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Personal tax

Salary or scholarship (Lecture P1296 – 13.47 minutes)

Summary – The taxpayer was not entitled to a refund of tax as the income received was employment income taxable under s62 ITEPA 2003 and not scholarship income exempted under s776 ITTOIA 2005.

Dorothy Johnson qualified as a Registered General Nurse in May 1994.

In 2001 she applied to South Bank University to train as a midwife with placements at Whipps Cross University Hospital Maternity Unit. South Bank arranged all the placements.

During the midwifery course, Dorothy Johnson received payments for what she called 'living expenses' on payment advice slips. She had been told that: 'when you enter into training, you would not be paid less than you were paid as a registered nurse' which was the case. She did not pay any of the course fees.

In March 2003, having passed the relevant exams and obtained the required practical experience, she became a Registered Midwife Nurse and became employed by Whipps Cross as a Band F midwife in May 2003.

She retired in March 2016, which was the earliest pensionable age allowed under the NHS superannuation scheme.

Less than a year later, she became aware of the Widening Access Training Scheme, a type of training scholarship that applied to those who had undergone post-registration training. She believed that as a trainee midwife she qualified. Under this scheme, qualifying individuals undertaking a relevant full-time training course aimed at widening their professional knowledge may be exempt from tax. She claimed a repayment of £4,868.64 relating to the period from 17 September 2001 to 24 March 2003 when she was on the payroll of Barts Health NHS Trust while undertaking training to qualify as a midwife.

However, Dorothy Johnson was informed that she was not eligible as HMRC guidance stated:

> '... employees of the Trust who were employed under a contract of employment and were receiving a salary and retained employment benefits (e.g. pay awards, increments, sickness, maternity and annual leave) should be classified as employees of Barts Health during the training period.'

As an employee receiving a salary rather than a training/scholarship bursary, no refund of income tax or national insurance was due for the period of her training.

She appealed to the First Tier Tribunal.

Decision

The principal issue for determination was whether the income received by Dorothy Johnson qualified as 'Scholarship Income' under s.776 ITTOIA 2005.

The First Tier Tribunal concluded that:

She was in employment from 1 October 1997 to 31 March 2016 when she retired. There was a change in her job position on 24 May 2003, from being a Band 6 RGN to an RMN on obtaining her qualification as a Registered Midwife Nurse.

The Tribunal reached this decision on the basis that:

- only workers directly employed by the NHS can participate in the superannuation scheme and the NHS trust continued to make contributions as an employer into her NHS superannuation scheme during her training period. Further, there were no gaps in her own contributions into the pension scheme.

- During the training period she continued to be paid as an employee on the same salary and she continued to receive benefits. This was in line with the guarantee being given when she made the decision to undertake training, that she would not take home less than before.

The income received during training represented ‘earnings’ under s.62 ITEPA 2003 and was therefore liable to income tax under PAYE. The income was not eligible for relief under s 776 ITTOIA 2005 as this only applies to individuals in full-time education, which covers ‘bursary, exhibition or other similar educational endowment’. No part of the income received during the training period could be identified as scholarship income.

Appeal dismissed

Dorothy Johnson v HMRC (TC08346)

Right to acquire – grant or exercise date? (Lecture P1296 – 13.47 minutes)

Summary – A share option is granted when the right was acquired and so the taxpayer was liable to UK tax on all three tranches despite being no longer resident in the UK on exercise. Further, his restricted shares remained granted by reason of employment when they were exchanged as part of a subsequent share for share exchange.

In 2001, John Charman had been granted three tranches of share options by reason of his employment, which were exercisable on the first, second and third anniversaries of the grant, conditional on him still being employed. He exercised all three tranches, the first two while UK resident but at the time that the third tranche was exercised, he was no longer UK resident.

The First Tier Tribunal had agreed with John Charman that he had acquired the options when each tranche became exercisable, and not when the options were granted in 2001. As he had become non-UK resident before the third tranche vested, he was only liable to UK tax on exercise of the first two tranches.

The Upper Tribunal had overturned the First Tier Tribunal’s decision finding that the lower Tribunal had erred in law. The Upper Tribunal found that the contractual rights created by the option documents amounted to the creation of a 'right to acquire securities' at the date the options were granted and so all three tranches were subject to UK tax.

In 2002, John Charman had been awarded restricted shares in the company which, as part of an initial public offering, were exchanged for restricted shares in another company. The restrictions were lifted in 2005. John Charman argued that he had acquired these shares as a shareholder, as when they were exchanged all shareholders were granted shares in the new company, whether or not they were employees. However, the First Tier Tribunal had found that he had acquired these shares as a director or employee of the company, making them subject to income tax. The Upper Tribunal agreed with the First Tier Tribunal that the share exchange did not change the link between the acquisition of the shares and his employment.

Decision

The Court of Appeal upheld with the Upper Tribunal's decision. To be taxable under UK law, a right to acquire securities did not have to be immediately exercisable but rather, what mattered, was that the employee had a contractual or other legal right, upon whatever terms, to acquire securities.

The Court of Appeal agreed that John Charman had acquired the share for share restricted shares by reason of his employment, making them liable to income tax. While it was true that some shareholders, who were not employees, benefited from the share for share exchange, this did not mean that John Charman's shares fell outside the employment-related legislation. The share for share exchange before the restrictions were lifted did not break the initial employment-related link. The shares were originally granted by reason of his employment and remained so, making them liable to income tax when the restrictions were subsequently lifted.

John Charman v HMRC [2021] EWCA Civ 1804

The tax benefits of electric cars (Lecture P1297 – 14.58 minutes)

The tax regime for company cars is designed to encourage the use of low-emission vehicles. Many clients are starting to realise quite how advantageous the electric car benefit in kind legislation has recently become. For example, it has been traditional for tax advisers to advocate that it is more tax-efficient for the proprietors of owner-managed businesses to hold cars in their own names rather than that of their companies. However, the electric car revolution means that this is no longer the case.

Car benefits

For low-emission cars first registered on or after 6 April 2020, the relevant percentage table for 2021/22 shows the following:

CO_2 emissions	Appropriate percentage
0	1%
1 – 50 with electric range of:	
• 130 miles or more	1%
• 70 – 129 miles	4%
• 40 – 69 miles	7%
• 30 – 39 miles	11%

- Less than 30 miles 13%

In other words, a higher rate taxpayer, who is provided by his company at the start of 2021/22 with a new Tesla Model 3 costing £40,990, will be subject to a benefit in kind tax charge of 40% x (1% x £40,990) = £163.96, given that the car is fully electric. The employer's Class 1A NIC liability amounts to 13.8% x (1% x £40,990) = £56.57.

Where an individual has a car made available to him under a salary sacrifice scheme, the benefit is valued as the higher of:

- the amount of the salary given up; or
- the taxable benefit.

However, the optional remuneration rules, which were introduced in FA 2017, do not apply if the company car has CO_2 emissions of 75g/km or less (S120A ITEPA 2003). It should be noted that this is a different definition of a low-emission car from that used in the capital allowances legislation (see below).

Car fuel benefits

Where an employer pays for the cost of charging a company-provided electric car, there is no taxable fuel benefit for the driver. Electricity is not classed as a fuel for car benefit purposes.

If the driver of an electric car pays for the electricity needed to power it, either from his own domestic supply or by charging at a roadside station, the employer can reimburse the employee on a tax-free basis for that cost. With a roadside charge, it is easy to determine the cost, but it is not so straightforward to calculate the monetary value when charging from a domestic supply. This problem has, however, been resolved, given that an employer can pay the driver 4p per mile to reimburse them for the cost of electricity used. This rate only applies to company cars, and not to private vehicles.

Electric charge-points

If an employer provides battery charging facilities for a vehicle which is not a taxable car because it belongs to a member of staff, there is no benefit in kind tax charge on electricity and other facilities which employers provide for this purpose (S237A ITEPA 2003).

S237A ITEPA 2003 applies where the relevant facilities are made available 'at or near' the workplace. The words 'at or near' are not defined in the legislation. HMRC have said that they will adopt the same approach with this section as they do for S237 ITEPA 2003 (parking provision and expenses). Thus, as long as the charging facilities are within a reasonable distance from the place of work, having regard to the nature of the locality, the exemption will be available. See Para EIM21685 of the Employment Income Manual for the details of HMRC's interpretation of 'at or near' in the context of parking facilities. Note that the S237A ITEPA 2003 exemption does not extend to the reimbursement by employers of costs incurred by employees when recharging their own cars away from the workplace (e.g. at a motorway service station).

Road tax and congestion charge

Vehicle Excise Duty (usually known as road tax) has been reduced to zero for all electric cars until 2025. Similarly, electric vehicles are exempt from the congestion charge, provided that they are registered for the Cleaner Vehicle Discount (which costs £10). However, with effect from 25 December 2025, all cars travelling in Central London will be subject to the congestion charge.

Capital allowances

The Capital Allowances Act 2001 (Car Emissions) (Extension Of First Year Allowances) (Amendment) Order 2021 (SI 2021/120) came into force on 1 April 2021. This enacts the announcement made by the Chancellor in his Budget last year that the 100% FYA regime for cars with low CO_2 emissions was being extended by a further four years. In order to qualify for 100% FYAs, the relevant car expenditure must meet the necessary requirements under S45D CAA 2001:

The expenditure must be incurred no later than 31 March 2025. There are no restrictions on the amount of this expenditure.

The car must have been acquired unused. It must not be second-hand.

The car must:

- be electrically-propelled; or
- have low CO2 emissions.

The expenditure must not be caught by any of the general exclusions in S46 CAA 2001.

The applicable CO_2 emissions figure in relation to the car must not exceed 0g/km. The previous limit – for cars bought before 1 April 2021 – was 50g/km.

With effect from 1 April 2021, cars with CO_2 emissions not exceeding 50g/km are eligible for capital allowances at the main WDA rate of 18% (S104AA(4) CAA 2001). This represents a significant reduction from the former threshold of 110g/km.

Illustration

Donald has a small family business and is looking to replace his existing company car with an electric one. In October 2021, he opts for a new Nissan Leaf at a cost of £25,995.

In view of the fact that the car's CO_2 emissions are zero, Donald can claim a 100% FYA against his company's profits for the current accounting period, thus obtaining an immediate corporation tax write-off of 19% x £25,995 = £4,939.

If Donald had spent £25,995 on a car which did not attract the 100% FYA, he would at best only qualify for an 18% WDA, as a result of which his company's tax bill would be reduced by 19% x (18% x £25,995) = £889.

By choosing a zero-emission car, Donald is able to write off the full cost with immediate effect and increase the corporation tax saving by £4,050 (£4,939 – £889).

Conclusion

Given that the driver of an employer-provided electric car suffers a very modest benefit in kind charge (and no car fuel tax for any private motoring), it will make sound tax planning sense for family or owner-managed companies (and others) to purchase such cars through the business rather than in the individual's own name, especially when one takes into account the unlimited 100% FYAs available until 31 March 2025.

Contributed by Robert Jamieson

Refundable Class 3 contributions (Lecture P1296 – 13.47 minutes)

Summary - Class 3 National Insurance Contributions paid, at a time when the taxpayer genuinely believed that they would never work again, should be refunded by HMRC.

Christine Bradley was employed as a personal shopper at an online supermarket for ten years. Over that period she felt bullied by her co-employees. Despite raising this with line management the situation did not improve and eventually she resigned in 2015 suffering with severe anxiety.

She believed that all workplaces would be the same as her previous employer and that she would be bullied again. She believed that she could live "off the land" picking and eating berries.

At the time she left her employment, aged 46, she had made 29 years of National Insurance contributions, with 35 years being needed to be entitled to a full state pension. In March 2017, without seeking any advice on the matter, she paid £733.20 in voluntary Class 3 contributions in respect of 2016/17.

From 1 April 2018 Christine Bradley started house sitting pets and subsequently set up a small business providing pet sitting services. Consequently, she was then entitled to make Class 2 contributions but was not required to do so as her business operated below the small business profit threshold.

In April 2018 and February 2019 she wrote to HMRC requesting that the Class 3 contribution paid be refunded and/or reallocated to later years as payment for 2017/18 and 2018/19 Class 2 NICs contributions. Both times HMRC refused the refund request and stated that the payments could not be reallocated.

Christine Bradley appealed to the First Tier Tribunal.

Decision

Where Class 3 NICs have been paid, they can be refunded where they do not enhance the contributor's entitlement to benefit at the time of payment. The First Tier Tribunal concluded that the contribution was not automatically repayable as Christine Bradley's contribution had enhanced her entitlement to benefit.

Where, as in this case, contributions had benefited the contributor, they can only be refunded where the contribution was made in error (but not through the benefit of hindsight).

The Tribunal concluded that such an error had been made. Suffering from extreme anxiety, she made an error of judgement, believing that she would never work again. Had she been thinking clearly, she only needed to work for six years in the twenty years before retirement age to obtain a full state pension. As an error was made at the time of paying the Class 3 contributions, the First Tier Tribunal found that repayment should be made by HMRC (Regulation 52 Social Security (Contributions) Regulations 2001).

Christine Bradley v HMRC (TC08344)

Late pension protection elections

Summary – The First Tier Tribunal had no jurisdiction to overrule HMRC where it denied late elections for Fixed Protection 2012.

This case concerned the taxpayers' late election for Fixed Protection 2012 that would have enabled them to protect their lifetime allowance at the higher level of £1,800,000.

The deadline for submitting such an election was 6 April 2012 but the taxpayers did not apply for Fixed Protection 2012 by the deadline, as their adviser mistakenly believed that they had already applied for Enhanced Protection, preventing them from also electing for Fixed Protection 2012.

Following a review of their files in 2014, it became clear to the advisors that no application for Enhanced Protection had ever been made.

The taxpayers engaged new advisors who filed applications for Fixed Protection 2012 on their behalf in August 2015. In their covering letter the advisors sought to rely on the provisions for "reasonable excuse" set out in the Enhanced Protection Regulations.

Unfortunately, these regulations were inapplicable for claims relating to Fixed Protection 2012. The relevant Regulations contained no provisions entitling taxpayers to have late applications accepted where a reasonable excuse existed.

The advisors came to realise that the Regulations relating to Fixed Protection 2012 contained no concept of a "reasonable excuse" but argued that s118 TMA 1970 meant that, because of the presence of a reasonable excuse, the elections should be treated as made in time. They also argued that HMRC should exercise their discretion to accept late notices.

The taxpayers' late elections were refused by HMRC and the taxpayers applied to the First Tier Tribunal to overrule HMRC's decision.

The First Tier Tribunal refused to overrule the decision on the grounds that HMRC was entitled to decide not to accept the elections, and based on the facts, HMRC's decision was reasonable.

The taxpayers appealed to the Upper Tribunal.

Decision

The Upper Tribunal found that the First Tier Tribunal's sole jurisdiction was to consider whether the requirements of Regulation 4 were met. This Regulation sets out the requirements that a Fixed Protection 2012 election must satisfy for it to be a valid election. The Tribunal could not overrule HMRC's decision.

With the appeal being outside of the scope of the First Tier Tribunal's jurisdiction, the appeals could not be upheld.

Executors of David Harrison (Deceased) and Simon Harrison v HMRC [2021] UKUT 273 (TCC)

Company ineligible for EIS (Lecture P1296 – 13.47 minutes)

Summary – Despite all activities being outsourced to third parties, the company was still trading but not on a commercial basis with a view to profit. EIS relief was not available.

CHF PIP! PLC (PIP) owned the intellectual property for the stories that became a children's TV series, PIP Ahoy! The company issued shares between May and November 2018 and submitted Form EIS 1 seeking HMRC's authority to issue compliance certificates to investors so allowing them to claim EIS income tax relief on their investments.

The company argued that it was carrying on a qualifying trade and that it satisfied the risk to capital condition contained within the legislation. The company created a children's television series and sold related merchandise for a profit.

However, HMRC refused permission, stating that the company was not carrying on a qualifying trade as all activities were outsourced to other companies and that the company had no control over business decisions. The company simply received royalties and license fees which were excluded activities.

The company appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal accepted that outsourcing activities rather than undertaking these themselves was trading. However this was not a qualifying trade as it was not conducted on a commercial basis with a view to making a profit. The company's turnover had been decreasing and it had been making losses. Although it had taken steps in an attempt to improve matters, the Tribunal found the company's turnover and profit forecasts to be "wholly unrealistic" and that they represented "a pious hope rather than evidence of a genuine intention to make a profit." Pip Ahoy was "a bit stale" and a "little quaint" and was behind the times for what preschool children were choosing to view.

The appeal was dismissed.

Although not needed, the First Tier Tribunal went on to consider whether the activity was an excluded activity as well as the potential risk to capital issue:

- The Tribunal concluded that receiving royalties and licence fees as the company did was not an excluded activity as the company had created the intellectual property and had the right to exploit that property.

- The Tribunal stated that the risk-to-capital condition would not be met because at the time of the share issue the company did not have a realistic objective of growing and developing its trade in the long term.

CHF PIP! PLC v HMRC (TC08305)

Capital taxes

Disposal of partnership office premises (Lecture P1296 – 13.47 minutes)

Summary – Entrepreneurs' Relief was available on the disposal of a partnership's premises as this disposal was part of the disposal of the partnership business as a whole, even though this had taken for more than 20 years.

In the 1970s, Christopher Thomson became a partner in an accounting firm, Voisey & Co. based in Warrington. In 1974 the partnership bought the premises it had been renting.

In 1996 Christopher started to consider his retirement and succession. He identified two accountants working in the practice who were suitable to take over from him. However, these 'New Partners' were young and he was concerned that many of the firm's clients were his personal clients for whom he had worked for a number of years. He also held a number of executorships, trusteeships and directorships.

Consequently, it was agreed that:

- The New Partners would each pay Christopher Thomson £20,000 a year for the then £434,000 of work in progress until he was left with a token 1%;
- Christopher Thomson would transfer clients over time to the New Partners, starting with compliance and audit matters followed by the more difficult longstanding clients;
- As clients were transferred the new work was credited to the New Partners and so gradually Christopher's share of profits reduced and he gradually reduced his hours to match.

This process took many years. Due to the deaths of key clients and threatened litigation in respect of trustee positions held by the retiring partner the full handover was not completed until 2021.

In 2017/18, prior to the full handover, the partnership disposed of its office premises to his pension scheme who rented it back to the partnership on a three-year lease at £32,000 a year with options to renew.

Christopher Thomson claimed entrepreneurs' relief on the gain arising on disposal arguing that there had been a material disposal of part of the business

Following an enquiry, HMRC issued a closure notice denying the entrepreneurs' relief claim stating that the sale of the partnership premises was the disposal of an asset that did not represent all or part of a business. HMRC accepted that it may be that separate disposals in different tax years could be taken to be the disposal of the whole or part of a business but evidence was required to treat these disposals together as part of the same transaction. In this case, the process has taken some 22 years from 1996 and HMRC stated that the facts did not justify treating the process as part of the same transaction.

Following Statutory Review, HMRC upheld the decision, and Christopher Thomson appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal stated that the disposal of the premises needed to be considered in context.

Since 1996, Christopher Thomson had been trying to transfer ownership of the accounting practice but was hindered by difficult client relationships. At the time that the premises was sold, Christopher Thomson was entitled to less than 10% of the profits and he had disposed of 99% of the goodwill and old work in progress. At this time it was only the premises that he still fully owned. So, while the period of time over which the disposal took place was long, based on the facts, the disposal of the property was part of the continuing disposal of his share in the partnership business.

The First Tier Tribunal found that the disposal of the partnership property to Christopher Thomson's pension scheme did represent the sale of part of a business and so entrepreneurs' relief was available.

Christopher Thomson v HMRC (TC 08337A/V)

BADR: Trading and investment activities (Lecture P1298 – 12.05 minutes)

Background

Business asset disposal relief (BADR) offers individual taxpayers a capital gains tax (CGT) rate of 10% on net chargeable gains up to a lifetime limit of £1 million.

A claim for BADR is available on a material disposal of business assets, such as on a disposal of shares in a company.

Is it a 'trading' company?

For an individual shareholder disposing of shares in a company, the disposal is material for BADR purposes if any of four alternative conditions is met. The most common condition ('Condition A' in the legislation) is that throughout a two-year period ending with the date of disposal, the company is the individual's personal company and is a trading company (or the holding company of a trading group) and that the individual is an officer or employee of the company (or a trading group member, if applicable) (TCGA 1992, s 169I(6)).

A 'trading company' for BADR purposes is defined as a company carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities. Unfortunately, the legislation does not provide a definition of 'substantial'. This has caused uncertainty for taxpayers, plus difficulties for HMRC officers faced with the task of establishing whether a company was a trading company for BADR purposes.

What is 'substantial'?

HMRC's published guidance on its interpretation of the meaning of substantial for BADR purposes (at CG64090) states that 'substantial' in this context means more than 20%. However, this begs the question: '20% of what?'.

HMRC's guidance states that some or all the following measures or indicators are among those that may be taken into account in reviewing a particular company's status:

- income from non-trading activities;
- the asset base of the company;
- expenses incurred, or time spent, by officers and employees of the company in undertaking its activities;
- the company's history; and
- balance of indicators.

HMRC points out that these indicators are not individual tests to which a 20% limit applies, and it may be that some indicators point in one direction and others in the opposite direction. The suggested approach is that the relevance of each indicator is weighed up in the context of the case and judged "in the round". This approach follows the Special Commissioner's in the inheritance tax case Farmer and anor (Executors of Farmer, dec'd) v IRC [1999] SpC 216.

Of course, HMRC's guidance in the Capital Gains manual does not carry the force of law and is open to challenge. The definition of trading company, and in particular the meaning of 'to a substantial extent' in the legislation, was considered in Allam v Revenue and Customs.

Is there an 'activity'?

In Allam, the taxpayer owned all the share capital in a company ('ADL') and was also director of the company. In July 2011, the taxpayer sold the entire share capital of ADL, and reported a capital gain of £4.925 million from the disposal on his self-assessment return for the tax year 2011/12. He claimed entrepreneurs' relief (now BADR) on the disposal and appealed after HMRC refused his claim.

The business of ADL in the relevant period involved property development and property investment. The First-tier Tribunal (FTT) ([2020] UKFTT 216 (TC)) noted that the turnover of ADL in the year ended 31 December 2011 was made up almost entirely of rental income from the properties (and it was inferred that the position in the previous year was very similar). There was no dispute that ADL was carrying on some trading activities. However, many properties were let to produce rental income. This was considered a non-trading activity. The proportion of company income which comprised non-trading rental income, and the proportion of its assets base devoted to properties which were let simply for their rental income, demonstrated that the property investment and rental activities had real importance and could not be ignored. The FTT concluded that those activities were not trading activities and they had to be regarded as 'substantial' in the context of the activities of the company as a whole.

On appeal, there were two grounds for the Upper Tribunal (UT) ([2021] UKUT 291 (TCC)) to consider. The first ground was that the FTT was wrong in law to take into account investment income from "passive activity" in determining whether ADL's activities included non-trading activities to a substantial extent. The UT considered that what amounts to a company's activity is a question of what the company does in commercial terms, and that the holding of investments was an 'activity'.

The taxpayer’s second ground of appeal was that in determining whether non-trading activities were substantial, the FTT was wrong to base its conclusions on the relative values of ADL’s assets on its balance sheet and to ignore unrealised development value generated by its development activities. However, the UT did not detect any errors in the FTT’s approach. The UT dismissed the taxpayer’s appeal against HMRC’s refusal to allow entrepreneurs’ relief.

Points to note

1. The tribunals did not find a 20% threshold test of ‘substantial’ to be particularly helpful. The FTT pointed out that there was no sanction in the legislation for the application of a strict numerical threshold. The FTT also found that the words in the phrase “to a substantial extent” should be given their ordinary and natural meaning in the context of the relief, and that ‘substantial’ should be taken to mean ‘of material or real importance’ in the context of the activities of the company as a whole.

2. The UT noted that the FTT did not refer to the Farmer case and considered that it was correct in not doing so. This would indicate that HMRC’s suggested tests for determining how a company’s non-trading activities should be measured to assess whether they are ‘substantial’ need to be approached with caution.

3. The UT referred to another entrepreneurs’ relief case, Potter v Revenue and Customs [2019] UKFTT 554 (TC). In Potter, the company in question was carrying on limited trading activities in the relevant period. Those trading activities had reduced considerably because of the financial crash in 2008/09. Previously, the company had been extremely successful and had substantial cash reserves. It used £800,000 of those reserves to purchase two six-year investment bonds, which paid interest of £35,000 per annum. The FTT held that the company was a trading company and that its activities did not include to a substantial extent activities other than trading activities. The tribunal noted that the investment was tied up for six years and the company did not have to do anything in relation to the investment. As such, it was not an investment activity. The taxpayer’s appeal in that case was allowed.

However, the UT in Allam noted that the FTT in Potter seemingly placed considerable weight on the absence of any physical activity in relation to the investment bonds. The UT did not consider that the FTT was right to view the investment bonds as not involving any activity at all. The UT’s view was that there would always be some activity involved in such an investment, even if it was only checking that interest was paid each year. In any event, the UT in Allam held that the test was not solely concerned with physical activity.

‘Surplus’ cash

A common point of uncertainty on the ‘substantial’ non-trading activities issue is ‘surplus cash’, i.e., whether the long-term retention of significant earnings generated from trading activities is capable of amounting to an investment activity. HMRC’s guidance (at CG64060) states that the first point to consider is whether there is an identifiable activity distinct from the company’s trading activity. However, the UT’s comments in Allam indicate that the ‘activity’ test is not reliant solely on the presence or absence of a physical activity.

Some commentators have previously suggested that the retention of accumulated profits in (for example) a non-interest bearing current account of the company would preclude HMRC from arguing that there was an investment activity. Nevertheless, advisers may wish to consider a non-statutory clearance application to HMRC on their clients' behalf with a view to obtaining comfort on this point.

Contributed by Mark McLaughlin

Education Trusts **(Lecture P1299 – 20.42 minutes)**

Introduction

Private education is expensive. School fees vary dramatically from school-to-school and area-to-area but seem to come in at around an average of £4,800 per term for a day school rising to £11,500 for boarding school. Multiply this by the number of children and eyes can begin to water.

And that just gets the children to either 16 or 18. I was fortunate enough to go to university at a time when both my degree and my liquid subsistence was paid for by the UK taxpayer (thank you all). Today's young adults are not so lucky and face fees of £9,250 year (plus living expenses). Student loans are all well and good, but the clue is in the title. Provided our newly educated offspring get a reasonably paid job, these loans are expected to be repaid.

Paying school fees from post-tax income is rarely the best solution. Instead structuring school-fee planning by using a trust can help soften the blow.

Trusts

Trusts offer a way of ring-fencing money for the benefit of our children and/or grandchildren without giving the beneficiaries unfettered and uncontrolled access to the funds.

The word "trust" can put some people off as the urban myth is that a) trusts are complicated, b) trusts are expensive both to set up and run and c) trusts are tax avoidance vehicles for the rich and infamous. All of these (unlike the creation of a child itself) are something of a misconception.

A trust is little more than a protected moneybox. The settlor puts money in, the Trustees look after it for a while and when either a) an event happens (such as a milestone birthday) or b) the Trustees decide it's the right time, the money is paid to (or used for the benefit of) those individuals who were chosen as the beneficiaries.

Most family trusts tend to invest in sensible assets such as listed shares, residential property and interest-bearing bank accounts, so the annual compliance and running costs are normally very manageable.

Trustees could charge for their time (and professional Trustees undoubtedly will), but this is not usually necessary as the Trustees tend to be members of the family who offer their time and experience free of charge. Yes, there is a cost in setting-up the trust as most will need a Trust Deed so the services of a solicitor will then need to be procured, but most Trust Deeds are standard documents (tailored for the specific requirements of the family) so costs should not be prohibitive.

The main decision to be made when looking to put some education planning in place is often therefore not whether a trust should be used but which type of trust is the most suitable.

Types of trust

Different types of trust give beneficiaries different rights at different times. Each is taxed slightly differently. Choosing the right one is therefore important.

The three menu choices are:

1. The discretionary trust;
2. The bare trust; &
3. The interest in possession (IIP) trust

There is no such thing as an "Education Trust". Yes, you can set a trust and call it the "Smith Family Education Trust" if you want to (and if your name is Smith which it might not be), but this will be one of the above types of trust duly renamed with your family moniker.

Discretionary trusts

These are the most flexible (and therefore the most common) type of trust in use today as they offer the Trustees complete discretion as to how and when the trust fund should be distributed to the beneficiaries. This is the trust which the prudent settlor tends to favour.

Kids change as they develop. It may have seemed like a good idea at the time to set up a trust giving Johnny the right to the fund in its entirely on his 18th birthday, but as Johnny goes through his teens clearly struggling to develop into a mature human being, this can quickly start to become a bad idea. And once in place, this can be very difficult to vary.

Having the flexibility to defer any distributions until the beneficiary is mature enough to deal with the windfall is one of the prevailing reasons why discretionary trusts are the weapon of choice for many settlors.

Bare trusts

This is the simplest form of trust as the Trustees are no more than a "nominee" acting on behalf of the beneficiary. The trust fund (and any income generated by it) belongs to and is taxed on the beneficiary and the beneficiary can call for the fund to be appointed to him in its entirety as soon as his reaches his majority on his 18th birthday.

Bare trusts are suitable for beneficiaries with a "good head on their shoulders" or where the fund is relatively modest.

Interest in possession (IIP) trusts

IIP trusts sit somewhere in between. They offer the keys to the castle but not the castle itself.

An IIP trust gives the beneficiary (the "life tenant") the right to the net income of the trust (after tax and expenses). This income cannot be accumulated by the Trustees (as it can in a discretionary settlement). This means that the beneficiary, however old he may be, will be legally entitled to a chunk of money each year and this cannot be held-back by the Trustees.

The life tenant's right to income can be open-ended or time limited. Despite its title, a life tenancy does not necessarily mean a right to income for life.

The capital of the trust is typically reserved for a "remainderman" or "reversionary beneficiary" stipulated in the trust deed, although some IIP trusts do give the Trustees the right to pay capital to the life tenant at their discretion.

Transfers into trust

Once the vehicle of choice has been decided upon, the next step is to fund it.

Trusts can either be established by the settlement of a lump sum, or by regular (eg, yearly) contributions or by a combination thereof.

Since 2006, a gift to a trust is a chargeable transfer for IHT meaning that in the event that the transfer exceeds the available nil band (currently £325,000), an IHT "entry charge" must be paid. This charge will be at 25% as the tax itself will be paid out of the settlor's funds which further increases the loss to his estate.

£325,000 is a sizeable sum and in many cases will be enough to cover expected education costs, so unless the settlor has a history of creating trusts, there is no reason why IHT needs to be paid on entry. Also bear in mind that in the case of a husband and wife settlement for the benefit of children or grandchildren, the nil band is effectively £650,000.

However, in the event that the trust needs to be funded at a level in excess of the IHT nil band, there are ways in which an entry charge can still be avoided:

- Create the nil band trust then resettle a further amount once seven years have elapsed. The initial settlement will fall off the clock after seven years and the nil band will be reinstated.

- Settle assets which are IHT relievable. Shares in family trading companies are the obvious choice as transfers are normally IHT-free by virtue of 100% business property relief.

- Make regular gifts to the trust from income. Regular gifts by an individual from surplus net annual income are exempt for IHT. The recipient is irrelevant. Funding the trust with an initial settlement equal to the nil band then topping up by (say) regular monthly cash donations from after-tax income means that no IHT is payable (even if the settlor dies within seven years). There is no monetary limit to the "gifts from income" exemption so this gives scope for potentially large settlements to be made without an IHT charge.

- Use a bare trust for any excess funds. Gifts to a bare trust are treated as direct gifts to the beneficiary and are therefore PETs for IHT purposes (chargeable to IHT only if the donor dies within seven years). Creating a nil band discretionary trust then setting extra funds aside on a separate bare trust will avoid any lifetime IHT charges.

Where non-cash assets are to be settled, capital gains issues must be considered as the transfer to trust will be a disposal at market value by the settlor for CGT. Gains can be deferred where the transfer is chargeable to IHT (even where the transfer falls within the nil band or covered by BPR) unless the beneficiaries are minor unmarried children of the settlor.

In the case of a gift to a bare trust, as there is no immediate IHT charge, CGT deferral relief is only available for "business assets" (primarily shares in unlisted trading companies or furnished holiday lets). As a bare trust is not a "settlement" for CGT, unlike discretionary or IIP trusts, there is no denial of gift relief where the beneficiary is a minor child of the settlor.

Gifts of shares in family companies are particularly attractive as IHT protection is normally available in the form of BPR and CGT can normally be deferred. Even if gift relief is not available, gains might only be taxed at 10% anyway by virtue of Business Asset Disposal Relief on gains above the CGT exemption.

Remember that a lack of CGT deferral means that the assets are rebased to market value in the hands of the Trustees. So settlors could decide that paying CGT now at 10% is preferable to paying 20% later. [The tax paid also reduces the settlor's estate for IHT which is an added bonus.]

Taxation of trust income

This depends on the type of trust.

1) Discretionary trusts

Discretionary trusts pay income tax on most of their trust income at 45% (38.1% for dividends). This equates to the additional rate of tax for individuals and is therefore quite penal. The savings nil band and the dividend allowance are not available.

But don't let this put you off. Income distributions to beneficiaries are deemed to carry a repayable 45% tax credit. This is the case even if the trust income consists wholly or partly of dividend income on which tax was paid at 38.1%. If the beneficiary is a non-taxpayer (or pays only at the basic rate), the 45% tax credit will be wholly or partly repaid.

The Trustees must retain a "tax pool" to compare the tax paid by the Trustees with the tax credits which frank income distributions. Care should be taken to make sure this pool does not become overdrawn as the Trustees will then have to make up the difference. This is a live issue in the case of trusts funded by the settlement of shares in family companies where dividends are the main income source. Unwary Trustees would fund themselves with an unexpected income tax charge if distributions were too generous.

2) Bare trusts

The income of a bare trust belongs to the beneficiary and is therefore taxed at the beneficiary's marginal rate. The savings nil band and the dividend allowance are available. In many cases this will mean that the income tax liability will be nil.

Moving income-producing assets from a higher-rate taxpaying settlor into a bare trust for non-taxpayers will therefore leave more after-tax cash in the pot to meet school fees. This is far more efficient than the settlor simply paying these fees from his own post-tax income.

3) IIP trusts

IIP trusts pay income tax at the basic rate (20%) and dividend ordinary rate (7.5%). The net income then flows through to the life tenant as taxed income with an appropriate 20%/7.5% tax credit. If the beneficiary is not a higher rate taxpayer (highly probable for education trusts), some or all of these tax credits can be repaid.

In this sense, from an income tax perspective, using an IIP trust for school fee planning is no different to using a bare trust. However using an IIP trust gives the added degree of protection in that the capital of the fund does not automatically vest in the children at age 18. This will be a consideration if the purpose of the trust is to fund university / college fees.

In all cases, where the beneficiaries are non-taxpayers, all trusts offer the opportunity to be "income tax free" as the tax paid by the Trustees can (with careful planning) be recovered. However, income tax planning should always have regard to the parental settlements rules.

Parental settlements

Parental settlements are problematic for income tax. Where the beneficiary is a minor unmarried child of the settlor, any trust income which is applied to or for the benefit of the beneficiary is taxed in the hands of the parent. This prevents income distributions being made from the trust in order to utilise the (otherwise wasted?) personal allowances of the minor child. [There is a de minimis exception for income under £100 but this isn't particularly helpful.]

In the case of a bare trust or IIP trust, this means that income generated by parental settlements will be taxed on the parent settlor as it arises. For discretionary trusts, the income will only be taxed on the parent settlor if it is paid out.

This settlor attribution can be avoided by:

- Creating grandparental settlements. We know how much grandparents love their grandkids (it's the "common enemy" syndrome). Setting aside funds for the benefit of grandchildren ticks a lot of boxes, not least that it fits nicely as part of an overall IHT planning strategy for clients of advancing years. Where the settlor is not a parent of the beneficiary, trust income could be paid out to utilise beneficiary personal allowances. Any tax credits attaching to those distributions (representing income tax paid by the Trustees) would then be repaid. The distributed funds could then be used to pay school fees or sit in tax efficient investments (such as junior ISAs and other such products) until required.

- Waiting until the child is 18. Distributions from a parental settlement to a child aged 18 and over are not attributed to the parent. Many 18-year olds are still waiting to be gainfully employed and do not use their personal allowances. Therefore, in the case of a discretionary trust, income can be accumulated and paid out as soon as the beneficiary is no longer a minor. For this reason, parental discretionary trusts are perhaps not the most suitable for school fee planning and should be reserved to provide funds for university / college fees post age 18.

- Investing in assets which produce capital growth and offer no / low income yield. There is no settlor attribution of capital gains in UK trusts, so any gains made within a bare trust arrangement will always be taxed on the beneficiary (and utilise his annual exempt amount). Alternatively, investments could be chosen which "roll-up" income until the beneficiary's 18th birthday such as single premium insurance bonds or offshore roll-up funds. [A word with an IFA would be prudent if this route is to be followed.]

- Settling non-income producing assets such as "alphabet" shares in family companies where dividend payments can be deferred as required.

Other points to consider

Many taxpayers are put-off from using a formal trust due to the possibility of IHT "relevant property" charges when either capital is appointed or on each 10-year anniversary. Both discretionary and IIP trusts are subject to relevant property charges. Bare trusts are not. Instead, the assets in a bare trust form part of the beneficiary's own estate (which with child beneficiaries is rarely a problem).

However, in the case of a nil band trust, any capital distributions within the first ten years will not give rise to exit charges as the effective rate of tax is zero. Breaking the trust before the principal charge kicks-in is often sensible planning.

Conclusion

There is no "one size fits all" solution to school fee planning. However, the use of trusts – if properly structured and managed – can minimise income tax and reduce the estate of the donor at the same time.

Contributed by Steve Sanders

SDLT discovery assessment - return lacked detail

Summary - An SDLT discovery assessment was valid. The taxpayers did not make an adequate disclosure in their return, so HMRC could not reasonably be expected to be aware that the SDLT paid was insufficient.

Victoria Carter and Peter Kennedy implemented a sub-sale SDLT avoidance scheme. They submitted an SDLT return that contained a disclosure that noted that the sub-sale rules in s.45 FA applied to the transaction and so a percentage of the contract price was not chargeable consideration for SDLT purposes. Further, the return stated that s.75A FA 2003 (anti-avoidance) did not apply to the transaction.

HMRC did not raise an enquiry into the SDLT return but later raised a discovery assessment.

The First Tier Tribunal held that an officer of HMRC could not have been reasonably expected, on the information made available to them before the end of the enquiry period, to be aware of the insufficiency of SDLT. This meant that the test in para. 30(3) Sch.10 FA 2003 was met and the discovery assessment was valid.

Victoria Carter and Peter Kennedy appealed to the Upper Tribunal on the basis that the First Tier Tribunal had erred in law.

Decision

The Upper Tribunal upheld the First Tier Tribunal's decision, finding that the discovery assessment was valid.

It held that the First Tier Tribunal was reasonably entitled to find that the disclosure contained in the SDLT return was inadequate because although the disclosure made it clear that some form of sub-sale scheme was involved, it did not give sufficient detail, neither did it provide an analysis of why s 75A would not apply. This was a complex case and the First Tier Tribunal's decision was reasonable based on the state of the law at the time and the evidence.

Further, the purpose of a disclosure is to prevent the issue of an assessment by HMRC. This means that the information that is treated as available at the relevant time must be sufficient to make the hypothetical officer aware of the actual insufficiency of tax to a level that would justify the making of an assessment.

The First Tier Tribunal was entitled to accept the actual HMRC officer's evidence that he first became aware that the SDLT scheme in question might be successfully challenged as ineffective after the enquiry window for the taxpayers' SDLT return had closed. The UT dismissed the taxpayers' argument that the actual officer's understanding of SDLT could not affect the understanding of the hypothetical officer because the taxpayer was not privy to this information.

The First Tier Tribunal had applied the test correctly: it had first considered the adequacy of the disclosure, it accepted the evidence of the actual HMRC officer involved and then applied the test in para. 30(3) Sch.10 FA by reference to what could reasonably be expected of a hypothetical HMRC officer (using the actual officer's knowledge in considering what was reasonable to ascribe to a hypothetical officer).

It was not necessary for the hypothetical officer to be able to quantify the insufficiency of tax. The taxpayers' assertion that the hypothetical officer's understanding should include an understanding of s 75A(3)(b) (which lists sub-sales as a possible scheme transaction) and HMRC published guidance at the time the SDLT return was made did not affect the analysis. The FTT was entitled to find that if the hypothetical officer had considered this evidence, it would only have prompted an enquiry (the guidance was not admitted as evidence at this stage as it had not been relied on at FTT level).

Why it matters: This decision provides a detailed analysis of discovery assessments in the context of SDLT and in particular, para. 30(3) Sch.10 FA. It confirms that, in order for a disclosure to be sufficient, it should contain a detailed analysis of how the SDLT provisions apply to the transaction and give sufficient details of the transaction itself.

Victoria Carter & Peter Kennedy v HMRC [2021] UKUT 0300 (TCC)

Adapted from the case summary in Tax Journal (7 January 2022)

Administration

The Worldwide Disclosure Facility (Lecture P1300 – 15.35 minutes)

The Worldwide Disclosure Facilities has been in existence for several years, and HMRC is keen to encourage its use. The process is likely to be familiar to many advisers. However, there are numerous dangers in using the WDF, and advisers should use it with caution. This session will hopefully be of interest to first-time users of the WDF, as well as those who are more familiar with it.

A brief history of offshore disclosure facilities

The Worldwide Disclosure Facility ("WDF") is the most recent of HMRC's disclosure facilities connected to offshore issues. The sequence started with the Offshore Disclosure Facility ("ODF") in 2007, followed by the New Disclosure Opportunity ("NDO") in 2009. Although labelled as the final chance for taxpayers to come forward, the NDO was quickly followed (a month later) by the Liechtenstein Disclosure Facility ("LDF"), which offered very favourable terms for settlement. Disclosure facilities specific to the Crown dependencies (Jersey, Guernsey and the Isle of Man) followed in 2013. The offshore disclosure facilities closed on 31 December 2015. Less than a year later, on 5 September 2016, the WDF opened.

What is the Worldwide Disclosure Facility?

The WDF is an online process, accessed through HMRC's Digital Disclosure Service. Although initially a short-term facility, the WDF is still with us today. The facility is open to taxpayers (covering individuals, companies, personal representatives, and executors) with an undeclared UK tax liability which is wholly or partly connected to an offshore issue. Advisers should note that, when using the WDF, they must ensure that any onshore issues are also disclosed. Where IHT liabilities are being disclosed, only those for the last 20 years can be notified through the WDF – any older liabilities must be disclosed separately.

The WDF is a different beast to previous disclosure facilities. Whereas earlier processes adopted a "carrot and stick" approach, the WDF does not have a "carrot" element. HMRC took the view that, given the significant volume of data they would be receiving following the introduction of the Common Reporting Standard ("CRS"), and the harsh penalty provisions under the Requirement to Correct regime, there wasn't a need to offer favourable terms to taxpayers to come forward. As a consequence, there aren't any special terms, or concessions, and, importantly, there isn't immunity from prosecution.

The taxpayer is required to self-assess their behaviour, submit their quantified disclosure (including a calculation of tax, interest and penalties) within 90 days, and to pay the amount due within the same timescale. An agent can register on behalf of the client. HMRC issue an acknowledgement within 15 days of the submission of the disclosure, and "aim" to notify their decision within 90 days of issuing the acknowledgement.

What is good about the Worldwide Disclosure Facility?

Although the terms of the WDF are that the disclosure must be submitted within 90 days, there is the ability to seek a 90-day extension where the circumstances are "complex".

Where there are complex issues, it might also be possible to obtain help from HMRC, although the assistance does not extend to that provided under the LDF where advisers had a single point of contact ("SPOC").

There is a non-statutory clearance process that can be used once the taxpayer has registered for the WDF. Where the taxpayer is not going to be able to pay the disclosure liability (including any interest and penalty) within the required timeline, it is possible to agree payment terms with HMRC, although this must be done in advance of submission of the disclosure.

What is not so good about the Worldwide Disclosure Facility?

Although the WDF may be suitable for simple or straightforward cases, the process is fraught with danger for the unwary. Also, advisers may not know, with any certainty, that the case before them is simple or straightforward.

The key downside of the WDF is that there isn't immunity from prosecution. The HMRC guidelines are very clear on this point, and state that "HMRC reserves complete discretion to conduct a criminal investigation in any case". Advisers need to consider whether the circumstances of the case are such that the Contractual Disclosure Facility should be used, where, among other advantages, immunity is available for a full disclosure.

There is the risk of investigation by HMRC (whether under their civil or criminal processes), including where an inaccurate disclosure is made. Another key downside is the need for the taxpayer's behaviour to be self-assessed, with the number of years to be included in the disclosure following on from this assessment. I have seen numerous examples since the WDF's introduction where an adviser has submitted a disclosure on the basis of reasonable care, or careless behaviour, only for HMRC to investigate and pursue the case on the basis of deliberate behaviour. This can arise in numerous ways, including where the adviser has not challenged the client robustly enough, or has failed to discuss the implications of submitting an incorrect disclosure. This can arise because of the very short time allowed for submitting a disclosure under the WDF. Even with an extension, 180 days is not always going to provide sufficient time to thoroughly investigate a problem that may cover a 20-year period.

The disclosure can get complicated where there are outstanding tax returns. Where those returns are for 2017/18 or later, they must be completed and submitted to HMRC, and are excluded from the WDF submission. As mentioned above, and unlike previous facilities, the WDF does not provide any incentives to use the process – all relevant years must be included, HMRC does not forego any tax, and the full penalty must be applied, based on current legislation.

A higher penalty will be charged, in various circumstances under the WDF, including where:

- There is an existing enquiry;
- The disclosure is connected to a previous inaccurate disclosure or settlement following an investigation;
- The existing penalty legislation is not followed.

One of the requirements of the WDF is that the taxpayer must give "any extra information" requested by HMRC, or face:

- Higher penalties;
- A civil or criminal investigation;
- Publication of details.

The above sanctions may also apply where an inaccurate disclosure has been made. There is a distinct lack of safeguards for taxpayers under the WDF. If HMRC requested information in the context of a formal enquiry, under s9A TMA 1970, for example, there is a reasonableness requirement.

Dangers of using the Worldwide Disclosure Facility

There are numerous pitfalls when using the WDF, as noted above, with, potentially, serious consequences for the client. Advisers must submit the disclosure within a short period, that will prove challenging even in the simplest of cases. The ability to correctly determine the category of behaviour requires an objective consideration of the circumstances, and available documentation. Getting this wrong will have significant implications for the client, and advisers may want to seek a second opinion, particularly in borderline cases. It is easy to overlook the provisions of the Requirement to Correct regime, but those rules will need to be considered.

The main danger, in my opinion, when using the WDF, is the risk of prosecution, including where there has been an incorrect determination of the client's behaviour, previous HMRC investigations, or false statements have been provided to HMRC. The risk or prosecution can, however, be mitigated, as noted below.

Considerations before using the Worldwide Disclosure Facility

Advisers should consider, when faced with an unprompted offshore-related disclosure or a prompted one, following, perhaps, a HMRC nudge letter, whether the WDF is the best option for the client. The WDF is suitable for simple or straightforward cases, but the adviser needs to establish whether the case fits description before proceeding down the WDF route. Otherwise, the adviser may want to consider approaching HMRC outside of the WDF process.

Where deliberate behaviour is determined, the adviser should consider whether the Contractual Disclosure Facility ("CDF") (HMRC's civil investigation of fraud process) is a better option, particularly where there has been a material under-declaration by the client, and/or there are aggravating factors. The key advantage of the CDF is that immunity from prosecution for tax offences is obtained where the client makes a full disclosure. It is recommended that specialist advice is taken when considering this option.

Contributed by Phil Berwick, Berwick Tax

Deadlines

1 February

- Corporation tax for periods ended 30 April 2021 (SMEs not paying by instalments.

2 February 2022

- Form P46(Car) for quarter ended 5 January 2022.
- 5 February 2022 Employment intermediaries report for quarter to 5 January 2022.

7 February 2022

- Due date for VAT returns and payment for 31 December 2021 quarter (electronic payment).

14 February 2022

- QIPS for large companies (depending on accounting year-end).
- Paper Monthly EC sales list – businesses in Northern Ireland selling goods.
- Application to defer class 1 NICs for 2021/22.

19 February 2022

- Non electronic PAYE, NIC, CIS, Student Loan Liabilities for month to 5 February 2022.
- File monthly construction industry scheme return.

21 February 2022

- Online monthly EC sales list –businesses in Northern Ireland selling goods.

22 February 2022

- PAYE, NICs, CIS and student loan liabilities should have cleared HMRC's bank account.

28 February 2022

- File Corporation tax Self Assessment returns for companies with periods ended 28 February 2021

News

Delayed Self Assessment late filing and payment for 2020/21

Concerned that the COVID-19 Omicron variant is affecting the ability of agents and taxpayers to deliver on time, to ease the pressure HMRC has announced that the late filing and late payment penalties for self-assessment taxpayers will be waived for one month.

The 31 January 2022 filing and payment deadline will remain unchanged but:

- no late filing penalty will be charged provided the return is filed online on or before 28 February 2022;

- no late payment penalty will be charged provided the tax that cannot be paid by the 31 January deadline is paid in full, or a Time to Pay arrangement is set up, by 1 April 2022

However, taxpayers should still aim to meet the deadline as interest on outstanding tax payments will still be payable from 1 February 2022 as normal.

https://www.gov.uk/government/news/hmrc-gives-self-assessment-taxpayers-more-time-to-ease-covid-19-pressures

Penalty for VAT reform delayed

In a Written Ministerial statement dated 13 January 2022, it was announced that the introduction of the new penalties for late submission and late payment of tax and the alignment of interest charges for VAT with other major taxes has been delayed.

Initially planned to come in from 1 April 2022, these changes will now be introduced 9 months later, from 1 January 2023.

The government states that this extra time will allow HMRC to ensure the IT changes necessary for the new penalties and interest charges can be introduced as effectively as possible.

https://questions-statements.parliament.uk/written-statements/detail/2022-01-13/hcws537

Potential date for Spring Statement 2022

The Chancellor has commissioned the Office for Budget Responsibility (OBR) to produce an economic and fiscal forecast for Wednesday 23 March 2022.

Tolleys stated:

> "The publication of these forecasts often coincides with a fiscal event. Under the government's preferred Budget timetable, Budgets take place in the autumn, and there is a Spring Statement at which new consultations are launched. If there is a Spring Statement this year, it is therefore likely to be held on or around 23 March 2022. Recent years have demonstrated that this preferred timetable is often derailed, and it cannot be discounted that there may be a full Budget on this date."

https://www.gov.uk/government/publications/forecast-2022-date-announcement/spring-2022-forecast-statement

Business Taxation

Legal fees allowed (Lecture B1296 – 22.03 minutes)

Summary – Legal fees incurred by a partnership to defend a partner against a criminal charge were deductible as they were incurred wholly and exclusively for the purpose of the partnership's trade.

T R Rogers and Sons is a scrap metal business run by Simon Rogers and his parents.

Operation Symphony was conducted by Thames Valley Police whereby undercover officers sold property which the police implied was stolen property. As a result of this operation criminal charges were brought against two partners, both of whom were subsequently cleared of charges. In the Simon Roger's case, this went all the way to the Court of Appeal. The legal costs of £543,091 incurred to defend the charges were deducted in the partnership accounts for the tax year ending 5 April 2014 and a further £61,240 were deducted in the year after.

Following an enquiry, HMRC issued a Closure Letter on 18 August 2019 disallowing the expenses on the basis that they were not wholly and exclusively incurred for the purpose of the trade as they had a duality of purpose. They agreed that there was a benefit to the trade but the defence also prevented a prison sentence and defended the individuals' personal reputations.

Unsuccessful at a review, the appellants appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal concluded that that the legal fees were incurred wholly and exclusively for the purposes of the trade. If found guilty, this would have had a major impact on the partnership's ability to continue trading. It was clear from the evidence provided that the lease would have been terminated, the Scrap Metal Dealer's licence was unlikely to be granted and insurance would not have been obtainable.

The Tribunal stated that they doubted that 'defence of liberty' was ever a concern. They found it extremely unlikely that Simon Rogers ever thought that there was a chance that he would go to prison. He had been told by his lawyers that he had a strong case, and the purported crime related to one purchase.

The Tribunal concluded that the damage to the Rogers' personal reputation occurred mainly when the police operation featured in the local news. Any positive impact on the reputation following the success at the Court of Appeal was effectively a by-product of the case and not a reason for the costs being incurred. The Tribunal stated that personal reputation was not relevant when deciding whether to incur the legal fees. It was the professional reputation that could be restored.

The appeal was allowed.

TR, SP and SR Rogers v HMRC(TC 08342A/V)

Tax relief on pension contributions denied **(Lecture B1296 – 22.03 minutes)**

Summary - Pension contributions made on behalf of key employees were not deductible as, through the tax scheme, they were not incurred wholly and exclusively for the purposes of the trade.

Through a promoter, the companies set up unfunded unapproved retirement benefit schemes to provide pensions to their directors and key employees. The scheme was registered under DOTAS.

The pensions were calculated by reference to the estimated profits for the relevant year. In each case, the aggregate amount of the pensions was set at 80% or 100% of the estimated profits before tax. Both companies deducted provisions in their accounts, in respect of their liability to make pension payments to employees in the future. A D Bly Groundworks and Civil Engineering Limited had provisions totalling £5 million and CHR Travel Limited a much smaller figure of around half a million pounds.

HMRC disallowed the provisions, arguing that they were incurred “for the purpose of a tax avoidance scheme and not wholly and exclusively for the purposes of paying pension income to the employees”.

The companies appealed and as the schemes were provided by the same promoter, the appeals were joined.

Decision

The First Tier Tribunal stated that there had been two purposes in mind when the companies had decided to establish the unfunded unapproved retirement benefit schemes:

1. To provide future pensions for key individuals in a way that did not involve any immediate reduction in working capital;

2. To create a tax deduction which reduced the amount of tax payable by the company.

The issue was whether the companies were doing so wholly and exclusively for the purposes of their businesses or whether there was a non-business purpose.

The First Tier Tribunal concluded that it was “inherently unlikely that two separate companies with very different businesses would independently decide to do the same thing for the same reasons and in exactly the same way.” The Tribunal was not satisfied that both companies separately came to the conclusion that they needed to discuss the remuneration packages of key members of the business to incentivise and motivate them while maintaining working capital. Neither produced any documentary evidence, such as minutes from board meetings, to support their claims. Further, there was no evidence to show that the companies had sought advice on the competitiveness of their remuneration packages.

The Tribunal concluded that “the provision of pensions to directors was, at best, only an incidental aim”.

The primary purpose was to reduce the companies' liabilities to pay tax without incurring any actual expenditure. This was supported by the facts that:

- the promoter's engagement letters stated that the scheme could be viewed as aggressive tax planning, indicating that tax panning was a fundamental consideration.

- The size of the pension liability "was determined as a percentage of the profits before tax regardless of the level of those profits and without discussion of or reference to any future pensions benefit to the directors."

Consequently, the "wholly and exclusively" test was failed and the appeal dismissed.

A D Bly Groundworks and Civil Engineering Limited and CHR Travel Limited v HMRC TC 08329/V

Is it a trade or a hobby? (Lecture B1299 – 11.05 minutes)

Background

The question sometimes arises whether an individual's part-time or occasional activity constitutes a hobby or a trade. The distinction can be important.

For example, individuals who buy and sell goods on internet sites such as Amazon and Etsy on a regular and structured basis may well be challenged by HMRC if profits from those sources are not declared as trading income.

What is a trade?

Unfortunately, there's very little guidance on the meaning of 'trade' in the tax legislation. 'Trade' is simply defined (in ITA 2007, s 989) as including 'any venture in the nature of trade' (NB an identical definition applies for corporation tax purposes, in CTA 2010, s 1119).

A 'venture in the nature of trade' might lack infrastructure and continuity, but otherwise contain characteristics of a trade. HMRC considers that activities which, in ordinary language may not be a full-blown trade, can nevertheless be taxable as trading income (BIM20065).

Is it a hobby?

In terms of whether something is a 'hobby', a dictionary definition of 'hobby' is 'an activity done regularly in one's leisure time for pleasure'. Aside from being a regular activity, a hobby will typically have some structure and purpose.

An activity that starts out as a hobby can escalate into a trade. For example, attending jumble sales or car boot sales are popular weekend activities. However, some people go one stage further and visit jumble sales and car boot sales regularly to buy goods with the intention of selling them for a profit on the internet marketplace.

A profit seeking motive is one of the 'badges of trade' (see below), and even a one-off transaction can be taxable as trading income, depending on the circumstances.

Trading allowance

If a hobby is taxable, the trading allowance is generally available. The trading allowance exempts trading, casual and/or miscellaneous income of up to £1,000 per tax year from income tax (ITTOIA 2005, ss 783A-783AR).

It is possible to elect for full relief not to be given, and to deduct actual expenditure instead. This may be beneficial if (for example) it gives rise to a trading loss.

Examples of activities that might be eligible for the trading allowance include casual babysitting, gardening or dog walking. If goods are sold which have been bought or produced (e.g., home baked cakes or handmade greetings cards) this activity is likely to be trading or a 'venture in the nature of trade', and once again the allowance potentially applies.

Badges of trade

The lack of statutory guidance on the meaning of 'trade' has resulted in extensive case law over the years. In addition, the 'badges of trade' can sometimes be helpful.

The badges of trade were first established by the Royal Commission for the Taxation of Profits and Income in 1955, using previous case law about what constitutes a trade. Subsequently, in Marson v Morton Ch D 1986, 59 TC 381, nine badges were identified. HMRC guidance (at BIM20205) lists these badges as follows:

1. Profit-seeking motive;
2. The number of transactions;
3. The nature of the asset;
4. Existence of similar trading transactions or interests;
5. Changes to the asset;
6. The way the sale was carried out;
7. The source of finance;
8. Interval of time between purchase and sale; and
9. Method of acquisition

However, applying the list of badges to the facts of individual cases in a mechanical fashion should be avoided, as this may not necessarily give the correct answer. For example, Marson v Morton included this statement:

> "…I would emphasise that the factors…are in no sense a comprehensive list of all relevant matters, nor is any one of them so far as I can see decisive in all cases." In addition: "I believe that in order to reach a proper factual assessment in each case it is necessary to stand back, having looked at those matters, and look at the whole picture and ask the question…was this an adventure in the nature of trade?"

In Salt v Chamberlain [1979] STC 750, the Judge (Oliver J) stated: "…I doubt whether the question whether in any given case a person is or is not carrying on a trade is capable of solution by the application of a logical progression of propositions culled from decided cases. The question is, I think, one of overall impression".

Exceptions to the rule?

In some cases, HMRC may seek to argue that an activity does not amount to trading. For example, some activities (e.g., gambling) are more conducive to incurring heavy losses than others. HMRC's approach is supported by an old established case, Graham v Green, KB 1925, 9 TC 309. One of the judges in that case stated:

> "There is no tax on a habit. I do not think "habitual" or even "systematic" fully describes what is essential in the phrase 'trade, adventure, profession or vocation'. All I can say is that in my judgment the income which this gentleman succeeded in making is not profits or gains…"

However, in McMillan v Revenue and Customs [2020] UKFTT 82 (TC), HMRC argued (unsuccessfully) that an individual's gambling winnings were trading income on the facts and evidence of the case.

In practice, whether someone is seeking to argue that their activity is a trade or a hobby, it is very important to ensure that complete and accurate evidence is kept demonstrating the characteristics of a trade or hobby as appropriate, in support of their argument (see Edwards v Bairstow and Another [1955] 3 All ER 48).

Contributed by Mark McLaughlin

Film scheme losses

The taxpayer invested in film distribution rights using a combination of his own funds and loans. In essence, investors, among whom was the taxpayer, were entitled to a share in the profits of the films, but this was subject to a minimum annual payment which was intended to enable them to meet their loan interest obligations. The aim of the arrangement was to generate a tax loss eligible for sideways relief and for the interest to be tax deductible.

HMRC denied the taxpayer's claim for sideways relief and issued discovery assessments to collect income tax on the minimum annual payments and disallowing the deductions for loan interest payments.

The First Tier Tribunal had dismissed the taxpayer's appeal and he appealed to the Upper Tribunal.

Decision

The first issue before the Upper Tribunal was whether the discovery assessments were stale. The taxpayer said they were because of the delay between the discoveries and the issue of the assessments. Referring to the Supreme Court's decision in Tooth v HMRC which found there was no notion of staleness in the statutory regime, the judges dismissed this aspect of the appeal. Further, the First Tier Tribunal had been entitled to conclude that the hypothetical HMRC officer would not have been alerted to an insufficiency of tax in relation to the minimum annual payments and interest payments.

On whether the taxpayer was entitled to the minimum annual payments and whether this was income from the non-trade business, the Upper Tribunal said the taxpayer 'obtained an enduring and “real benefit”' from the payments because he used them to pay interest under the loan agreement. His rights to them were not a 'mere legal shell'. It was necessary for the taxpayer to have a right to the income to be able to direct it be paid elsewhere but as stated in Bostan Khan v HMRC, entitlement and control were different concepts.

Further, the payments were income 'from' the non-trade business of exploiting films because they were part of the consideration received by the taxpayer under the distribution agreement. It was not necessary for the income to be variable or calculated by reference to the film exploitation.

The First Tier Tribunal had also dealt with the interest payments correctly. The test in s.612 ITTOIA 2005 was much narrower than the general trade deductibility test because the expenses had to be incurred wholly and exclusively for the purpose of generating the income chargeable under s 609 and s 610, rather than for the purposes of the business. The lower tribunal was correct to find that the taxpayer had to establish that he had incurred the expenses wholly and exclusively for the purpose of generating the minimum annual payments. The judges also supported the First-tier Tribunal's conclusion that there was more than one purpose in incurring the interest payments and, as a result, they were not deductible.

The taxpayer further argued that he should be entitled to a non-trade loss that he could carry forward and set off against the income which HMRC had assessed on him (s.152 ITA 2007). Again, the Upper Tribunal agreed with the lower tribunal that this was not possible. The information in the taxpayer's return related to a trade loss, and the judges did not accept that the 'clear entries in the return and white space should somehow be rewritten or converted many years later' into a s 152 claim.

The taxpayer's appeal was dismissed.

Thomas William Good v HMRC [2021] UKUT 0281 (TCC)

Adapted from the case summary in Taxation 16 December 2021

Planning for corporation tax in 2023 (Lecture B1297 – 19.34 minutes)

For the financial year 2023:

- the main rate of corporation tax will be 25% (S6(2)(b) FA 2021); and
- a so-called standard small profits rate of 19% is being introduced for companies with ‘augmented profits’ of £50,000 or less (S7(2)(a) FA 2021).

The relevant details about the standard small profits rate are spelled out in Ss18A – 18J CTA 2010. The £50,000 limit is specified in S18D(2)(a) CTA 2010.

A company’s augmented profits for an accounting period comprise:

- its profits chargeable to corporation tax for that period; plus
- its non-group distribution income received (S18L CTA 2010).

The full rate of 25% applies to companies with augmented profits of £250,000 or more (S18D(2)(b) CTA 2010). This rate is also chargeable on the profits of close investment companies and non-UK resident companies with UK source income or gains, regardless of the level of their profits (ie. even if the profits are less than £250,000).

Companies with augmented profits below £250,000 but greater than £50,000 will be liable at the main rate of 25%, but that charge is then reduced by a marginal relief.

The marginal relief formula is set out in S18B(2) CTA 2010 as follows:

F x (U – A) x N/A

where:

F	=	the standard marginal relief fraction;
U	=	the upper limit;
A	=	the amount of the augmented profits; and
N	=	the amount of the taxable total profits.

The special fraction for profits falling into the marginal zone is 3/200ths (S7(2)(b) FA 2021). The effective rate of tax on profits in the marginal zone is 26.5% and this can be demonstrated by comparing the tax on profits at the upper limit and the tax on profits at the lower limit. Thus:

	£		£
Upper limit	250,000	25%	62,500
Lower limit	50,000	19%	9,500
Difference	200,000	26.5%	53,000

The upper and lower profit limits are reduced on a pro rata basis where there are one or more associated companies (S18D(3) CTA 2010). For an accounting period of less than 12 months in length, the limits contract on a time basis (S18D(4) CTA 2010).

Illustration 1

Ted Enterprises Ltd has one wholly owned subsidiary. For the year ended 31 March 2024, the company's taxable profits amount to £100,000. It has no non-group dividend income.

For a company with one associated company, the upper profit limit is £125,000 and the lower profit limit is £25,000.

Ted Enterprises Ltd's taxable (and augmented) profits are £100,000. The company's corporation tax liability for this accounting period is calculated as follows:

		£
100,000 @ 25%		25,000
Less:	3/200 x (125,000 – 100,000)	375
		24,625

This produces an overall tax rate of 24.625%, but another way of showing the liability is to tax the first £25,000 at the standard small profits rate and the balance at the marginal rate. Thus:

	£
25,000 @ 19%	4,750
75,000 @ 26.5%	19,875
	24,625

The need to prorate the upper and lower profit limits between associated companies can have a seriously distortive effect on the aggregate tax liability where profits accrue unevenly across a group.

Illustration 2

Bertram Ltd, Reginald Ltd and Wilberforce Ltd are associated companies for the 12-month accounting period ended 31 March 2024.

Their respective taxable profits are:

	£
Bertram Ltd	3,000
Reginald Ltd	30,200
Wilberforce Ltd	16,800

Where there are three associated companies, the upper and lower profit limits are £83,333 and £16,667.

Because of the size of its profits, Bertram Ltd will pay corporation tax at the standard small profits rate, whereas Reginald Ltd and Wilberforce Ltd both fall into the marginal zone. Thus:

Bertram Ltd 3,000 @ 19%		£570
Reginald Ltd 30,200 @ 25%		7,550
	Less: 3/200 x (83,333–30,200)	797
		£6,753
Wilberforce Ltd 16,800 @ 25%		4,200
	Less: 3/200 x (83,333 – 16,800)	998
		£3,202

This gives rise to an aggregate corporation tax liability of £570 + £6,753 + £3,202 = £10,525 on combined profits of £50,000.

On the other hand, a single company with taxable profits of £50,000 would pay tax at the standard small profits rate.

Thus:

50,000 @ 19%	£9,500

This represents a saving of £1,025. From a corporation tax planning point of view, Illustration 4 represents the importance of trying to even out the profits of group members.

Where an accounting period straddles the introduction of the FA 2021 regime, the company's profits are apportioned between those falling into the financial year 2022 (which are taxed at 19%) and those falling into the financial year 2023 (which are taxed at the appropriate rate depending on the level of profits for that period, with the upper and lower profit limits being proportionately reduced). This apportionment must be done on a time basis (S52 CTA 2009) – for more details, see Para CTM01405 of the Company Taxation Manual.

Illustration 3

Derek Industries Ltd draws up its accounts to 30 June each year. The company has taxable profits of £360,000 for the year ended 30 June 2023. There are no associated companies.

The profits falling into the financial year 2022 are 9/12 x £360,000 = £270,000 (although, strictly speaking, this apportionment should be done on a daily basis). These profits will be taxed at 19%.

For the financial year 2023, the upper and lower profit limits are reduced on a pro rata basis to reflect the fact that only three months of the accounting period are included in the financial year 2023. The upper profit limit is 3/12 x £250,000 = £62,500 and the lower profit limit is 3/12 x £50,000 = £12,500. The profits apportioned to this financial year are 3/12 x £360,000 = £90,000. Given that this figure exceeds the upper profit limit for the period, the corporation tax charge will be at 25%. Thus:

	£
Financial year 2022	
270,000 @ 19%	51,300
Financial year 2023	
90,000 @ 25%	22,500
	73,800

This represents an overall rate of 20.5%.

Companies and their advisers wishing to mitigate the impact of the tax rate increase which will take effect on 1 April 2023 should note the following:

1. Where profits are likely to exceed the lower profit limit of £50,000, it will be worthwhile trying to establish whether profits can be accelerated so that they are chargeable in the financial year 2022 rather than in the financial year 2023.

2. Where the rate of corporation tax after 31 March 2023 is likely to be higher than 19%, it will be sensible for the company to delay any allowable expenditure in order to secure relief at a higher rate.

3. If the company has been making trading losses, will it be more beneficial to carry them forward rather than to carry them back? Remember that loss carry-forwards can now be set against total profits instead of (as used to be the case) against future profits from the same trade. In other words, is it preferable to obtain relief potentially at a higher rate or to have an earlier relief (or repayment), but at a lower rate?

4. Give careful thought to the impact of associated companies and consider whether some form of restructuring might be advantageous.

Contributed by Robert Jamieson

Loans to participators and Collins v Addies (Lecture B1298 – 16.22 minutes)

HMRC have recently produced new guidelines on the repayment rules for participator loans, explaining how they plan to proceed in the future with regard to these arrangements.

Everyone knows about loans to participators. If a close company makes a loan to a participator which is outstanding more than nine months after the end of the accounting period in which it was made, the company must make a payment to HMRC equal to 32.5% (rising to 33.75% for loans made on or after 6 April 2022) of the amount of the loan (S455 CTA 2010). This money remains in HMRC's hands until the loan is repaid.

In Para CTM61602 of the Company Taxation Manual, HMRC comment that they are finding 'an increasing number of cases' where loans and overdrawn directors' loan accounts (DLAs) are said to have been paid back, but in fact all that has happened is the movement of the debtor balances around a series of group or associated companies, with the original lender never actually being repaid.

Using the decision in Collins v Addies (1992), HMRC, who won the case before both the Court of Appeal and the High Court, argue that 'the substitution of a fresh debtor (for the original debtor) does not constitute repayment'.

In the High Court hearing, Millett J concluded:

> 'While payment by a third party on behalf of the debtor, or payment in kind by the debtor himself of by a third party, accepted in full discharge of the debt may well constitute repayment or satisfaction and not a release for the purpose of (the relevant legislation), I do not consider that the substitution of a fresh promise to pay by a third party can be similarly treated. A promise to pay by a new debtor constitutes valuable consideration and may properly be accepted by the company in substitution of the debt of the original obligee, but as a matter of ordinary usage it would not be regarded as payment. It seems to me that there is a clear distinction to be drawn between a novation, which involves the release of one debt and the substitution of another, and all other forms of payment or satisfaction under which the debt is actually repaid with no outstanding obligation on any party in respect of the debt or any similar sum.'

In contract law, novation is the replacement of one of the parties in a two-party agreement with a third party, with all three parties consenting. HMRC say that the release of a loan by way of novation does not represent repayment and so no relief is allowed under S458 CTA 2010. This sounds fair enough, except that S458 CTA 2010 now specifically refers to the repayment or release of a loan (which earlier versions of the section did not). Accordingly, a release by way of a novation should entitle the company to relief. The speaker suggests that this part of the loan to participator legislation needs to be reworded.

In addition, in Para CTM61602 HMRC express their concern about the increasing frequency with which repayments of close company loans are said to have been affected by circular or recycling arrangements.

They provide the following example:

> A shareholder wholly owns Company A which in turn wholly owns Company B.
>
> In the accounting period to 31 March 2019, the shareholder withdraws £2,000,000 from Company A. Just before the date (which falls) nine months after the end of the accounting period in which he borrowed the funds, e.g. on 28 December 2019, he borrows enough from Company B to repay Company A the amount outstanding at the end of its accounting period to 31 March 2019 (i.e. £2,000,000).
>
> His overdrawn DLA in Company A is therefore cleared, but his DLA in Company B is now overdrawn to the tune of £2,000,000. He continues to draw funds from Company B throughout the accounting period to 31 March 2020 and owes £6,000,000 by the end of that accounting period.
>
> On 23 December 2020, the shareholder borrows £6,000,000 from Company A to repay the amount outstanding in Company B at the end of 31 March 2020.
>
> This clears the 2020 DLA in Company B and creates an overdrawn balance on the DLA in Company A in the accounting period to 31 March 2021.
>
> This process continues in the accounting period to 31 March 2021 such that, at the end of that accounting period, the shareholder owes Company A £15,000,000. The same process is repeated.
>
> Clearly, the shareholder continues to hold an increasing amount of company funds from a combination of Company A and Company B, on which he has paid no income tax and on which it would seem that no S455 CTA 2010 charge arises.
>
> However, HMRC consider that, looking at the legislation as a whole and its purpose, there is no repayment here – rather S455 CTA 2010 should apply to the increasing amounts withdrawn from the companies.
>
> Therefore, £2,000,000 should be charged to S455 CTA 2010 on Company A in the accounting period to 31 March 2019, £4,000,000 on Company B in the accounting period to 31 March 2020 and £9,000,000 on Company A in the accounting period to 31 March 2021.

Ploys of this sort deserve to be challenged, given that the reality of the situation is obvious. However, HMRC's rationale for their line of attack as set out in the penultimate paragraph of (g) above hardly seems adequate as a technical challenge. Indeed, it is difficult to say that the loan from Company A has not been repaid if a genuine repayment has been made. But, in that case, could not S464A or S464C CTA 2010 apply? Why do HMRC appear reluctant to use these last two anti-avoidance sections which were brought in as recently as FA 2013? Are we likely to see further legislation being introduced in order to strengthen HMRC's hand?

Contributed by Robert Jamieson

Pillar two model rules published

The OECD has published detailed model rules for pillar two, providing governments with a template to implement the two-pillar agreement to address the tax challenges of the digitalised global economy, as agreed in October 2021.

Tax challenges arising from the digitalisation of the economy: global anti-base erosion model rules (pillar two) provide for a coordinated system of interlocking rules that:

- define the MNEs within the scope of the minimum tax;
- set out a mechanism for calculating an MNE's effective tax rate on a jurisdictional basis, and for determining the amount of top-up tax payable under the rules; and
- impose the top-up tax on a member of the MNE group in accordance with an agreed rule order.

The pillar two model rules also address the treatment of acquisitions and disposals of group members and include specific rules to deal with particular holding structures and tax neutrality regimes. The rules also cover administrative aspects, including information filing requirements, and provide for transitional rules for MNEs that become subject to the global minimum tax.

An explanatory commentary is expected later this month in January, and a more detailed implementation framework is expected in the middle of 2022 at the earliest. The stated aim is for pillar two to be brought into law in 2022, to be effective in 2023, with the undertaxed payments rule to come into effect in 2024.

Tim Sarson, head of tax policy at KPMG UK, said: 'The publication of model rules for the 15% global minimum corporate tax puts paid to any rumours of its derailment. Some had theorised that President Biden's domestic tax agenda getting delayed had put the OECD's plans at risk. But this new documentation suggests that international political consensus and confidence in the reforms remains strong.

'The move is a significant step towards realisation for the pillar two changes but businesses will be rightly concerned about the amount of detail they are still waiting for. With little over a year to go until enforcement, and a full implementation framework not due until next year, question marks linger over the administrative burden of compliance.'

'The OECD did include one early stocking filler from the UK Treasury's perspective – as requested, it looks as though tax per the accounts, not cash tax, will be used as the starting point for calculating if a business is required to pay top-up tax under the rules. This should simplify compliance for most firms,' Saron added. 'However, the revenue threshold of €750m is a steep cliff edge and means businesses just below the cut-off need to start thinking about compliance now before their growth might tip them over.'

In related news, the European Commission has since proposed a new directive to support the global minimum 15% effective tax rate, for large groups operating in the EU. The directive will set out how the principles will be applied in practice in the EU, with a common set of rules to ensure the effective minimum rate is 'properly and consistently applied across the EU'.

As the Commission's Q&A document explains: 'the proposal sets out how the effective tax rate will be calculated per jurisdiction, and includes clear, legally binding rules that will ensure large groups in the EU pay a 15% minimum rate for every jurisdiction in which they operate'.

Next steps for the directive will require unanimous agreement of member states via the Council, and the European Parliament and European Economic and Social Committee will also be consulted.

Tax Journal (7 January 2022)

VAT and indirect taxes

Learning to swim is not education (Lecture B1296 – 22.03 minutes)

Summary – A partnership running a swimming school was not providing education similar to that provided by a university or school. Its supplies were standard rated.

Dubrovin & Tröger GbR – Aquatics, a German partnership, runs a swimming school for children, with courses of different levels relating the basics and techniques of swimming. The partnership treated their supplies as exempt for VAT purposes.

Following a tax inspection relating to the years 2007 to 2011, the German tax authorities disagreed, stating that the partnership was not providing education similar to that provided by a university or school. The supplies were standard rated and issued assessments on that basis.

Dubrovin & Tröger was successful in their appeal to the Finanzgericht (The German Finance Court) who held that the teaching of basic swimming techniques constituted school education. Furthermore, a civil-law partnership may rely on Article 132(1)(j) of Directive 2006/112 in the same way as individual traders.

The German Tax Office appealed to the Federal Finance court arguing that the services were not exempt, on the ground that Dubrovin & Tröger did not have the status of a teacher giving private tuition, within the meaning of Article 132(1)(j) of Directive 2006/112.

The Federal Finance court referred the matter to the CJEU.

Decision

The CJEU found that the VAT exemption did not apply as 'school or university education' does not cover swimming tuition.

The Court acknowledged that swimming tuition was of undoubted importance but stated that it:

> “constitutes specialised tuition provided occasionally, which does not amount, in itself, to the transfer of knowledge and skills covering a wide and diversified set of subjects or to their furthering and development which is characteristic of school or university education.”

HMRC currently allows a sole trader or partnership to treat education in subjects normally taught in universities and schools as exempt from VAT and swimming is commonly taught in primary schools in the UK. Although no longer bound by CJEU decisions, it will be interesting to see whether HMRC policy will be influenced by this decision.

Finanzamt München III v Dubrovin & Tröger (Case C-373/19)

Student consultancy services (Lecture B1296 – 22.03 minutes)

Summary – Career coaching and other support services supplied by a company were standard rated as the company was unable to provide adequate evidence that the recipient was permanently resident outside of the UK.

The company supplied career coaching and support services to Chinese students. Arguing that it was supplying consultancy services to persons usually resident outside the UK, the company did not account for VAT as the place of supply of consultancy services is where the recipient belongs

The First Tier Tribunal agreed that the services were consultancy services rather than educational services, supplied where the non-taxable recipients of those supplies had their permanent address, or usually resided.

But that was not the end of the matter. Prior to July 2016, the company supplied its services direct to the students who were studying in the UK but from July 2016, the company contracted with their parents, who were usually resident in China.

It was common ground that parents had their usual residence in China and so from July 2016 onwards, the company's supplies were outside the scope of VAT.

The issue in this appeal to the Upper Tribunal concerned the VAT treatment for the supplies that took place before July 2016 when the company supplied the student's directly, even though in most cases it was the parents that funded the fees payable.

Mandarin Consulting Limited did not obtain information as to the students' "permanent addresses" in China but they did obtain information on where they were living while studying in the UK. The First Tier Tribunal concluded that the company did not take the steps required under Article 23 of the Council Implementing Regulation 282/2011/EU to establish the usual residence of its customers before the time it made supplies to them.

The company appealed to the Upper Tribunal.

Decision

The Upper Tribunal found that the First Tier Tribunal had erred in law and set aside their decision. The company was entitled to seek to establish that its customers had their usual residence outside the EU based on information gathered at, before, or after the time of supply, provided that this showed that this was the case at the time of the supply.

However, this did not change the final decision. Although not limited to evidence that it gathered at, or before, the time of supply, the company still failed to demonstrate, based on the evidence before the First Tier Tribunal, that the place of supply of the services provided to all students was outside of the EU. While its students would often have been usually resident in the same jurisdiction as their parent in China, this was not the same as all students being so resident. This was due to the multi-factorial nature of the test of residence. Consequently, these supplies were not outside the scope of VAT.

Mandarin Consulting Limited v HMRC [2021] UKUT 0292 (TCC)

Roof or roof insulation (Lecture B1296 – 22.03 minutes)

Summary - Insulated roof panels forming part of the roof were roofing and not insulation that could be separately attached to a roof.

Greenspace Limited supplied and installed insulated roof panels to residential customers, fitted onto customers' pre-existing conservatory roofs. It was common ground that these panels had insulating properties.

Having taken measurements, a third-party company manufactured the insulating panels, which Greenspace Limited then installed by removing the existing glass or polycarbonate panels and slotting in the new panels to the existing roof structure.

HMRC argued the new panels were roofing materials subject to the standard rate of VAT. By contrast, Greenspace Limited argued that they were subject to the reduced 5% VAT rate as a supply of energy saving insulation materials (Sch.7A Group 2 Note 1(a) VATA 1994). Energy saving materials are defined as insulation for walls, floors, ceilings, rooves or lofts or for water tanks, pipes or other plumbing fittings.

The First Tier Tribunal found as a matter of fact that the new panels were not self-supporting and could be used only if the customer already had an existing conservatory roof structure. It was important that, after the removal of the existing panels, the new panel installation disturbed as little as possible of a customer's pre-existing roof structure in order to prevent leaks. The Tribunal dismissed the appeal, finding that the company supplied new standard rated rooves.

The company appealed to the Upper Tribunal.

Decision

Whether a supply was the insulation of a roof or the supply of the roof itself, was not a question of fact and degree. The Upper Tribunal concluded that the First Tier Tribunal was entitled to question whether the overall supply of panels involved the company supplying a roof or insulation for a roof.

The Tribunal was not restricted to consider the panels in isolation from "the back of the van". Once fitted, the panels covered the entire conservatory roof. The Tribunal concluded that the panels formed a roof, and so the reduced rate could not be available. Had the panels been installed on top of the existing glass or polycarbonate panelled roof, it might have been supplying insulation for rooves, rather than a roof itself but this was not the case.

The appeal was dismissed

Greenspace Limited v HMRC [2021] UKUT 290 (TCC)

Reclaiming VAT on rent (Lecture B1296 – 22.03 minutes)

Summary – With no evidence provided to support his claim, recovery of input tax suffered on rental payments was denied.

Mpala Mufwankolo ran a pub from rented premises in London. The landlord had opted to tax the property and raised invoices accordingly.

Between 2015 and 2017, Mpala Mufwankolo sought to reclaim VAT of £1,300 and one for £4,923 in 11 quarterly returns.

HMRC denied the claim stating that there was no taxable supply from the landlord to Mpala Mufwankolo as the lease was in his wife's name. Further, there were no VAT invoices to support the claims or indeed evidence that he had actually paid the rent.

Decision

Despite being requested by HMRC, there was no evidence to support the repayments claimed. Far from supporting the taxpayer' case, the documents provided actually contradicted his claims:

- There was no property lease produced in either his sole name or jointly with his wife;
- There was no partnership business between Mpala Mufwankolo and his wife registered for VAT, nor any partnership agreement between them produced;
- There were no VAT rental invoices produced that were addressed to Mpala Mufwankolo but rather, the rent demands produced were addressed to his wife;
- There were no bank statements provided showing payment of any rent.

The appeal was dismissed.

As Neil Warren, independent VAT consultant, stated:

> 'There was probably a commercial reason why the lease was agreed between the landlord and the taxpayer's wife but this would not have been a problem if she had registered for VAT herself and opted to tax the property. She would then have claimed input tax on the invoices from the landlord and charged output tax to her husband, who could then have claimed input tax on his own returns. There would have been no VAT leakage with this arrangement.'

Mr Mpala Mufwankolo v HMRC (TC08308)

Claiming the cost of charging electric vehicles for business

HMRC and HM Treasury received a number of representations from businesses and business representatives about the limited options for reclaiming VAT on the cost of charging electric vehicles.

As a result, Revenue & Customs Brief 1 (2022) explains that HMRC is reviewing:

- the evidence required to allow an employer to claim the related VAT when reimbursing an employee for the actual cost of electricity used in charging an electric vehicle for business purposes;
- What simplification measures could be introduced to reduce the administrative burdens in terms of accounting for VAT on private use.

VAT Notice 700/64 on motoring expenses was updated on 6 January 2022, confirming that VAT incurred by businesses charging electric vehicles is recoverable on the business use element where vehicles are charged at work or at public charging point.

By contrast, where an employee charges a vehicle at home, the supply of electricity is made to the employee meaning that the employer is not entitled to recover the VAT on that cost.

https://www.gov.uk/government/publications/revenue-and-customs-brief-1-2022-reviewing-how-to-claim-vat-when-charging-electric-vehicles-for-business-purposes

https://www.gov.uk/guidance/vat-on-motoring-expenses-notice-70064

Matchmaking services (Lecture B1296 – 22.03 minutes)

Summary – Matchmaking services were 'services of consultants' and 'the provision of information' and so outside the scope of UK VAT when supplied to non-EU customers.

Gray & Farrar International LLP provided an exclusive matchmaking service to clients in many countries, with fees ranging from £15,000 to £140,000. The services provided included an initial interview and vetting process, the creation of the client's requirement brief, the matching process and then a follow up phone call to the client, seeking feedback following each introduction. All but the last stage of the services were carried out by Claire Sweetingham, the managing partner.

The partnership argued that no VAT should be charged on fees to non- EU customers because their services qualified as consultancy services or similar services including data processing and the provision of information under Art 59(c) of the Principal VAT Directive enacted as Sch.4A para 16(d) VATA 1994 within the UK.

HMRC disagreed and so the partnership appealed to the First Tier Tribunal.

The First Tier Tribunal found that the supply made by Gray & Farrar International LLP was a single composite supply of services and so the question as to whether that supply of services fell within Article 59(c) should be determined by reference to the principal components of the supply. The First Tribunal stated that 'if material elements of the supply went beyond the provision of expert advice, the supply was not services of a consultant.'

The Tribunal concluded that the services provided as the post-introduction liaison calls were important and material and were what distinguished Gray & Farrar International LLP's approach from other matchmaking businesses. This part of the service was not merely incidental to other parts of the supply. It could not be regarded as assisting the provision of information about a potential partner or the expert advice provided by Claire Sweetingham. This part of the service "went beyond" the provision of information and expert advice and so could not fall within Article 59(c). The appeal was dismissed.

Gray & Farrar International LLP appealed to the Upper Tribunal arguing that the First Tier Tribunal had erred in law by failing to properly characterise the partnership's supplies, and more specifically by not giving effect to the 'predominant element' test (Cases Levob and Mesto).

Decision

The Upper Tribunal agreed that the activities listed under Art 59(c) of the Principal VAT Directive were not confined to services provided by members of 'the liberal professions', as claimed by HMRC.

However, the Upper Tribunal confirmed that the First Tier Tribunal had erred in law by finding that the addition of 'post-introduction liaison' services changed the supply so that it “went beyond” what was covered by the Article. The First Tier Tribunal should have considered the potential application of 'the predominant element test'. It was possible to fall within Art 59(c), despite a material element of the supply going beyond what was covered in the legislation.

Applying this test, the Upper Tribunal found that a typical customer received expert advice and information relating to potential matches and that the post-introduction liaison services were not enough to change the character of the supply. The most important element supplied was the introduction to a possible match in the form of expert advice about the potential partner and the provision of related information.

The Tribunal remade the decision concluding that the matchmaking services supplied to non-EU clients fell within the scope of the special rule and were outside the scope of UK VAT.

Gray & Farrar International LLP v HMRC [2021] UKUT 0293 (TCC)

International Services **(Lecture B1300 – 20.09 minutes)**

Basic rule

The majority of services provided to overseas business customers will be supplied where the business customer belongs – the so called B2B supply.

So, if you are billing a French company the place of supply is France and the French company has a <u>mandatory</u> reverse charge obligation.

The UK company must ensure they have proof of their customers business status (e.g. VAT number, contracts, letterhead etc).

B2B services are outside the scope of VAT but the UK company must include the sale in Box 6 of their VAT return. From 1 January 2021, there is no requirement to complete an EC Sales List.

It is also good practice (but not mandatory) for the UK company to put the reverse charge narrative on their invoice to remind their French customer of their reverse charge obligation.

There are limited overrides to the basic B2B rule and these can be found in VATA 1994 Schedule 4A. VAT Notice 741A is also very useful.

Services supplied to non-business overseas customers are generally B2C and UK VAT would be charged. Again Schedule 4A and Notice 741A are useful for any overrides to these rules.

Overrides to the basic rules

Schedule 4A VATA 1994 lists the overrides in three parts:

Part 1 – General Exceptions (Paras 1 to 8)

Part 2 – B2B overrides only (Paras 9 to 9E)

Part 3 – B2C overrides only (Paras 10 to 16)

Whilst the basic rules remain unchanged post Brexit there are some important changes to the overrides within Schedule 4A. I will outline the more common overrides below.

General exceptions

<u>Land related services</u>

Services relating to specific sites are supplied where the land is situated.

Services relating to the sale of a UK property by an overseas individual would be subject to the standard rate of UK VAT e.g. estate agent commission, lawyers' conveyancing fees etc.

Likewise, if a UK individual was selling their Spanish holiday home, they would be charged Spanish VAT on similar costs.

UK providers of land related services would need to be careful of requests to undertake land related services on EU sites as this can create an EU registration obligation for the UK provider. For example, an interior designer is engaged by a high worth individual to work on his French, Italian and Austrian homes. These are land related services and as such the interior designer would have registration obligations in France, Italy and Austria.

From 1 July 2021 the designer could register for the non-union OSS and account for the relevant VAT through their OSS registration. Prior to 1 July 2021 multiple EU registrations would have been required.

If the land related services were provided to an EU registered business, we would need to check whether the destination state had a reverse charge rule for land related services. If it did then the reverse charge would take precedence and no OSS reporting would be required.

<u>Passenger transport</u>

The transport of passengers (or of any luggage or motor vehicles accompanying passengers) e.g. coach trips, is treated as being made in the country where the transportation takes place and in the case of more than one country, in proportion to the distances covered in each.

So if a coach trip crossed three EU countries the coach company would need to consider their VAT registration obligation in those three EU member states. Whilst passenger transport is zero rated in the UK it would be lower rated (at best) in EU Member States.

From 1 July 2021 the coach company could register for the non-union OSS and account for the relevant VAT through their OSS registration.

Hiring of a means of transport

Short term hire would be supplied at where the customer collects the means of transport e.g. car hire. Short term would be periods up to 30 days for cars (90 days for vessels).

Long term hire of transport would be supplied where the customer belongs (B2B or Schedule 4A Para 13A override if B2C).

Restaurant and catering services

Supplies of restaurant and catering services are made in the place where they are physically carried out.

UK caterers being asked to cater for an EU event would need to be aware of their potential registration obligation in the country in which the event takes place. The reverse charge may deal with that when the customer is a businessperson but when catering for private individuals an EU registration obligation is likely to arise. From 1 July 2021 this could be met via the non-union OSS.

B2B overrides

Admission to cultural, educational and entertainment activities etc

Admission to conferences, fairs, exhibitions etc are treated as made in the country in which the event takes place.

So, if a UK business was running a tax technical conference in the UK they would be charging UK VAT on the admission fee - irrespective of whether the attendee was a UK or non-UK business.

B2C overrides

Valuation or work on goods

Valuing or working on goods will be supplied where the work is physically performed.

This could create an EU registration obligation for UK businesses performing such work in the EU. From 1 July 2021 the non-union OSS can be used to discharge any EU VAT obligations.

Broadcasting, telecommunication and electronically supplied services

The override for broadcasting, telecommunication and electronically supplied services supplied B2C is found within Schedule 4A Para 15 and it shifts the place of supply to where the customer belongs. The most commonly accounted by practitioners would be electronically supplied services e.g. clients who offer downloaded software, apps, games, books, music etc.

This means that supplying electronically supplied services to consumers will create a registration obligation in the EU member state of download. Providers of electronic services will often have multiple EU registration obligations as one download in any member state will create a registration obligation – this would be the case pre and post Brexit.

Non-established traders do not enjoy the registration threshold that applies to established traders. So, a UK supplier providing electronic services to individuals in France, Germany and Netherlands would have a registration obligation in those member states.

Service providers avoided multiple EU registration obligations up to 31 December 2020 by taking advantage of the Union Mini One Stop Shop (MOSS) simplification. Rather than registering in each member state of download they could register for the Union Scheme MOSS via the UK portal. This was separate to their existing UK registration.

The service provider would still charge French VAT to French individuals, German VAT to German individuals etc but they report and account for the VAT via their MOSS return. UK VAT registration were still maintained for their UK sales and UK input VAT recovery.

From 1 January 2019 to 31 December 2020 there was a £8,818 annual de-minimus for your total EU sales. So, if the electronically supplied services into the EU were below this level, the service provider could charge UK VAT. The de-minimus rule is not available to UK service providers from 1 January 2021.

From 1 January 2021 the union MOSS scheme closed to UK service providers. If UK service providers wanted to continue with the MOSS simplification, they had to register for the non-union MOSS scheme in a member state of their choosing. Many chose Ireland or Malta as these portals and returns are in English. The effective date of their non-union MOSS registration would be 1 January 2021. So rather than submitting their MOSS return via the HMRC portal they submitted their MOSS return via the portal where they registered for non-union MOSS. Other than that, the practicalities remained the same.

From 1 July 2021 the non-union MOSS scheme was changed to the non-union OSS.

Schedule 4A Para 16 services

Para 16 services include consultants, accountants, and lawyers.

Up to 31 December 2020 para 16 services provided to non-EU consumers were supplied where the customer belongs. As a result, no UK VAT was chargeable when invoicing non-EU consumers.

Consultancy fees must be for the provision of information and expert advice. Where the services fall short of this then the basic B2C rule will still be in point and UK VAT should be charged.

From 1 January 2021 Para 16 was extended to any consumer outside the UK i.e. EU and non-EU consumers.

So, accountants would not charge VAT to any overseas client from 1 January 2021. B2B services remain basic rule whilst B2C services are covered by Para 16. There would be no EU registration obligation for B2B services as these are covered by the mandatory reverse charge. And unless the member state has a use and enjoyment rule for Para 16 services (unlikely) there will be no EU VAT registration for B2C services either.

The use and enjoyment rule post 1 January 2021

The use and enjoyment rules shift the basic place of supply to where the goods are used and enjoyed. The use and enjoyment rules only apply if we have a UK place of supply but the serviceis used outside the UK or vice versa.

The use and enjoyment rules only apply to specific services:

- Hiring of a means of transport (short and long term)
- Hiring of goods
- Broadcasting services
- B2B electronically supplied services and telecommunication services

For example, a UK car hire company renting a car to a US tourist for 6 weeks would charge UK VAT under the use and enjoyment rules i.e. USA basic rule re long term hire BUT as used and enjoyed in the UK the place of supply shifts to the UK.

Contributed by Dean Wootten