant Product-specific rule (PSR) of which there are three types:

    - Value-added rule; or
    - Change of tariff classification; or
    - Manufactured from certain products or through specific processes.

ANNEX ORIG-2 of the TCA will specify which rule(s) must be met for each HS code, a copy of which can be found at: https://ec.europa.eu/info/sites/info/files/draft_eu-uk_trade_and_cooperation_agreement.pdf

HMRC has an online tool at https://www.gov.uk/trade-tariff that can be used to find commodity codes, duty and VAT rates.

Bilateral cumulation

Under bilateral cumulation EU materials used in UK production would be regarded as having UK origin and vice versa. So if an EU product is incorporated in the production of a further product in the UK, its full value is considered as UK originating when the final product is exported.

Bilateral cumulation will **not** apply if the EU product is only subject to simple operations in the UK. Article ORIG-7 of the TCA describes this as "insufficient production".

In this instance the final product could still qualify but the EU element would be regarded as non-originating and the product would need to meet the PSR rules from there.

Insufficient Production

The exporter may only apply cumulation where the work or processing carried out in their country has gone beyond the operations regarded as insufficient.

Article ORIG 7 Insufficient Production states:

> Notwithstanding the General requirements a product shall not be considered as originating in a Party if the production of the product in a Party consists only of one or more of the following operations conducted on non-originating materials:
>
> - preserving operations (drying, freezing etc to keep in good condition)
> - breaking-up or assembly of packages
> - washing, cleaning....
> - ironing or pressing textiles

- simple painting and polishing
- husking and partial or total milling of rice, polishing and glazing of cereals
- operations to colour or flavour sugar…
- peeling, stoning and shelling of fruits, nuts and vegetables
- sharpening, simple grinding or simple cutting
- sifting, screening, sorting, classifying, grading, matching, making sets etc
- simple placing in bottles, cans, flasks, bags, cases, boxes, fixing on cards or boards and all other simple packaging operations
- affixing or printing marks, labels, logos etc on products or their packaging
- simple mixing of products etc
- simple addition of water….
- simple assembly of parts of articles to constitute a complete article or disassembly of products into parts
- slaughter of animals

Example – HS Code 2002.90 - Chopped tomatoes

Spanish tomatoes are imported and processed in the UK before being exported to the EU.

Bilateral cumulation is possible here because EU sourced tomatoes are subject to a sufficient process. Let's see how this works.

Using HMRC's online tool we can establish that HS Code 2002.90 applies to chopped tomatoes. The first two digits'20" refer to Chapter 20 which is within Section IV.

SECTION IV PREPARED FOODSTUFFS; BEVERAGES, SPIRITS AND VINEGAR; TOBACCO AND MANUFACTURED TOBACCO SUBSTITUTES

Chapter 20 Preparations of vegetables, fruit, nuts or other parts of plants

Under this Chapter there are three groups of HS codes:

1. 20.01 CTH;
2. 20.02-20.03 Production in which all the materials of Chapter 7 used are wholly obtained;
3. 20.04-20.09 CTH, provided that the total weight of non-originating materials of headings 17.01 and 17.02 used does not exceed 40 % of the weight of the product.

Chopped tomatoes fall into the second of these groups (20.02-20.03) with the specific rule of origin stating that all materials from chapter 7 (edible vegetables and certain roots and tubers) must be grown and harvested in the UK. However, with bilateral cumulation, UK producers can import EU tomatoes of HS heading 0702 (grown and harvested in the EU) and <u>process</u> them by <u>chopping, cooking and packaging</u> them into chopped tomatoes for onward sale. The final product can be exported back to the EU as a UK 'originating' product.

Claiming preferential treatment

Preferential treatment is not automatic. When importing into the UK or EU, to benefit from preferential tariffs, a business must:

- Claim preference on the Customs Declaration; and
- Declare that they hold proof that the goods meet the rules of origin.

Proof can be either a statement of origin completed by the exporter on a commercial document, such as an invoice, or knowledge obtained by the importer, supported by documents, confirming the goods' origin.

Importer responsibilities

The importer must obtain proof on originating status before claiming preference. This could be an invoice or origin declaration or supporting documents if knowledge based. The importer should claim preference on the Customs Declaration and provide proof of origin to Customs Authorities if requested. Records must also be maintained for at least four years

Exporter responsibilities

They must understand whether they need obtain a supplier's declaration to prove the origin of materials used in production or bought in for resale. Supplier declarations are not required for UK-EU trade in 2021 but the exporter must be confident of origin status.

The exporter must hold evidence that the goods meet the origin rules before issuing a Statement on origin or supporting documentation if it is a knowledge based preferential claim. The exporter must also keep their records for at least four years.

Statement of origin

Statements or origin are valid for two years when issued by an EU exporter but only 12 months when issued by UK exporter and there are a number of things that must be disclosed.

They must include:

- The date of the shipment or period covered must be included, as a statement of origin can cover multiple shipments over a specified period of time, up to the 12 or 24 month limits stated above.
- Words stating "The exporter of the products covered by this document (Exporter reference #................) declares that, except where otherwise clearly indicated, these products are of…………… preferential origin."
  - The Exporter reference will be the EU exporter's REX number or if it is a UK exporter, it will be their EORI number.
  - The exporter will need to specify where they are moving from by inserting that the products are of either UK or EU origin.
- Place and date of export.
- Name of the exporter.

Conclusion

The rules of origin must be addressed to benefit from tariff free trading. UK sourced goods should be fine when exporting into the EU and vice versa. However, clients that simply import and export without processing the goods will have to rely on other Customs Procedures to avoid double duty. For example:

- returned goods relief if clients are moving goods from the EU to the UK and then on to another EU state without any processing;
- temporary admission or customs warehousing to avoid double duty where goods come into the UK from a Non-EU country and are then exported to the EU without any processing in the UK.

If clients import from non-EU, process the goods and then export into the EU, clients will need to consider the PSR to determine if the goods are of UK origin.

Prepared from the seminar by Dean Wootten, Wootten Consultants