Tolley®CPD

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CONTENTS

Personal tax 5
Year-End Income Tax Planning (Lecture P1357 – 17.13 minutes) 5
PAYE offset denied (Lecture P1356 – 17.09 minutes) 8
Termination payments (Lecture B1359 – 16.27 minutes) 9
High income child benefit charge discovery (Lecture P1356 – 17.09 minutes) 15
Personal Liability Notice to collect NICs (Lecture P1356 – 17.09 minutes) 16
Capital taxes 18
CGT lettings relief (Lecture P1358 – 25.28 minutes) 18
Rollover relief (Lecture P1359 – 13.56 minutes) 20
SDLT on grazing land and woodland (Lecture P1356 – 17.09 minutes) 25
Multiple Dwellings but not mixed use (Lecture P1356 – 17.09 minutes) 26
Never a main residence 27
Administration 29
Postponement of tax 29
Rugby player was too late (Lecture P1356 – 17.09 minutes) 30
Electronic sales suppression (Lecture P1360 - 11.25 minutes) 31
HMRC and the regulation of tax advisers (Lecture B1360 – 15.23 minutes) 34
Deadlines 38
News 39
When to ignore a nudge letter 39
Hybrid and distance working 39
Business Taxation 41
Basis period reform – provisional figures 41
Basis period reform and averaging (Lecture B1356 – 21.29 minutes) 41
Transfer of a business and goodwill (Lecture B1356 – 21.29 minutes) 44
Profit dispute out of time (Lecture B1356 – 21.29 minutes) 45
R&D - changes to the tax reliefs (Lecture B1357 – 14.58 minutes) 46
Proposed amendments to FRS 102 (Lecture B1358 – 18.52 minutes) 48
VAT and indirect taxes 52
R&C Brief 1: Option to tax notification (Lecture B1356 – 21.29 minutes) 52
Medical supplies (Lecture B1356 – 21.29 minutes) 52
Council provided off-street parking (Lecture B1356 – 21.29 minutes) 53
Best judgement not applied 54
Works performed by public authority 55
Default surcharge 56

Personal tax

Year-End Income Tax Planning (Lecture P1357 – 17.13 minutes)

It's that time of year when tax return season is (theoretically) over, 5 April is on the horizon and we start to get queries from clients about things they could possibly do in order to save some tax for 2022/23.

The intention of these notes is just to throw a few simple ideas out. All of these suggestions are relatively simple to achieve, won't cost much in professional fees and shouldn't upset anyone on the 'other side'.

Use Personal Allowances

The personal allowance (PA) offers £12,570 of tax-free income and should not be allowed to go to waste. Which it will if you don't use it.

It isn't always easy to 'magic-up' a chunk of income, but small family companies could generate an income stream for those family members with income below the PA either by means of paying dividends or remuneration.

The remuneration route (salary, bonus, director fee etc) is more clunky as certain compliance hoops have to be negotiated (PAYE / RTI being the obvious one), but the upside is that a corporate deduction will be available providing that the payment is made for the purposes of the business and is reasonably commensurate with duties performed.

Care also needs to be taken so as not to trigger a Class 1 NIC charge for the employer as the NI thresholds for the earnings period will be lower than the PA.

The dividend route on the other hand is much simpler to put in place and can be made without worrying about PAYE obligations or NIC, but there is no corresponding corporation tax deduction. The recipient does, of course, need to have shares in order to provide the conduit through which to pay the dividend. But if these are in place, a dividend of £14,570 can be paid tax-free as this will utilise both the PA and the dividend allowance.

If businesses can afford to do so, a dividend could be paid so as to utilise not only the PA and dividend allowance but also the basic rate band (within which dividends are charged at the still generous rate of 8.75%). For a family member with no income, a dividend of £50,270 could be paid before 5 April at a tax cost of £3,124 (an effective rate of just north of 6%).

If there is a family trust in existence, conversations should be had with the Trustees with a view to making income distributions to beneficiaries who do not use their PAs. Minor children are the obvious weapon of choice. As long as the trust has not been settled by a still-living parent, gross distributions up to the PA can be made tax-free with a subsequent tax refund claim made to recover any tax deemed to have been deducted at source. For discretionary trusts, this generally means that payments of around £6,900 can be made to the child with the associated 45% tax credit (£5,600 or so) repaid later by HMRC.

Avoiding PA abatement

Personal allowances are restricted where total income exceeds £100,000 (meaning there is a full clawback of the PA where income from all sources exceeds £125,140). Remember here that interest and dividends are counted as income even though some of this income will be taxed at 0% by virtue of the savings or dividend allowances.

The effect of the PA abatement is that income in the £100,000 - £125,140 band suffers tax at an effective rate of 60%.

With this in mind there are various strategies to bring income down to £100,000 and avoid the PA clawback such as:

1. Shift income to a spouse or partner for example by transferring interests in assets such as shares and properties or by putting assets (bank accounts or rental properties) into joint names. For married couples, this can be achieved without worrying about CGT or IHT. For unmarried couples CGT needs to be considered as any transfers of chargeable assets will take at place at market value (although gift relief can eliminate any charge for transfers of assets such as shares in family trading companies or furnished holiday lets). Be careful here to make sure that the asset itself is transferred (not just the right to income from the asset) as the shifting of income alone could open the door to the arrangement being attacked under the 'settlements' rules.

2. Defer income until after 5 April where possible. [This may of course be 'kicking the can down the road' as this increases income for 2023/24, but we can worry about that this time next year.]

3. Exchange a bonus for additional employer pension contributions (salary sacrifice arrangements still work for pension contributions). Employer contributions are tax-free benefits thereby giving a tax and NI saving for the employee and an NI saving (and a corporate deduction) for the employer. You need to watch out for the annual allowance charge (see below).

4. Make personal pension contributions. "Net Income" for the purposes of the PA abatement rules means income after deducting of gross pension contributions. Paying enough pension contributions to bring net income down to £100,000 means that the pension contribution in this band will be effectively relieved at 60% (being 20% at source, an extra 20% by extending the basic rate band and the final 20% by virtue of the reinstated personal allowance. Pension contributions can no longer be carried back to the previous tax year so the payment must be made by 5 April to take effect for that tax year. Please remember to give your pension provider the heads-up that this is happening so that ducks are nicely in a row before 5 April. The pension provider may ask for information (for example to comply with anti-money laundering policies) which could take a day or so to be processed, so leaving this to the last minute is rarely a good idea. Care should be taken not to exceed the annual allowance (AA) as otherwise an annual allowance charge could be triggered. The AA is currently £40,000 but it is increased by any unused AA of the previous 3 tax years. This affords taxpayers the opportunity to make substantial pension contributions without a corresponding clawback charge.

5. Make charitable donations under Gift Aid. This also has the effect of reducing income when determining the PA abatement. Gift Aid donations should be made by the spouse with income chargeable at the higher marginal rates. Unlike pension contributions, Gift Aid payments can be paid after 5 April and then carried back to the previous tax year, as long as they are paid by the earlier of 31 January 2023 or the date when the self-assessment tax return is filed.

Transfer unused Personal Allowance

A member of a married couple / civil partnership who has been unable to fully utilise his/her personal allowance can transfer 10% of their personal allowance to their spouse or civil partner. Tax relief is then given to the recipient by means of a tax reducer equal to 20% of the transferred amount. The tax saving for 2022/23 is therefore £252 (which is not a lot, but it is free money).

What does help is that the election to transfer unused PA can be backdated 4 years (in this case to include 2019/20 if made before 5 April 2023). The election then stays in force until it is withdrawn (so there is no need to elect every year).

The election is only available for years in which both parties are not higher rate or additional rate taxpayers.

Avoid the child benefit clawback

Child benefit is clawed back in households where one of the carers has income exceeding £50,000. The benefit is clawed-back in full where income exceeds £60,000.

This means that for individuals with income in the £50,000 - £60,000 band, the marginal rate of tax on additional income is 40% plus 1% of the child benefit for every extra £100 of extra income. For a family with 2 children, this equates to a marginal tax rate of 59%. For a family with 3 children, this equates to a marginal tax rate of 66%.

Equalising income between the carers will help as the clawback charge is based solely on the income of the higher earning carer (not on joint income).

Again, making pension contributions so as to reduce “net income” to £50,000 will avoid the clawback charge (and obtain higher rate tax relief on the payment). For taxpayers with 3 children and income of around £60,000, £10,000 can be added to the pension fund at a net cost of less than £3,400.

Use the ISA allowance

The ISA allowance is still £20,000 and is available to each family member. Tax savings using ISAs are now essentially the preserve of investors with savings income in excess of the savings allowance (£1,000 for basic rate taxpayers and £500 for higher rate taxpayers). But for those in that position, these remain useful options.

ISAs are also useful alternative investments for individuals with excess cash whose pension pots are (or will be) affected by the lifetime allowance (currently standing at just north of £1 million).

Junior ISAs are also available with an annual investment limit of £9,000. These can be settled by parents without worrying about the parental settlement rules simply because they generate no taxable income.

One type of ISA which seems to fly under the radar is the "Lifetime ISA". These were introduced in 2017 to help individuals between the ages of 18 and 40 to save either for their first home or towards their retirement. The beauty of "LISA" is that the government adds a 25% tax-free bonus on deposits up to £4,000 per year. No other ISA has that facility.

Everyone under 40 should be advised to take out a Lifetime ISA as it opens-up the possibility of £1,000 a year of 'free money'. Contributions can then be made until age 50. For those individuals saving towards retirement, the Lifetime ISA can be accessed without penalty at aged 60. Withdrawals are tax-free.

Claims deadlines

Finally, do take the opportunity in March to review your claims deadlines. Many claims have a 4-year time limit pegged by reference to the end of the tax year. Claims for 2018/19 are therefore still in time. A quick check back to 2018/19 returns is never a bad idea.

Contributed by Steve Sanders

PAYE offset denied (Lecture P1356 – 17.09 minutes)

Summary – With no PAYE paid and the partnership losses used to reduce the tax liability to virtually nil, no PAYE credit was available.

James Baillie worked in the mobile phone industry and had his own companies. He was aware of "MTIC fraud" and was falsely accused of involvement in such a MTIC scheme, spending some 8 months in prison, before he was acquitted.

In 2003/04, earnings of £2,067,600 had been credited to James Baillie's directors loan account with Baillie Limited. He claimed that this was the net earnings, after deductions for PAYE and NIC, where the gross earnings were actually £4,425,000. This company was put into receivership. HMRC issued a final proof of debt against Baillies Limited which did not include the disputed PAYE liabilities.

James Baillie invested in film partnerships and it was not disputed that James Baillie claimed and had the right to utilise UK tax losses amounting to £3,642,125 arising from two film partnership transactions, the Third Close Film Fund No 3 Partnership and Grosvenor Park 2001 Partnership (the Film Partnerships). In 2003/04, his available partnership losses covered the whole of his income for the year, leaving only £2.50 as payable. As a result, he sought to reclaim the PAYE referred to above and understood that in order to do so, the PAYE must have been paid, which he believed had been done. He argued that HMRC had not included a debt for PAYE on the liquidation, so it must have been paid.

HMRC argued that the PAYE had not been paid, which was confirmed by James Baillie's advisers. While losses from the partnership were available to be offset against other profits, they could not be set against the PAYE related earnings, as the PAYE had never been paid.

Decision

The Tribunal noted that HMRC had amended James Baillie's tax return to reduce his employment income to the amount on his director's loan account, removing the credit for PAYE deducted. Mr Baillie's available partnership losses covered the entirety of this income for the year.

Consequently, the Tribunal concluded that HMRC were correct not to include the PAYE in the debts settled by the liquidator, since from their perspective, no income tax was due from James Baillie or Baillies Limited at that time.

The First Tier Tribunal found that the only evidence provided of the PAYE payment having been made to HMRC was the accounting entry in his director's loan account.

As the Tribunal stated:

> "in the *McVeigh* decision, the mere entry in the accounts of a company is not sufficient to amount to payment. In order to succeed, Mr Baillie needs to show that payment of this amount was actually paid to HMRC."

James Stuart Baillie v HMRC (TC08661)

Termination payments **(Lecture B1359 – 16.27 minutes)**

Specific legislation exists for termination payments because they do not fall to be treated as earnings under the general definition explained above. To put it simply, a termination payment does not arise 'from' the employment, it arises 'from' the termination. Without specific legislation, such payments would be tax-free.

The legislation covers all payments and benefits arising from the termination. It subjects these to a charge to tax to the extent that they exceed £30,000. However, the situation is more complex than this. The termination payment provisions are a 'back-stop', that is that they are only considered once a payment is not taxed under any provision.

It is important to consider all of the different elements which make up a termination package. This is normally included within a compromise agreement.

Redundancy payments are always treated as termination payments. You need to make sure that it is really redundancy.

> '*An employee who is dismissed shall be taken to be dismissed by reason of redundancy if the dismissal is wholly or mainly attributable to –*
>
> *(a) the fact that his employer has ceased or intends to cease –*
>
>> *(i) to carry on the business for the purposes of which the employee was employed by him, or*
>>
>> *(ii) to carry on that business in the place where the employee was so employed, or*
>
> *(b) the fact that the requirements of that business –*
>
>> *(i) for employees to carry out work of a particular kind, or*

> *(ii)for employees to carry out work of a particular kind in the place where the employee was employed by the employer,*
>
> *have ceased or diminished or are expected to cease or diminish.'*

Once redundancy has been established an employee is entitled to statutory redundancy once they have at least two years' service with the amount to be paid per year of service dependent on their age whilst working. Service of more than 20 years is ignored and there is a maximum weekly pay to be applied. Non-statutory redundancy can be paid above this and it is normal to obtain HMRC clearance on any amounts to be paid so that you can be sure it is redundancy.

The first thing we need to consider is whether they are taxable as earnings. Is there a contractual right to receive this payment? If so, it is likely to be earnings. Expectation of payments on termination can cause problems as HMRC have been known to argue that these become quasi-contractual. This is not an area which they have been particularly successful in arguing before the FTT or beyond.

Secondly, does it fall to be taxed under a specific heading? The most common would be a payment which can be treated as a payment under an unapproved retirement benefit scheme. Alternatively, a payment under a restrictive covenant would be taxable as earnings.

A payment is a receipt from an unapproved retirement benefit scheme if it is paid on or in anticipation of retirement, other than retirement due to ill-health or disability. You do not have to be actually retiring and HMRC can argue this point very aggressively.

EIM15300 contains examples of situations where HMRC consider that retirement has occurred.

Payments in relation to things like employment-related securities would follow the tax treatment for those. Payments to pensions can be exempt, even if paid on termination.

The tax treatment of termination payments was changed considerably in 2018. This was particularly targeted at the tax treatment of payments in lieu of notice (PILONs) but some other changes were also made.

Most employees have a notice period. This is the amount of notice an employee must give their employer before leaving their job. It is also the amount of notice an employer needs to give an employee before the termination of their contract.

The legal minimum period of notice that an employer is required to give an employee is generally one week for each complete year worked, up to a maximum of 12 weeks. However, notice periods are normally specified in the employment contract and can exceed the statutory notice period. As a general rule, the more indispensable the employee, the longer the notice period.

If an employment is terminated (other than for reasons of gross misconduct), the employee normally has a legal right to work and is entitled to receive wages for the duration of the notice period.

When notice of the termination of employment is given, the employer has a number of choices:

- It can honour the notice period by allowing the employee to work for the notice period and terminate the contract at the end of that period. In this case the employee will receive wages, all of which would be taxable.

- It can honour the notice period by paying wages but not require the employee to work (the so-called "garden leave"). Employers may do this to protect their client base (for example if the employee is leaving to work for a competitor) or if the employer feels that the employee's continued presence is likely to be disruptive or unhelpful. Amounts paid during a period of garden leave are fully taxable.

- It can terminate the employment within the notice period. This will typically be accompanied by a termination payment which at least in part represents pay which the employee would have been entitled to had the notice period been honoured. Such payments are called PILONs.

The latter has been something of a moving target since the case of EMI v Coldicott in 1999 when HMRC successfully argued that a PILON should be treated as earnings from the employment as the contract reserved the right for the company to make a PILON. Non-contractual PILONs on the other hand were not earnings and instead fell within the rules for termination payments thereby qualifying for the generous reliefs that those provisions bring. This never sat comfortably in Whitehall and things have now changed. The only real surprise is that it has taken the Government the best part of two decades to get around to it.

Until 5 April 2018, PILONs were either:

- Taxed in full if the employment contract gave the employer the right to make a PILON (which some contracts did to preserve the integrity of other elements of the contract such as non-disclosure agreements or restrictive covenant clauses); or

- Treated in the same way as an ex-gratia termination payment if the contract did not give the employer the right to make a PILON. In this case the making of the PILON was a breach of the contract and the subsequent compensation payment was treated as damages, thereby triggering eligibility for the £30,000 exemption. Non-contractual PILONs of less than £30,000 therefore escaped tax.

In cases within a), PAYE and NIC should have been applied to the full payment. I use the word "should" deliberately here as history is littered with cases where payments should have been put through payroll and haven't. If PAYE has not been applied correctly, thought should be given to treating the payment as having been made net of PAYE leaving HMRC to seek the tax from the employer.

In cases within b), PAYE should have been applied to the excess over £30,000. There is no NIC liability.

Since 6 April 2018, whenever a termination payment (other than a statutory redundancy payment) is made before the expiration of the contractual notice period, the payment needs to be divided into:

- Post-Employment Notice Pay (PENP); and

- Amounts which are not PENP.

PENP is taxable and subject to Class 1 NICs (employer and employee). It is treated as part of the earnings.

The amount of the payment that is not PENP is taxed under the rules for termination payments.

These new rules only apply to payments received on or after 6 April 2018 in circumstances where the employment ended on or after 6 April 2018. PILONs made after 6 April 2018 in respect of an employment that ended before 6 April 2018 will be taxed under the old rules.

It should also be noted that termination payments in excess of £30,000 became liable to Class 1A NICs with effect from 6 April 2019.

Calculating PENP

PENP is calculated using the following formula: (BP x D)/P less T

where:

> BP = the employee's basic pay for the pay period immediately before the date on which notice is given. Basic pay excludes taxable benefits and "extra-ordinary" payments such as bonuses, commissions, overtime payments and share-option gains. If the employee participates in a salary sacrifice arrangement (for example by giving up salary for employer pension contributions), pre-salary sacrifice pay must be used.
>
> D = the number of days in the "post-employment notice period" being the period from midnight on the last day of employment through to the 'earliest lawful termination date' (this being the date when the minimum notice period would have expired if given in full).
>
> P = the number of days in the pay period immediately preceding the period in which the termination payment was made; and
>
> T = amounts included as PENP that are already taxable as earnings (excluding holiday pay and termination bonuses). Deducting amounts already classed as earnings prevents a double charge. Amounts deducted would typically be payments such as contractual PILONs.

The intention of the formula is to produce a number that is equal to the basic salary the employee would have earned had they remained in employment for the whole of their notice period.

In essence, the slice of the termination payment that correlates with a PILON will now be taxable, irrespective of whether there is a PILON clause in the employment contract.

Example 1

Julian worked for Alpha Ltd. His basic salary was £52,000 per annum, paid weekly. Julian's employment contract specified a 4-week notice period. The contract did not contain a PILON clause.

Alpha Ltd gave notice of termination to Julian on Monday 13 August 2018. It was agreed that he would work for 5-days to clear his work on hand. He left the employment on Friday 17 August 2018 receiving a termination payment of £5,000.

Alpha Ltd is required to work out the amount of PENP within the termination payment.

If we apply the formula to Julian's payment:

BP = £1,000

D = 18 August 2018 – 9 September 2018 (23 days)

P = 7 days

T = Nil (i.e., none of the termination payment is otherwise taxed as earnings).

The post-employment notice pay (PENP) is:

$$\frac{1{,}000 \times 23}{7} \quad - \text{ Nil} \qquad = £3{,}286$$

This amount will be treated as earnings and is fully taxable. This should be put through payroll with PAYE and Class 1 NIC applied.

The remaining payment of £1,714 (5,000 – 3,286) will be treated as an ex-gratia termination payment and will qualify for the £30,000 exemption. None of this will therefore be taxable or NICable.

This new regime reflects HMRC's historical opinion that all PILONs should be taxable on the grounds that, had the employee worked and earned his wages as usual until the end of his notice period, that pay would be fully taxable. PENP is the way of ensuring this now happens.

Monthly basis calculations

HMRC Guidance at EIM13886 confirms that a monthly basis can be used where:

- The pay period is exactly a calendar month;
- The notice period is expressed in calendar months; and
- The unexpired period of notice is a period of whole calendar months.

'P' in the formula is then taken to be 1 (and thereby ignored) and 'D' is calculated in months rather than days.

Example 2

Julia worked for Beta Ltd. Her basic salary is £72,000 per annum, paid monthly. Julia's employment contract specified a three-month notice period. Julia resigned on 1 September 2018 and was immediately dismissed without notice. A termination payment of £60,000 was paid to Julia on 8 September 2018.

If we apply PENP the formula to Julia's payment (working in whole months):

BP = £6,000

D = 3 months

T = Nil

The post-employment notice pay (PENP) is:

6,000 x 3	- Nil	£18,000

The remaining payment of £42,000 (60,000 – 18,000) is treated as an ex-gratia termination payment. After deducting the £30,000 exemption, £12,000 of this will be taxable.

PAYE should be applied to the £12,000 but it is not currently subject to NICs.

As this falls within the termination payments rules, the £12,000 will be treated as the "top-slice" of income and should be taxed after savings income and dividends. [This will make a difference in cases where taxable non-savings income does not exceed the basic rate threshold.]

What you will notice here is that the taxable amount of £30,000 (being PENP of £18,000 plus non-PENP of £12,000) is the same as would have been the case under the old rules. Julia received a non-contractual PILON of £60,000 that, under the pre-2018 regime, would have qualified for the £30,000 exemption leaving £30,000 taxable.

The PENP rules ensure that:

- Where the non-contractual PILON is less than £30,000, some part of it – ie, the bit correlating with a PILON – is taxable (this wouldn't previously have been the case);

- The PENP element is earnings and is subject to Class 1 NICs. Under the old rules, none of the taxable amount of £30,000 would have been subject to NICs.

Overseas aspects

Problems can rise when you have termination payments being made.

Prior to 2018, there was foreign service relief available where an individual had their employment terminated in the UK but had spent significant time working outside the UK. This does not apply now and so you have to look to relief being provided by Double Tax Treaties.

Contributed by Ros Martin

High income child benefit charge discovery (Lecture P1356 – 17.09 minutes)

Summary - Discovery assessments issued to collect unpaid high income child benefit charges were invalid as the law at the time only allowed HMRC to assess tax relating to untaxed income.

Jason Wilkes had not submitted tax returns as his income was fully taxed under PAYE. However, he earned more than £50,000 and his wife had been receiving child benefit. Following up on an HMRC nudge letter received in November 2018, Jason Wilkes established that he was liable to the High Income Child Benefit Charge (HICBC), HMRC issued discovery assessments to collect the sums due for the tax years 2014/15 to 2016/17.

Jason Wilkes appealed and he was successful at both the First Tier and Upper Tribunals who found that legislation allows HMRC to assess income that ought to have been so assessed. At the time, it did not allow a discovery assessment to be used to collect a tax charge such as the HICBC.

HMRC appealed to the Court of Appeal.

Decision

Agreeing with the Upper Tribunal, the Court of Appeal confirmed that the HICBC was an unpaid tax charge, that did not relate to untaxed income. Jason Wilkes had been correctly taxed on his income through PAYE, meaning that no additional tax was due on his income. The discovery assessments were invalid.

The Court of Appeal stated that it was not its role amend the legislation to enable HMRC to collect the HICBC, In any case, the Court could not be sure that the wording differed from Parliament's intentions.

HMRC's appeal was dismissed.

Note: In s.97 FA 2022, the legislation was amended with retrospective effect, to allow HMRC to use discovery assessments to recover the HICBC. However, this legislation does not apply to discovery assessment appeals made before 30 June 2021.

HMRC v Jason Wilkes [2022] EWCA Civ 1612

Personal Liability Notice to collect NICs (Lecture P1356 – 17.09 minutes)

Summary – With the company in Creditor's Voluntary Liquidation, the Personal Liability Notice was not time-barred.

Gary Wagstaff was the sole director of Warehouse Holdings Limited (WHL). The company set up a PAYE scheme that was active from December 2009 to August 2013 and during this time, the company made deductions of income tax and NICs from its employees' salaries.

The company:

- filed its P35 Return for the tax year 2009/10 on 20 March 2012, almost two years after the deadline of 19 May 2010, declaring NICs due of £13,238.26;
- failed to submit its P35 Returns for the tax years 2010/11 to 2012/13;
- failed to submit monthly RTI returns for the tax year 2013/14.

Between June 2012 to October 2013 the company made payments to HMRC totalling £22,258.68 but failed to pay any further sums due for the periods 2009/10 to 2013/14.

On 20 November 2015 the company entered Creditors' Voluntary Liquidation (CVL).

Using computerised P11 Deduction Working Sheets provided by the company, HMRC were able to ascertain the NICs deducted from employee salaries in the years 2009/10 to

2013/14. In October 2016 HMRC submitted a proof of debt to the liquidators that included a claim for unpaid NICs for the tax years 2009/10 to 2013/14.

On 13 March 2019, on the basis that the company's failure to pay the NICs arose due to neglect by Gary Wagstaff, HMRC issued a Personal Liability Notice for unpaid NICs plus interest, totalling £301,941.10.

The sole issue before the First Tier Tribunal was whether the Personal Liability Notice was issued out of time. Gary Wagstaff contended that under s.9 Limitation Act 1980, the NICs were subject to a limitation period of six years. He argued that the NICs in respect of periods prior to the tax month ending 5 March 2013 were statute barred by 13 March 2019, when the Personal Liability Notice was issued. The First Tier Tribunal had dismissed Gary Wagstaff's appeal against the notice, finding that the Personal Liability Notice was not time-barred.

Gary Wagstaff appealed to the Upper Tribunal.

Decision

The Upper Tribunal found that:

> "When a company enters into CVL, its unsecured liabilities are inevitably in and to be determined within the liquidation. There is no other regime that applies to determine the existence of WHL's liabilities and their enforceability for limitation purposes".

The 6-year limitation period claimed by Gary Wagstaff did not apply. It did not matter that the Personal Liability Notice was not issued until March 2019.

The Upper Tribunal finished by saying:

> "There is no inherent unfairness in a culpable director remaining liable so long as their company is (still liable).
>
> …And in any event, limitation periods are often extended, for example if the debt is acknowledged.
>
> …Furthermore, when the company is dissolved, it is no longer liable to pay and so a PLN could not be issued."

At the time the Personal Liability Notice was issued, the company was still liable as the Creditors' Voluntary Liquidation was not completed, and the company was not dissolved until the months immediately prior to the Upper Tribunal's hearing.

The appeal was dismissed.

Gary Wagstaff v HMRC [2022] UKUT 00327 (TCC)

Capital taxes

CGT lettings relief (Lecture P1358 – 25.28 minutes)

CGT lettings relief was introduced in FA 1980 to ensure that property owners could rent out spare rooms within their house or flat without losing the advantage of main residence relief. However, in practice, the regime extended somewhat further than the original policy intention and benefited those who let out an entire property which had previously been their main residence.

This relief has, however, been subject to an important restriction in FA 2020 which took effect on 6 April 2020, and which seems to have been overlooked by significant numbers of tax advisers. There is little doubt that one of the main causes for this oversight was the start of the COVID-19 pandemic which hit the UK in March 2020.

The position prior to 2020/21

Where an individual had let out all or part of his main residence (or former main residence), a special relief was available under what used to be S223(4) TCGA 1992. This relief, which was set against the gain on the disposal of the property, was the lowest of three alternative figures:

1. the amount of the individual's main residence relief, i.e. his exempt gain; or
2. £40,000 per individual; or
3. the amount of the individual's chargeable gain in relation to the letting.

If a property was jointly owned by, say, a married couple, the maximum relief was £80,000. The effect of the original form of lettings relief is shown in the Illustration below.

Illustration

Jason purchased a flat in London with a 99-year lease on 1 March 2000 for £250,000 and occupied it as his main residence until 28 February 2015. He then acquired a new property which he used as his main residence from 1 March 2015 onwards. He made the requisite nomination under S222(5) TCGA 1992.

Jason rented out his old flat for five years until 1 March 2020 when he sold the long lease for £850,000.

Jason owned the flat which he sold on 1 March 2020 for a period of 20 years (240 months). During that time, he occupied the flat as his main residence for 15 years (180 months) and rented it out for five years (60 months).

Jason's overall gain was:

	£
Sale proceeds	850,000
Less: Cost	250,000
	£600,000

£450,000 (180/240 x £600,000) was eligible for main residence relief and so this part of his gain was not liable to CGT.

In addition, £45,000 (18/240 x £600,000) qualified for what was then the final period of exemption under S223(1) TCGA 1992.

This part of the gain was also not liable to CGT.

Jason’s CGT position at this stage was:

		£
Overall gain		600,000
Less:		
Main residence relief	450,000	
Final period exemption	45,000	
		495,000
		£105,000

Jason’s lettings relief would have been set against this figure and was the lowest of:

1. £495,000; or
2. £40,000; or
3. £105,000 (this was Jason’s chargeable gain which was attributable to the letting).

In other words, his lettings relief amounted to £40,000.

In order for lettings relief to apply in 2019/20 and earlier years, it was only necessary for the residential property to have been the taxpayer’s main residence within the terms of S222 TCGA 1992 at some time during the ownership period. As one commentator has pointed out:

‘This meant that former homes (which) were let out after occupation would qualify, as would buy-to-let properties (which) were occupied by the owner as their main home before sale.’

The position for 2020/21 onwards

The FA 2020 change, which was originally announced on 29 October 2018, restricts the availability of lettings relief to those who share occupation of their property with a tenant (S223B TCGA 1992). As mentioned above, this revised rule applies for disposals made on or after 6 April 2020. In this context, HMRC have stated:

> ‘Shared occupation is considered to apply where the owner is residing in the same dwelling with the tenant and continues to occupy that dwelling as his/her only or main home throughout the period of the letting.’

It is important to bear in mind that, where the property disposal takes place in 2020/21 or a later tax year, the sharing requirement operates throughout the letting process (including any period which predates 6 April 2020). In cases where the letting began before 2020/21, the FA 2020 amendment erases all the potential lettings relief built up in earlier tax years when the property was let. However, the calculation of the lettings relief itself has not changed.

HMRC's stance

HMRC are known to be challenging CGT calculations which include lettings relief on a regular basis. Where there is a disposal of a let residential property, there is no box in the CGT pages to confirm that the landlord was in occupation of the property at the same time as his tenant. The only information required to be provided is the three-letter code 'LET' which has to be inserted in Box 8 of SA 108 to notify HMRC that a rental property has been disposed of. Consequently, taxpayers need to confirm that the current CGT rules have been satisfied in the white space elsewhere in the tax return. However, as someone has pointed out, 'there is no guarantee that this part of the tax return will be read by a human before a letter is dispatched by the HMRC computer'.

One of the problems for taxpayers (and their advisers) is that, at present, the Capital Gains Manual contains no updated examples of lettings relief following FA 2020. The only examples – found in Para CG64737 – are illustrations relating to the period prior to 6 April 2020.

Of course, in practice, lettings relief is now rarely relevant for a gain on residential property. Where a landlord and his tenant are occupying the home as one household (and there is no exclusive use by the tenant), lettings relief is inapplicable since the entire gain for the dual occupation period will be covered by main residence relief (see Para CG64702 which expands on Statement of Practice SP 14/80). The only situation where lettings relief may be available for 2020/21 onwards is if part of the property is occupied separately by a tenant (eg. an annex or a granny flat). But this assumes that the let area is not self-contained. If it is, it may be regarded as a different dwelling.

Conclusion

The modern maxim is to double-check that the legislative requirements have been satisfied before making a claim for lettings relief.

Contributed by Robert Jamieson

Rollover relief **(Lecture P1359 – 13.56 minutes)**

Rollover relief is available where a trader sells an asset and then buys a replacement. The basic idea is that a trader does not have to suffer the tax on a sale which might then reduce the amount of proceeds available to buy a new asset.

To qualify for relief, both the old and new assets must be 'relevant' business assets and the required reinvestment must take place within a given time frame.

Relief is only available if both the original asset and the new asset fall within specified classes. It is not, however, a requirement that they should both fall within the same class.

The classes specified are:

- Class 1:

  (1) Head A:

  (a) Buildings, parts of buildings and structures in the nature of buildings;

  (b) Land.

  (2) Head B: Fixed plant or fixed machinery.

- Class 2: Ships, aircraft and hovercraft.

- Class 3: Satellites, space stations and spacecraft.

The remaining classes are only applicable to individuals and trustees. For corporation tax purposes, the assets within these classes are taken outside the scope of chargeable gains and dealt with under the intangible assets regime:

- Class 4: Goodwill.

- Class 5: Milk and potato quotas

- Class 6: Ewe and suckler cow premium quotas

- Class 7: Fish quota

- Class 7A: Entitlements under the Single Payment Scheme and the Basic Payment Scheme

- Class 8:

  (1) Head A: Syndicate rights of an underwriting member of Lloyd's.

  (2) Head B: Syndicate rights held through a members' agent pooling arrangement

There is no requirement to ensure that the actual sale proceeds of the old asset are used for the purchase of the new asset. Indeed, as the new asset may be purchased before the disposal of the old asset, this would be impossible in such a case. All that is required is that an amount equal to the disposal proceeds is expended on the acquisition of the new asset. HMRC accept that the comparison to be made is between the net disposal proceeds (after allowable costs of disposal) and the cost of acquisition (including incidental costs).

In this context, the disposal proceeds include any consideration deemed to have been received on the disposal, e.g. the market value of the asset in the case of a disposal to a connected person and the market value of any non-monetary consideration. This reinforces the fact that there is no actual matching of the sale proceeds to the purchase cost.

The relief works by reducing the allowable cost of acquisition and other expenditure of the new asset by the amount of the gain on the old asset. Thus, on a disposal of the new asset an enhanced gain arises which comprises the gains on both assets.

The way the relief works is to reduce the disposal consideration to an amount which produces no gain/no loss. The amount by which the consideration is reduced is then knocked off the purchase price for capital gains purposes for the new asset.

In a simple example, an asset is sold for £450,000 and crystallises a gain of £73,223. A new asset is purchased for £500,000. The notional sale price is reduced to £376,777 so that no gain and no loss arises on the disposal. The purchase price for the new asset is reduced by the same amount so becomes £426,777.

Where the amount reinvested in the new asset is less than the disposal proceeds, then partial rollover relief may be available as long as the amount not reinvested is less than the gain.

In that case, the chargeable gain on the old asset is reduced to the amount by which the amount reinvested falls short of the disposal proceeds and the cost of acquisition is again reduced by the amount by which the gain is reduced. In effect, the amount not reinvested comes back into charge as the gain on disposal.

In the above example, if the new asset had cost £400,000, then a gain of £50,000 would have come into charge on the sale. If it had cost less than £376,777 then no rollover relief would have been available. It should be noted that this does not affect the purchaser of the old asset or the vendor of the new asset.

There are two different forms of relief: 'roll-over relief' and 'hold-over relief'. Roll-over relief is the title given to the principal relieving section but is not otherwise a statutory term as the headings do not strictly form part of the legislation. It implies that the gain being relieved is 'rolled-over' onto the new asset. Hold-over relief is a variant of roll-over relief where the new asset is one which depreciates. In this instance, if the gain was deducted from the allowable cost of the new asset, it would gradually waste away under the rules relating to such assets.

Instead, the gain is held in abeyance and becomes chargeable on certain specified events. Those events are the earlier of:

- The date of sale
- The date the asset ceases to be used for the business
- 10 years

There is no specified time limit for the making of a claim and therefore the normal time limits apply. Individuals and trustees must claim within four years of the end of the year of assessment to which the claim relates and companies must claim within four years of the end of the accounting period to which the claim relates. Because a claim cannot be made until both a qualifying disposal and a qualifying reinvestment has occurred, the relevant tax year or accounting period is that in which the later of the acquisition or disposal occurs. As a consequence of the fact that a reinvestment may be up to three years after the disposal, a claim could be made up to seven years after the disposal.

Under the power granted by TMA 1970, Sch. 1A, para. 2(3), HMRC have determined the format of a valid claim to roll-over relief. It must be in writing and identify the following:

- the claimant;
- the assets which were the subject of the disposal giving rise to the gains;
- the date of disposal of each of those assets;
- the consideration received for each of those assets;
- the new assets which have been acquired;
- the dates of acquisition, or the dates of the unconditional contracts for the acquisition, of each of those new assets;
- the consideration given for each of those new assets; and
- the amount of the consideration received for the disposal of each of the specified assets that has been applied in the acquisition of each new asset.

Because a claim cannot be made before the reinvestment has occurred, taxpayers could be faced with having to pay the tax due on disposal and reclaim that tax once the reinvestment has occurred. Moreover, payment of the tax could actually prejudice the taxpayer's ability to fund the reinvestment. To overcome this problem, the statute gives relief on a provisional basis. If the reinvestment does not take place, then additional interest will apply on unpaid tax and HMRC will potentially levy penalties if they believe the return was incorrectly completed.

Individuals and trustees may make a declaration in the self-assessment return for the chargeable period in which the disposal takes place, to the effect that:

- all or a specified part of the consideration will be applied in acquiring new assets which will be used and used only for the purposes of the trade;
- the acquisition will take place within the time limit specified; and
- the new assets will fall within the qualifying classes.

It is a basic requirement for relief that the old asset must be used and used only for the purposes of a trade. It must be in use at the time of disposal which can cause some issues with achieving the relief. For example, trading property where planning permission has been obtained so it can be sold to a developer might not be available for rollover relief if HMRC can argue that the use for the purposes of the trade has ceased before the sale.

It is important to make sure that the activities undertaken are, in fact, trading. This would be judged in accordance with the normal badges of trading. A recent case focussed on whether land used for glamping on a farm as part of a diversification away from agriculture would prejudice the ability to claim rollover relief if the property was sold.

The asset which is the subject of the disposal must be used for the purposes of a trade or other business activity throughout the claimant's period of ownership, in order for full relief to be available. However, restricted relief is available if this condition is not fulfilled.

Where the asset has only been partially used for the purposes of a trade during the whole or any substantial part of the period of ownership, the part which has been used for the trade is treated as being a separate asset from that which has not. Thus the gain on the disposal is to be apportioned to the two notional assets on a 'just and reasonable' basis and only that attributable to the notional asset used for trade purposes is eligible to be rolled-over.

It is important that this apportionment only applies where the asset is still in use for the purposes of the trade at the date of disposal. If it is not, then no rollover is available at all even if there has been previous business use.

The new asset must be brought into use in the new trade on purchase or as soon as possible afterwards. Delays due to refurbishment or adaptation may be acceptable but it is important to ensure any delay in bringing the asset into use in the trade must be avoided. Trade in this context include furnished holiday lettings businesses. This can lead to a useful planning opportunities although the availability of business asset disposal relief has meant that rolling over into FHL has become less common.

All trades carried on by the same person either concurrently or successively are treated, for these purposes only, as a single trade. Thus it is possible for an individual or company to sell an asset used in one trade and acquire an asset used in a different trade.

Relief is also extended to situations where an asset is held by an individual in a personal capacity but used for the purposes of a trade carried on by his 'personal' company; that is, a company in which he is able to exercise not less than 5% of the voting power. It should be noted that there is no requirement that the individual must be a director of that company. To qualify for relief, the company must be the individual's personal company both at the date of the disposal of the old asset and at the date of the acquisition of the new one. The old and new assets must be used in the same company.

The receipt of rent by the individual from his personal company for the use of the asset does not prejudice roll-over relief. This is in contrast to the entrepreneurs' relief, applicable from 6 April 2008, where the receipt of rent will restrict relief.

Contributed by Ros Martin

SDLT on grazing land and woodland (Lecture P1356 – 17.09 minutes)

Summary – Grazing and rewilding land were not residential property, meaning that the mixed use rates of SDLT applied to the purchase.

Gary Withers and his wife bought a dwelling with an independent annexe, some 39 acres of gardens, fields and woodlands. They submitted their SDLT return on the basis that the property was mixed use as some of the land was used for sheep grazing and for cutting hay, and further land fell under a Woodland Trust rewilding scheme. The couple also claimed Multiple Dwellings Relief (MDR).

HMRC accepted the claim for MDR but argued that the land was wholly residential, with the grazing and rewilding land representing the dwellings 'grounds' (s.116(1)(a) FA 2003).

The grazing land had been used for this purpose continuously for 20 years and the Woodland Trust rewilding land was subject to strict conditions regarding access and use, as well as obligations on the Withers to control pests and not graze livestock. Written agreements were in place at the effective date of the land transaction. The taxpayer appealed.

Decision

Both parties agreed that the house and annexe were residential property; the issue was whether the land could be used by the owner as they wished, making it part of the garden and grounds of the property.

To qualify as mixed-use land, the First Tier Tribunal stated that the land needed to have a function other than garden or grounds. With both grazing and Woodland Trust agreements in place at the time purchase, the Tribunal found that these areas of land had separate purposes. More specifically, the sheer volume of sheep grazing meant that the land had a commercial use. Farming equipment including a feeding station and water troughs demonstrated that the land was used agriculturally rather than for personal use. Under the rewilding agreement with the Woodland Trust, the Withers were responsible for 50% of the relevant costs and they had an obligation to control rabbits and prevent animals grazing.

The Tribunal found that the purchase was of mixed-use and the appeal was allowed.

Gary Withers v HMRC (TC8649)

Multiple Dwellings but not mixed use (Lecture P1356 – 17.09 minutes)

Summary - A commercial lease entered into to enable the taxpayer to reduce their SDLT breached anti-avoidance provisions so the scheme failed but Multiple Dwellings Relief was then available.

Daniel Ridgway wanted to acquire two adjacent properties: a semidetached house and a property converted from a garage, previously used as an artist's studio, The two properties had separate titles and land registrations.

Daniel Ridgway wanted to make the best offer possible. He took advice on how to reduce the SDLT payable, so enabling him to increase the price he could offer. He was advised that if the 'artist's studio' was in commercial use at completion, then following HMRC's Guidance at SDLTM00365, his purchase would qualify for the lower mixed-use rates of SDLT. The guidance stated:

> 'SDLT is assessed on the basis of use at the time of the purchase, so if there is a genuine arm's length commercial tenancy, that should be mixed use, rather than residential.'

Daniel Ridgway was also advised that if a commercial lease was not possible, Multiple Dwellings Relief could be claimed.

Based on this advice, and prior to the purchase, Daniel Ridgway found a photographic studio that agreed to take on a 9-month commercial lease. This prohibited use of the property as a dwelling and further, sub-letting was not allowed. With the lease in place at completion, Daniel Ridgway claimed mixed use relief from SDLT.

HMRC stated that their guidance did not have the force of law and preferred to apply their latest thinking. Consequently, HMRC argued that, despite not being used as a dwelling at completion, it was suitable to do so, meaning that the residential rates applied. HMRC's current guidance reflects this thinking.

HMRC denied the Multiple Dwellings Relief as, although the taxpayer would have been eligible for the relief, the claim was not made in the SDLT return.

Decision

The First Tier Tribunal found that the terms of the commercial lease and the consequences of breaching those terms made the property not "suitable for use" as a dwelling at the effective date.

However, under the s.75 FA 2003 anti-avoidance provisions, mixed use relief was denied. The Tribunal noted that although s.75A FA 2003 refers to "Anti-avoidance", the section applies whether or not there is a tax avoidance motive (Project Blue Limited v HMRC [2018] UKSC 30). All that is required is that a lower amount of SDLT would be payable because of the scheme transactions. Daniel Ridgway had entered into the commercial lease to reduce his liability to SDLT, so enabling him to pay the largest price possible for the properties and so out-bid the competition. Having fallen foul of s.75A, the lease was ignored, meaning that the notional transaction that had taken place was simply the sale and purchase of the properties.

Finally, the Tribunal considered the Multiple Dwellings Relief claim and found that:

- Multiple Dwellings Relief was deemed to be available as a result of the disregard of the commercial lease;
- there is no statutory requirement to make a claim for relief in a land transaction return or an amendment to a return.

The appeal was allowed in part.

Daniel Ridgway v HMRC (TC08636)

Never a main residence

Summary – Having never lived in the second property as their main residence, the Additional Dwelling Supplement could not be repaid when it was later sold.

Meng Choo Tan owned a home in Edinburgh and decided to downsize, buying a second property in March 2020. She submitted her Land and Building Transaction Tax return and paid the £8,000 Additional Dwelling Supplement (ADS) that was due.

Due to COVID-19, she was unable to sell her first property or able to occupy her second property.

In 2021, she sold her first property and bought a third property. Less than two years later, she sold the second property and claimed repayment of the £8,000 ADS previously paid, arguing that she had never intended to own two properties for more than 18 months. This had only happened as a result of the pandemic.

Revenue Scotland refused the claim and Meng Choo Tan appealed.

Decision

The First Tier Tribunal for Scotland found that, despite the taxpayer’s intentions, it must apply the law as stated, with no discretion to deviate from what was enacted. The tribunal had no jurisdiction to consider fairness.

The Land and Buildings Transaction Tax (Scotland) Act 2013 states that a repayment would only be allowed if she had lived in the second property as her only or main residence, which she had not.

The appeal was dismissed.

Ms Meng Choo Tan v Revenue Scotland [2022] FTSTC 10

Administration

Postponement of tax

Summary – postponement of tax was refused as there were no reasonable grounds to believe that tax was being overcharged.

Philip Ravicher was UK tax resident and non-UK domiciled. He owned a property in Epsom, a property in Russia where his parents resided rent free and a property in Cyprus (beneficially owned by his ex-wife who was resident in Cyprus).

In August 2018, HMRC opened an investigation under Code of Practice 8 and notified Philip Ravicher that an enquiry into his tax returns for the 2016/17 tax year had been opened under section 9A TMA.1970. HMRC stated that they were concerned about the taxpayer's business interests, residency status and his means.

On 22 August 2018, Philip Ravicher engaged WLH Taxation Limited to represent him. The company submitted a draft Outline Disclosure to HMRC, including an estimate of £500,000 of taxable remittances to the UK. Having never sought advice before, Philip Ravicher claimed that he was unaware of the need to declare these remittances prior to this time.

On 25 February 2020, HMRC informed his advisors that having reviewed 25 of 28 bank accounts, they had identified potential remittances of some £1.2million for the tax year 2016/17. HMRC pointed out that Philip Ravicher had become UK resident in the tax year 2009/10 for the purposes of the remittance basis charge.

HMRC stated that in order to protect time limits for earlier years, protective assessments for the tax year 2013/14 had been issued based on the assessment of the information HMRC held. HMRC also indicated that they intended to open enquiries into the tax years 2017/18 and 2018/19.

In 2021, HMRC confirmed that they were amending the tax return for 2016/2017, to include £1,340,000 of taxable remittances. HMRC amended the 2017/18 and 2018/19 tax returns with the additional tax in respect of those two years postponed, since those assessments had been raised on the basis of the presumption of continuity. Philip Ravicher requested postponement of payment of all the tax until he had finished disputing it with HMRC. However, HMRC refused to postpone the 2016/17 tax as Philip Ravicher had only disclosed £500,000 of taxable remittances and he had not convinced HMRC that certain loans repayments accounted for a significant proportion of the remittances made.

Decision

The First Tier Tribunal did not accept that Philip Ravicher had fully cooperated with HMRC as HMRC had to resort to issuing a Schedule 36 Information Notice and still intends to issue more. Much of what had been provided by the taxpayer was misleading and incorrect. There are many unanswered questions.

The Tribunal found that there was no evidence that the remittances were capital in nature. Philip Ravicher had not established that there was a loan or, even if there was one, that there were any repayments made accounting for the remittances made to the UK. The arguments put forward were at times ‘contradictory and, looked at in the round, are not credible’.

The First Tier Tribunal concluded Philip Ravicher did not have any grounds to believe that he had been overcharged to tax by HMRC. In fact, the Tribunal concluded that ‘in all probability he has been undercharged’.

The appeal was dismissed.

Philip Gutmanovich Ravicher v HMRC (TC08659)

Rugby player was too late (Lecture P1356 – 17.09 minutes)

Summary – An application for permission to make a late appeal against HMRC’s IR35 assessments was dismissed.

Michael Lynagh, a former professional rugby player, was employed by Dow Jones but also provided his services as a “pundit’ through his personal service company, MPTL Limited.

HMRC challenged the tax treatment of the services provided, arguing that they fell foul of IR35. HMRC raised assessments to collect income tax and NICs totalling some £230,000.

Following a statutory review, HMRC’ sent a letter that upheld the application of IR35 and the determinations and decisions made. The letter was lengthy and detailed, extending to 19 pages. It concluded with a section setting out MPTL Limited’s appeal rights, stated that an appeal had to be made in writing to the First Tier Tribunal within 30 days.

MPTL Limited’s agents notified HMRC that they intended to appeal within the time limit but failed to notify the tribunal.

Unhappy with their agents, MPTL Limited appointed new agents, who then discovered that the previous agents had failed to lodge an appeal with the First Tier Tribunal by the deadline stated. The new agents applied for permission to make a late appeal.

Decision

The First Tier Tribunal considered the three-fold test set out by the Upper Tribunal in Martland v HMRC [2018] UKUT (TCC):

1. How late was the appeal? - 59 days late was sufficiently long to be considered ‘serious'.

2. What was the reason for being late? - there was no good reason for the appeal not being made on time. HMRC's letter was clear and the agents were a professional firm who should have been aware of the procedure for filing appeals. The company could not distance itself from its agent. Stating that “compliance with clear time limits, failures by MPTL's professional advisers are to be treated as failures by MPTL itself.”

3. Circumstances of the case - The Tribunal did not feel that the case was sufficiently strong as outside of his “pundit’ role, Michael Lynagh worked as an employee for Dow Jones and had no other self-employment activities to support his case.

The application was refused.

MPTL Limited v HMRC (TC08669)

Electronic sales suppression **(Lecture P1360 - 11.25 minutes)**

This article considers HMRC's focus on the misuse of electronic till systems, and other electronic sales suppression methods, and the sophisticated methods being adopted by some businesses to under-declare their profits.

What is Electronic Sales Suppression?

Electronic Sales Suppression ("ESS") is where a business (for example, bars, restaurants and retail) uses a tool to either hide or reduce the value of individual transactions on electronic sales records. This goes beyond software manipulation in electronic tills, and also includes computer code and hardware. The definition of "tool", at Paragraph 1 (6), Schedule 14, Finance Act 2022 is wide-ranging.

HMRC consider that you are involved in ESS if you made, supplied, or promoted an ESS tool. You are also involved in ESS if:

- you own an ESS tool;
- have access to an ESS tool;
- have tried to access an ESS tool.

The manipulation can take place either at, or after, the point of sale. The result is that the records appear to be correct and complete.

Penalties, and HMRC's information powers

Advisers will be aware that HMRC have extensive information powers, and a considerable array of penalties that can be imposed on taxpayers. Those penalties, and powers, were extended by the provisions of Schedule 14, Finance Act 2022.

The provisions introduce the ability for HMRC to charge penalties to those making, supplying or promoting the use of an electronic sales suppression tool. The maximum penalty is £50,000, although the exact amount is subject to various factors, including the complexity of the tool.

The provisions also allow HMRC to charge taxpayers a penalty when they are in possession of an ESS tool. The penalty is worked out differently from that noted above, with a maximum initial fixed penalty of £1,000, plus daily penalties of up to £75 per day. HMRC's guidance states that it is their policy to charge the full £1,000 fixed penalty where the taxpayer has already been charged an ESS penalty in the last five years. In addition, after the fixed penalty has been charged, the daily penalty rate will normally be £75. Although the penalty for possession of an ESS tool may seem more favourable than the penalty charged for making, supplying or promoting the use of an ESS tool, advisers should be aware that other penalties may be applied (including for failing to notify, or the submission of an incorrect tax return, etc).

The provisions at Schedule 14, Finance Act 2002, extend the existing information powers at Schedule 36, Finance Act 2008, to include persons that HMRC suspect may be liable to an ESS penalty. The provisions enable HMRC to ask for certain information that only applies to ESS, and allows HMRC to issue a notice to a ‘relevant person’ for a ‘relevant purpose’.

Disclosure facility

On 8 December 2022, HMRC announced that they would provide a disclosure facility for taxpayers who had misused their electronic till system to under-declare their profits, with a consequent underpayment of tax. The facility provides that disclosures can be made between 6 January 2023 and 9 April 2023. Details of the undeclared sales for all years must be provided to HMRC.

Advisers can use the facility on behalf of their client. HMRC have, so far, produced limited guidance on the disclosure facility, but state that the maximum penalty is 100%. The guidance states that they will open an investigation if the information that is provided by the taxpayer is "significantly incorrect". Advisers should note that, in common with other recent disclosure facilities, HMRC do not provide immunity from prosecution. Advisers need to proceed with care when considering using the facility, and should consider the other options available.

Where there has been a significant under-declaration of profits by the business, or the taxpayer's behaviour may be considered "deliberate" or fraudulent by HMRC, advisers should consider making a disclosure under Code of Practice 9 (the Contractual Disclosure Facility, covered in a separate session).

Practical points for advisers

As with most of HMRC's disclosure facilities, there has not been widespread publicity regarding the process relating to electronic sales suppression. Most taxpayers are not in the habit of scouring HMRC's website for information that may relate to them. Advisers may want to consider whether they should contact their clients who may be impacted by the new provisions, to make them aware of the disclosure facility. The skill in any such communication is in not being accusatory, but providing the relevant information to clients. Advisers may, for example, want to consider a comment in their newsletter, if they have one, if they feel uncomfortable contacting specific clients, or a group of clients, directly. I appreciate that some may consider this to be a controversial suggestion. However, I would take the view that it is better that clients learn of the facility from their own adviser, rather than a third party. Whether affected clients make themselves known is another matter.

Where a client indicates that they have a disclosure to make, advisers need to ensure that they consider whatever options are available to the client. The disclosure facility may not be the only option. Where there has been a significant under-statement of profits, or HMRC may view the client's behaviour as deliberate or fraudulent, consideration should be given to using the Code of Practice 9 process (the Contractual Disclosure Facility). Advisers should seek specialist assistance if they are unsure how to proceed, or do not have suitable experience in these matters.

As noted earlier, the disclosure facility is only open for a very limited period. After the expiry of that period, clients may approach you for assistance. Also, HMRC can be expected to follow-up on the information they have obtained, and will continue to obtain, regarding electronic sales suppression. That will mean the issue of enquiry or investigation letters, as well as a significant number of nudge letters to taxpayers they suspect may have participated in such behaviour.

Contributed by Phil Berwick, Director at Berwick Tax

HMRC and the regulation of tax advisers (Lecture B1360 – 15.23 minutes)

Background

The professional standards of tax advisers are variable. Furthermore, around 65% of individuals and firms who undertake tax work are not members of any professional body, so are unregulated in that sense.

Regulation by professional bodies

The professional standards for those engaged in tax work who are members of professional bodies are generally set out in regulatory documents produced by those bodies.

For example, 'Professional Conduct in Relation to Taxation' (PCRT) was produced by seven professional bodies, '…to assist and advise members on their professional conduct in relation to taxation, and particularly in the tripartite relationship between a member, client…and HMRC'.

Those professional bodies include the CIOT, ICAEW, ICAS, and STEP. Solicitors and barristers who advise on tax are subject to their own rules and regulations, but still need to be mindful of the PCRT standards for members of the relevant professional bodies.

HMRC regulation of tax advisers

HMRC has been engaging with the tax profession to agree a single common standard for all agents, but this has not been achieved at the time of writing.

In the absence of common standards and regulations for qualified and unqualified advisers alike, HMRC has set its own standards for tax advisers, with sanctions for advisers who fail to meet those standards. HMRC expects all tax advisers who interact with them to maintain HMRC's standards, regardless of professional body membership.

HMRC's standard for agents

HMRC has produced a document 'HMRC: the standard for agents', which sets out the minimum standards expected of agents ('agents' in this context applies to both agents and tax advisers).

For compliance work, the HMRC standard requires agents to maintain high standards in respect of the following three areas:

- Integrity;
- Professional competence and due care;
- Professional behaviour.

In addition, HMRC applies the following standards for those advising on tax planning:

- Lawful behaviour;
- Disclosure and transparency;

- Tax planning arrangements (i.e., agents must not create, encourage or promote tax planning which sets out to achieve results contrary to the clear intention of Parliament in enacting relevant legislation, or which are highly artificial or highly contrived and seek to exploit shortcomings in the relevant legislation); and

- Professional judgement and appropriate documentation.

HMRC monitors agents and collects evidence of poor agent behaviour. The HMRC standard is a benchmark, and if the behaviour of an agent falls below that standard, HMRC will consider taking action against the agent. HMRC has a range of powers and practices to deal with breaches of the standard by agents.

The HMRC standard for tax agents can be downloaded from the gov.uk website (https://www.gov.uk/government/publications/hmrc-the-standard-for-agents/the-hmrc-standard-for-agents).

HMRC and agents

HMRC have also produced guidance on its approach to working with agents in a document entitled 'How HMRC works with agents', which was published on 11 January 2023. The document sets out HMRC's approach to working with tax agents and advisers.

Those agents who are compliant with the HMRC standard for agents benefit from full access to HMRC's agent services. However, HMRC warns that if an agent does not meet the standard for agents, action will be taken against the agent, which HMRC states will be proportionate, reasonable, justifiable, lawful and procedurally fair.

The HMRC approach to working with agents in its document 'How HMRC works with agents' can be downloaded from the gov.uk website at:

> *https://www.gov.uk/government/publications/hmrc-approach-to-working-with-agents/how-hmrc-works-with-agents*

HMRC sanctions for breaches

HMRC's range of approaches, policies and powers for addressing poor agent behaviour is set out in a separate HMRC document 'Raising standards in the tax advice market – HMRC's review of powers to uphold its standards for agents'. Once again, the term 'tax agent' refers to all individuals and businesses involved in a professional capacity representing or advising taxpayers.

The document points out the actions HMRC will take to help support good tax agents and continue to tackle poor tax agent behaviours.

HMRC policies and statutory powers

There are three main HMRC policies and statutory powers:

1) HMRC might consider suspending agent codes to limit access to self-assessment and corporation tax functions.

2) HMRC can adopt a ‘refusal to deal with’ approach to agents. This approach is reserved for extreme and exceptional circumstances of poor agent behaviour, such as threatening, abusive and rude behaviour towards HMRC staff, and serious abuses of the tax system.

3) Certain statutory powers are potentially available for HMRC to address what it considers to be poor agent behaviour. In summary:

   - HMRC has the power to issue conduct notices and financial penalties of up to £50,000 to tax agents who have acted dishonestly in their dealings with HMRC (FA 2012, Sch 38).

   - Public interest disclosure - This applies to tax agents who are members of professional bodies with responsibility for regulation of their members. The power is contained in The Commissioners for Revenue and Customs Act 2005, s 20(3), and is a public interest disclosure power that enables HMRC to make a disclosure of conduct to the tax agent’s professional body.

   - The penalty regime for errors in tax returns and other documents, where an error in the taxpayer’s document is attributable to another person (FA 2007, Sch 24, para 1A).

   - The promoters of tax avoidance scheme (POTAS) provisions (in FA 2014 and FA 2021). POTAS allows for the issue of formal notices, such as ‘conduct notices’ and ‘defeat notices’, to tax agents who promote avoidance schemes.

   - The disclosure of tax avoidance schemes (DOTAS) rules) (FA 2004, Pt 7) and corresponding rules for the disclosure of avoidance schemes relating to VAT and other indirect taxes (DASVOIT) (F(No 2)A 2017, Sch 17), which require promoters of tax avoidance schemes to disclose to HMRC details of the schemes they are promoting, how they work, and who their clients are.

   - The ‘enablers’ provisions (F(No 2)A 2017, Sch 16), which allow HMRC to impose financial penalties on those who have enabled tax avoidance where abusive tax arrangements have been defeated.

   - The money laundering regulations, which require external accountants and tax advisers to be supervised for anti-money laundering purposes.

   - The corporate criminal offences power introduced in September 2017, which created two criminal offences; one relating to the evasion of UK tax, and the other relating to the evasion of foreign tax.

   - In the most extreme cases, HMRC may carry out criminal investigations into tax agents that have potentially committed offences such as tax fraud.

The list of statutory powers is not exhaustive. For example, further powers (introduced in FA 2022, ss 85-91) include provisions to enable HMRC to name promoters, the websites they use and the schemes they promote, to warn taxpayers of the risks of entering into avoidance arrangements and to help those already involved to exit avoidance.

The HMRC document ‘Raising standards in the tax advice market – HMRC’s review of powers to uphold its standards for agents’ can be downloaded from HMRC’s website (tinyurl.com/HMRC-RPUSA).

Contributed by Mark McLaughlin

Deadlines

1 February 2023

- £100 penalty and extended enquiry window if 2021/22 SATR not filed by 31 Jan. 2023
- Corporation tax for periods ended 30 April 2022 for SME companies not pay by instalments

2 February 2023

- Form P46(Car) for quarter ended 5 January 2023

5 February 2023

- Employment intermediaries report for quarter to 5 January 2023

7 February 2023

- VAT returns and payment for 31 December 2022 quarter (electronic payment)

14 February 2023

- Monthly EC sales list paper return–businesses in Northern Ireland selling goods only
- Application to defer class 1 NICs (leaflet CA72A) for 2022/23, subject to approval of deferred employer(s)

19 February 2023

- Pay PAYE, NICs, CIS and student loan for month to 5 February 2023 if not paying electronically
- File monthly construction industry scheme return

21 February 2023

- File online monthly EC sales list –businesses in Northern Ireland selling goods only

22 February 2023

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

28 February 2023

- File CTSA returns for companies with periods ended 28 February 2022

News

When to ignore a nudge letter

HMRC has been sending nudge letters chasing missing 2020/21 Self Assessment tax returns.

However, HMRC has advised the CIOT that, due to a mailing list error, some taxpayers and their agents have received a letter, when in fact they had no returns outstanding.

Where clients and their agents are confident that their affairs are up to date, no action is required.

https://www.tax.org.uk/2020-21-income-tax-self-assessment-filers-incorrectly-receiving-hmrc-nudge-letters

Hybrid and distance working

On 23 September 2022, as part of its "Growth Plan 2022", the government announced that the Office of Tax Simplification will be closing, with no further work being undertaken after 2022.

At the end of December, the Office of Tax Simplification (OTS) published what will be its final report, looking at the tax implications of hybrid and distance working. This is its own initiative report by the OTS reflecting the responses to its call for evidence in August 2022 entitled "Review of hybrid and distance working - Call for evidence".

The abbreviated time for the work has meant that the OTS has not included its own recommendations but rather reflected calls from businesses and others for change and improvements. The OTS did not receive enough evidence to make any comments on hybrid working by self-employed individuals.

Changing working practices

Employers now recognise that, in order to attract and keep their staff, they need to offer flexible working conditions. The report concludes that hybrid working that was essential during COVID-19, will continue to play an important part in working practices in the future. Statistics show that about 40% of the workforce is able to work from home, with many splitting their working time between home and office-based working.

What is needed?

The report states that employers want a review of the expense and benefits systems, where many concepts are tied to more traditional ways of working. Adding additional tax reliefs would have a significant exchequer cost – but new ways of working present the opportunity to reconsider the approach to employee tax reliefs.

At present, there is limited guidance on hybrid working. Respondents asked for HMRC to improve guidance to help both employers and employees.

The social security and payroll implications of cross-border working are complex, and these and the UK's position on issues such as taxable presence for the business (permanent establishment) were seen by businesses as unclear where the staff are the ones choosing to work overseas for short periods. On both cross-border payroll and social security issues businesses want to see improved HMRC processes, turnaround times, more PAYE relaxations and better guidance

Multinational businesses want to see the UK taking a lead on how permanent establishment and transfer pricing interact with staff who choose to work overseas on for personal reasons and longer term, and where possible, businesses would like the UK to set out unilateral guidelines that can be clearly understood.

https://www.gov.uk/government/publications/ots-report-on-hybrid-and-distance-working

Business Taxation

Basis period reform – provisional figures

The CIOT has reported receiving an update from HMRC regarding provisional figures that will be used under the basis period reform.

Amending provisional figures

HMRC will allow businesses to amend provisional figures following the normal time limits for amendments. This will effectively allow businesses and agents to amend provisional figures at the same time as the business's following tax return. HMRC guidance will be amended to reflect this before the start of the transitional year, 2023/24.

Overlap relief

If a business is planning to change its accounting date and does not have a record of its overlap profits brought forward, HMRC has stated that it may be able to assist.

Where businesses are looking to change their accounting date in 2021/22, HMRC will be able to provide details of overlap relief figures or historic profit figures on request, if these figures are recorded in HMRC systems. Where this information is needed:

- Taxpayers should ring the HMRC Self Assessment Helpline;
- Their agents should ring the Agent Dedicated Line.

Businesses looking to change accounting dates or use overlap relief in 2022/23 or 2023/24 should wait until HMRC can provide further information on overlap relief support for these businesses and agents. HMRC is planning to provide certainty on this in the coming months.

https://www.tax.org.uk/basis-period-reform-easements-for-provisional-figures-provision-of-overlap-relief-figures-and-hmrc-s-communications-strategy

Basis period reform and averaging **(Lecture B1356 – 21.29 minutes)**

Following their engagement with HMRC, ATT has released a technical article that looks at how the basis period reform will interact with the averaging rules for farmers and creative artists. This includes two worked examples which are reproduced below.

Example 1 – profits in standard and transition part

Farmer Giles, with a year-end of 30 September, has been trading for some years and has overlap profits of £5,000. His profits are as follows:

- 30 September 2022 - £10,000
- 30 September 2023 - £20,000
- 30 September 2024 - £40,000
- 30 September 2025 - £15,000

2022/23

In 2022/23 he will be taxed on the profits for the year ended 30 September 2022 - £10,000. For the purposes of this example, we assume he does not opt to average with the previous year.

2023/24

This is the transition year and without basis period reform, he would have been taxed on profits in the year ended 30 September 2023 - £20,000. However, under the new rules, he will be assessed on the profits of the standard part (defined by the current year basis) plus his transition profit (profits of the transition part after overlap relief and spreading).

Taxable profits for 2023/24 before averaging will therefore be:

Year ended 30 September 2023 (Standard part under CYB)		20,000
Plus: Transition profit:		
Six months* of y/e 30 September 2024	20,000	
Less: Overlap relief	(5,000)	
	15,000	
Spread over maximum 5 years = (£15,000/5		3,000
Total taxable profits		23,000

(* Note that the legislation requires apportionment on a day basis, but we have used months for simplicity in this example.)

For the purposes of averaging, any transition profit brought into account (i.e., the £3,000 this year) is ignored. Only the standard part of £20,000 is considered.

Averaging is permitted, as £10,000 (2022/23) is less than 75% of £20,000 (2023/24 CYB).

The profits for 2022/23 will be reassessed as if he had taxable profits of £15,000 (being the £10,000 for 2022/23 and the £20,000 standard part profit from 2023/24 added together and divided by two).

The assessable profits of 2023/24 will be £15,000 plus the transition profit of £3,000, making £18,000 in total.

2024/25

We are now in the new rules, so Farmer Giles' profits are calculated by apportionment (again we are using months for simplicity, a proper calculation would use days):

Six months of year ended 30 September 2024 (6/12 x 40,000)	20,000
Six months of year ended 30 September 2025 (6/12 x 15,000)	7,500
Total	27,500
Plus spread element of the transition profits	3,000
Taxable profits (pre averaging)	30,500

For the purposes of averaging, we again ignore any transition profits. We are therefore required to compare the £27,500 above with the 2023/24 figure of £15,000 (being the assessable profits after averaging with 2022/23, ignoring transition profits). As £15,000 is less than 75% of £27,500, averaging is permitted.

The profits for 2023/24 will be reassessed as:

Average of 2023/24 and 2024/25, ignoring transition profits (calculated as 15,000 + 27,500)/2	21,250
Plus spread element of transition profits	3,000
Total taxable profits	24,250

The assessable profits for 2024/25 will also be £24,250 (i.e., the average of £21,250 plus the £3,000 of spread transition profits brought in).

Example 2 – profit in standard part, loss in transition part

Farmer Giles, with a year-ended 30 September, has been trading for some years and has overlap profits of £5,000. His profits and losses are as follows:

- 30 September 2022 - £21,000
- 30 September 2023 - £20,000
- 30 September 2024 – (£12,000) loss
- 30 September 2025 - £15,000

2022/23

In 2022/23 he will be taxed on the profits for the year ended 30 September 2022 - £21,000. For the purposes of this example, we assume he does not opt to average with the previous year.

2023/24

In 2023/24, which is the transition year, without basis period reform he would have been taxed on profits in the year ended 30 September 2023 - £20,000. Under the new rules however, in 2023/24 he will be assessed on the profits of the standard part (defined by the current year basis) plus his transition profit (profits of the transition part after overlap relief and spreading)

Taxable profits for 2023/24 before averaging will therefore be:

Year ended 30 September 2023 (Standard part under CYB)		20,000
Plus (minus) transition profit / (loss):		
Six months of year ended 30 September 2024*	(6,000)	
Plus: Overlap relief	(5,000)	
		(11,000)
Total taxable profits		9,000

(* Note that the legislation requires apportionment on a day basis, but we have used months for simplicity in this example.)

Spreading is not available as there is a loss in the transition part. The taxable profits for the period before averaging are therefore £9,000.

As only transition profits (and not losses) are ignored for the purposes of averaging, we need to compare this £9,000 with the £21,000 in the prior year, 2022/23. Averaging is permitted, as £9,000 is less than 75% of £21,000

The profits for 2022/23 will be reassessed as if he had taxable profits of £15,000 (being the £9,000 for 2023/24 plus the £21,000 for 2022/23, divided by two) and the assessable profits of 2023/24 will also be £15,000.

2024/25

We are now in the new rules, so Farmer Giles' profits are calculated by apportionment (again we are using months for simplicity, a proper calculation would use days):

Six months of the year ended 30 September 2024 (6/12 x (12,000))	(6,000)
Six months of the year ended 30 September 202 (6/12 x 15,000)	7,500
Taxable profits (pre averaging)	1,500

As £1,500 is less than 75% of £15,000, averaging is permitted.

The profits for 2023/24 will be reassessed as £8,250 (being £15,000 plus £1,500, divided by 2) and the profits for 2024/25 will also be £8,250.

https://www.att.org.uk/basis-period-reform-averaging

Transfer of a business and goodwill (Lecture B1356 – 21.29 minutes)

Summary – On 1 December 2014 there was a de facto transfer of the business (including the goodwill) from the partnership to the company; goodwill could be amortised, and income generated from that date belonged to the company.

Prior to December 2014 Ameeka Patel and Rajiv Ruwala were partners in a dental practice business run from premises at 2 Green Walk, Dartford.

In 2014, the partners decided to incorporate and set up a company 2 Green Smile Limited for that purpose. Minutes from a Board meeting held in November 2014 confirmed that the partners had orally agreed to transfer the business, including the business premises, the NHS and private patent contracts together with the goodwill with effect from 1 December 2014.

The following February, staff were given P45s and informed that going forward they were employed by the company. Then later that year, in October, the company registered with the Care Quality Commission with the NHS contracts novated from the partnership to the company.

With the transfer having taken place before 3 December 2014, the company amortised the purchased goodwill in full in its accounts, HMRC later challenged this, arguing that the business was not transferred at that time. HMRC argued that the goodwill was transferred when the NHS contracts were novated on 23 October 2015. Since 8 July 2015, amortisation of purchased goodwill has not been deductible and so HMRC denied the deduction in the accounts. Further, HMRC sought to assess the partners on the business income up to 23 October 2015, rather than the company.

The company and the partners appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal found that the business was not transferred at the time of the oral agreement that had been minuted. This agreement was unenforceable, as agreements including the transfer of land must be in writing.

However, the Tribunal found that case law supported the fact that an intention to transfer a business that later becomes reality can effect a de facto transfer. Consequently, the First Tier Tribunal found that although the oral agreement was ineffective, the evidence supplied by the taxpayers was enough to confirm that there was a de facto transfer on 1 December 2014, with legal formalities completed at a later date.

The appeals were allowed.

2 Green Smile Limited and Dr Ameeka Patel (As Nominated Partner of 2 Green Dental Partnership) v HMRC (TC8677)

Profit dispute out of time (Lecture B1356 – 21.29 minutes)

Summary **–** *A referral of a profit allocation dispute between a partner and partnership was invalid as it was out of time.*

From July 2016, Jason Anderson was a partner in PricewaterhouseCoopers LLP (PwC). After being served with a compulsory retirement notice, he retired from firm in November 2018.

He claimed PwC had unlawfully discriminated against him in requiring him to retire and received a settlement claim, consisting of

1. balance of profit share for the period 1 July 2018 to 30 November 2018; and
2. an amount described as 'an additional payment of an amount equal to 12 months' profit share' (the additional payment).

PwC filed its 2018/2019 partnership return on 26 October 2020. Both elements of the settlement payment to Jason Anderson were included in that statement as profit share allocated to him. Jason Anderson became aware of this after receiving an email of 5 January 2021 from PwC.

On 10 December 2021, Jason Anderson made a referral to the First Tier Tribunal under s.12ABZB(3) TMA 1970. He contended that the additional payment element was compensation in settlement of his claim and should not have been allocated to him as profit share in the partnership return.

Decision

The First Tier Tribunal found that Jason Anderson ‘s referral was made out of time and that it did not have the power to admit the referral out of time. The 12-month referral time limit in s.12ABZB(5) ran from the date the partnership delivered the partnership return to HMRC, not from the date the return is delivered to the individual partner making the referral. The First Tier Tribunal decided it did not have the power, under the Tax Chamber Procedure Rules, to admit the referral out of time because to do so would conflict with the time limit laid down in TMA 1970.

Further, the First Tier Tribunal found that it was precluded from admitting the referral by s.12ABZB(4) because the dispute was directly or indirectly, in substance, about the amount (before sharing) of the partnership's profits; it was at least indirectly so because, if the additional payment was a payment of compensation, it would have been deductible in computing PwC's overall profit.

Jason Anderson v PricewaterhouseCoopers (HMRC, third party)(TC08662)

Adapted from the case summary on Tax Journal 13 January 2023

R&D - changes to the tax reliefs (Lecture B1357 – 14.58 minutes)

One of the announcements that was made in the Autumn Statement on 17 November 2022 related to research and development tax credits.

There are currently two reliefs:

1. The relief for SME companies being an entity which has a staff headcount of less than 500 and either turnover not exceeding €100m or balance sheet total not exceeding €86m. Some companies within that definition do not qualify for the relief for various reasons and can claim under the large scheme. This allows an additional deduction of (currently) 130% of qualifying costs and an ability to reclaim (currently) 14.5% of surrenderable losses as a repayable tax credit. The surrenderable loss is the lower of:

    1. the total unrelieved trading loss for the accounting period (although losses must first be treated as if they have been offset against other profits of the same period), and

    2. 230% of the qualifying R&D expenditure for the accounting period.

    The repayment has been subject to a potential cap linked to PAYE and NIC since 2021 and this is to be retained.

2. The relief for all other companies. This gives a taxable credit called RDEC of (currently) 13% which is then offset against corporation tax liabilities or other outstanding tax bills but can be repaid.

HMRC had already announced various measures to tackle abuse of the system but the Chancellor went further in the Autumn Statement by announcing that a consultation would consider the viability of moving to a single RDEC type scheme for all companies.

As a starting point, changes were made to the level of relief available. For SME businesses, the additional deduction is reducing from 130% to 86% from 1 April 2023.

The tax credit, which is currently at a rate of 14.5%, is allowed in relation to the 'surrenderable loss'. This figure will reduce to 10% from 1 April 2023.

The RDEC will rise from the same date from its current level at 13% to 20%.

Example of impact

Company incurs £100,000 on qualifying R&D and is eligible to claim under the SME scheme.

The current additional deduction would be £130,000 giving corporation tax relief of £24,700 at current rate of 19% (this is the amount that is gained on the additional deduction only as the allowable costs would still get tax relief even if no additional relief was available).

From 1 April 2023, the additional deduction would be £86,000.

This will give relief at £16,340 if the company is paying tax at the small companies rate (which is unlikely given the level of the relief) or £21,500 if paying at main rate. The benefit if the company has profits in between the lower and upper profit limits, paying a marginal rate of tax of 26.5%, will be higher.

If this was eligible for a payable tax credit, then currently would get £33,350 (£230,000 x 14.5%) based on the 130% deduction. From 1 April 2023, the company will get £18,600 (£186,000 x 10%) based on a lower deduction and lower repayment rate. This clearly represents a significant reduction in relief (56% of the previous figure).

If this company had been claiming under the RDEC scheme (assuming that they are in a net loss position), the RDEC would be £20,000 and the net repayable amount would be £15,000 (if paying at the main rate of CT, i.e. 75% x £20,000) or £16,200 (if paying at the small companies rate, i.e. 81% x £20,000) as you have to net off the corporation tax on the RDEC when calculating the repayment. So the company would be even worse off.

These changes apply for any expenditure incurred on or after 1 April 2022.

Other changes announced

The Autumn Statement also reiterated that other previously announced changes to R&D tax reliefs would be included within the Finance Bill to be published after the Spring Budget.

These include:

- Adding data costs and the costs of cloud computing to qualifying expenditure under the consumable and software costs category;

- Extending the scope of R&D relief to cover mathematical advances to enable the pure mathematics costs involved in the video gaming industry to be covered by these reliefs;

- Adding a new condition to the sections covering contracted out and independent R&D such that the expenditure will only be allowed if it is UK expenditure or qualifying overseas expenditure. Qualifying overseas expenditure will be defined as that which is attributable to activity undertaken overseas due to geographical, environmental or social conditions not present or capable of being replicated in the UK. Cost of the work and availability of workers are specifically excluded as factors.

Additionally, where R&D is undertaken through externally provided workers, they must be paid through PAYE;

- Introducing a requirement to have all CT returns containing an R&D claim to be submitted digitally through HMRC's tax return portal;

- Mandating that additional information be provided where a claim is made for R&D tax reliefs. This will include a description of the R&D undertaken, a breakdown of the qualifying costs, details of any agent who has advised on the R&D claim and a formal sign off of the claim by a senior officer of the company;

- A requirement that companies must notify HMRC in advance that they are going to make an R&D claim. This notification must be made within 6 months of the end of the chargeable period, but only if an R&D claim has not been made in the previous 3 years.

There are also measures which are to be changed to address previous anomalies or unforeseen consequences of previous changes:

- Schedule 18 FA1998 will be amended to allow a claim for RDEC where a corporation tax assessment is amended by HMRC.

- Schedule 18 FA1998 will be amended to permit a claim for RDEC to be made where the claimant made a claim for SME relief but was not entitled to do so.

- A new definition will be introduced giving the time limit for making claims.

- New legislation will clarify that where an enterprise is treated as an SME and a linked enterprise becomes large, the first enterprise will continue to be treated as an SME for that accounting period and the following accounting period.

- The definition of going concern is to be amended.

- There is to be an exception to the rules which preclude the making of a discovery assessment in various circumstances where such an assessment needs to be made to recover overpaid R&D tax relief or expenditure credit.

- The patent box provisions will be amended as required to include the changes to the definition of qualifying expenditure.

Contributed by Ros Martin

Proposed amendments to FRS 102 **(Lecture B1358 – 18.52 minutes)**

The FRC has announced proposed changes to FRS 102 – the first in many years. The starting point for computing taxable trading profits is the profit computed in accordance with GAAP (UK GAAP or UK IAS), so some of the changes will change the way that some items are accounted for and this will affect their corporation tax treatment.

There is a proposed change to the section on income taxes which tax practitioners will need to provide input for.

When finalised, the changes will be mandatory for accounting periods beginning from 1 January 2025. Earlier adoption is permitted but if so, all of the amendments must be adopted.

Leases – Section 20

Tax law allows all expenses recognised in respect of leases for tax purposes if the accounts are prepared in accordance with GAAP, i.e. no adjustments would be needed to the accounting figures, but need to ensure that GAAP has been followed, apart from the 15% disallowance for cars with CO_2 emissions above the allowed maximum (currently 50g/km).

Broadly, lessees will recognise a 'right-of-use' asset and lease liability. The right-of-use asset will be depreciated (broadly over the lease term). The lease liability will attract interest expense (reducing over the lease term as rentals paid reduce the liability). This is similar to finance lease accounting under existing FRS 102.

Preparers can choose to expense the following leases like current operating leases:

1. Short term leases – i.e. the lease term is less than 12 months;

2. Leases where the underlying asset is of low value (c. £5,000 - £10,000).

Examples of low value items include tablet computers, PCs, home printers and photocopiers, mobile phones and desk phones, televisions, small items of furniture and portable power tools.

These can continue to be accounted for as presently.

Examples of non-low value items include vehicles, heavy plant (e.g. bulldozers), farm machinery (e.g. tractors, harvesters), vessels, aircraft and land and buildings.

These leases will need to be capitalised as right-of-use assets and lease liabilities.

If a lease contract contains separate lease components, the lessee must account for each separately, but can choose to treat it as a single lease if at least 50% of the consideration relates to a single lease component.

Non-lease components payable to the lessor (e.g. maintenance costs, crew, insurance, fuel, servicing should be accounted for separately to the lease, but there is a practical expedient where the lessee can choose to include these non-lease components as part of the lease. This would change the way they are recognised in the P&L as the costs would form part of the depreciation of the right-of-use asset and interest expense on the lease liability.

This will be acceptable for tax purposes as it is in accordance with GAAP.

The lease liability must be remeasured in certain circumstances, but unlike IFRS, if the payments vary because of inflation or market rent review, the entity can choose:

1. To recognise the change in the payments from the original amounts in P&L each period; or

2. Remeasure the lease liability, using the revised cash flows but discounted at the original discount rate when the lease commenced.

Each of these will affect the timing of expense recognition for the lease and therefore its tax treatment.

On adoption of the revised lease section, there is no prior period adjustment to make. For leases still existing at the start of the first mandatory adoption period, the lease liabilities are measured at the present value of the future lease payments.

The opening right-of use asset will equal the lease liability, adjusted for any prepayment or accrual that was recognised at the previous year-end.

The tax law provides that any prior-period adjustment on adoption of a new leases standard must be spread over the weighted average lease term remaining at the start of the period of adoption, but on adoption of the FRS 102 changes there should be no transitional tax rules to be concerned about.

Revenue – Section 23

The FRC is proposing to adopt the IFRS model for revenue recognition:

1. Identify the contract with the customer;

2. Identify the promises in the contract;

3. Determine the transaction price;

4. Allocate the transaction price to the promises in the contract;

5. Recognise allocated revenue when the entity satisfies a promise.

For simple businesses, the change is unlikely to affect the way revenue is recognized. For more complex transactions, and long-term service providers such as bespoke software, the changes are likely to result in deferral of revenue over a longer period

Any changes to revenue recognition would need to be made retrospectively for contracts not completed by the start of the comparative period. The effect on prior-year profits would be recognised in the year the changes are adopted for tax purposes.

Income taxes – Section 29

The amendments introduce the concept of ‘uncertain tax treatments’, i.e. uncertainty over whether HMRC will accept the treatment adopted in the return (or proposed to be adopted)

If it is more than 50% likely, the treatment will not be accepted, the entity must book a liability for the expected additional tax payable in the accounts, using either the most likely outcome (in a binary decision) or expected value if there are multiple possible outcomes (e.g. a transfer pricing or asset valuation scenario).

This covers all material liabilities, unlike the tax law requirement for an uncertain tax position return where the difference is more than £5 million.

Contributed By Malcolm Greenbaum

VAT and indirect taxes

R&C Brief 1: Option to tax notification (Lecture B1356 – 21.29 minutes)

Any options to tax notified to HMRC before 1 February 2023 will still receive a standard option to tax notification receipt.

However, from 1 February 2023, HMRC will no longer issue receipt letters in response to notifications. Going forward, an acknowledgement or receipt of an option to tax will only be provided when the notification is sent by email.

Taxpayers should:

- send an option to tax notification by email to: optiontotaxnationalunit@hmrc.gov.uk
- include the following in the subject line of the email:
  - property address, including postcode
  - effective date of the option to tax notification

The automatically generated e-mail response will have the date when the notification was received by HMRC and will constitute evidence of the notification date. This should be kept as evidence of the notification.

HMRC will cease processing requests for confirmation of existing options to tax, except where the effective date of the option is likely to be over six years ago or the request is made by an appointed Land and Property Act receiver or insolvency practitioner.

https://www.gov.uk/government/publications/revenue-and-customs-brief-1-2023-changes-in-processing-option-to-tax-forms-by-the-option-to-tax-national-unit

Medical supplies (Lecture B1356 – 21.29 minutes)

Summary – The supply of medical staff by an umbrella company was a standard-rated supply of staff and was not an exempt supply of medical services.

Mainpay Ltd employed, or treated as employed, consultants and GP specialists, taxing them through PAYE, with their payroll outsourced to another company.

The company supplied their medical staff to an intermediary agency company, who in turn had separate contracts for their supply to NHS Trusts. It was the NHS Trust and agency company who determined which consultants would fulfil assignments and what they would be paid. If the consultant was agreeable to the terms of an assignment, the agency would then inform Mainpay Limited.

Mainpay Limited treated the supplies as exempt medical care (Group 7 Schedule 9 VATA 1994), arguing that they were providing medical care, not staff.

HMRC disagreed and raised assessments on the basis that the company was making standard-rated supplies of staff. The disputed VAT in this case was £165,000 relating to supplies made between 1 November 2010 to 31 January 2014.

Both the First Tier and Upper Tribunal found that the only contact Mainpay Limited had with the consultant was in relation to payroll matters. There was no contact between the consultant and Mainpay Limited in relation to medical matters. The company played no part in deciding who worked where or what their rate of pay was and had no relationship with the patients to whom medical care was provided. The company did not arrange professional indemnity insurance either for itself or for its consultants. It was not supplying medical care.

The Upper Tribunal granted Mainpay Limited permission to appeal to the Court of Appeal.

Decision

The Court of Appeal confirmed that the decision reached by both the First Tier and Upper Tribunal was correct.

The term 'medical care' required the services supplied to include diagnosis, treatment or cure of disease or ill-health. The services supplied by Mainpay Limited provided none of these. The company possessed no medical expertise, exercised no degree of control over the consultants' decision-making. The company simply provided staff to the agency.

The appeal was dismissed.

Mainpay Limited v HMRC [2022] EWCA Civ 1620

Council provided off-street parking **(Lecture B1356 – 21.29 minutes)**

Summary - Overpayments at a council's pay and display car parks were found to be consideration for VAT purposes.

This case concerns the VAT treatment of off-street parking provided by the Borough Council of King's Lynn and West Norfolk, where the pay and display parking machines used to collect payments from customers did not provide change.

The issue was whether when, for example, a customer inserted a £1 coin and 50p piece to pay for an hour's parking costing £1.40 whether the 10p overpayment represented consideration paid for the supply of car parking making it liable to VAT.

In 2012, the Borough Council of King's Lynn and West Norfolk had previously appealed a similar case (Borough Council of King's Lynn and West Norfolk v HMRC [2012] UKFTT 671 (TC) with the First Tier Tribunal finding that an overpayment was not part of the consideration for a supply made by a local authority. This decision was not challenged by HMRC.

Subsequently, the Court of Appeal reached a decision in National Car Parks Limited v HMRC [2019] EWCA Civ 854, finding that an overpayment was part of the consideration for a supply of off-street parking by a private sector provider. The Court of Appeal did not hear any argument regarding the provision of such supplies by a local authority and declined to take a view on the correctness of the earlier First Tier Tribunal case.

As a result, the issue in this case was essentially whether the Court of Appeal’s case applied equally to the provision of car parking services by local authorities. If so, the earlier First Tier Tribunal case involving the Borough Council of King's Lynn and West Norfolk was wrong.

The Borough Council of King's Lynn and West Norfolk argued it could only charge for parking by exercising its powers within the statutory framework by charging a set fee. With no direct link with the supply, any overpayment was a voluntary non-taxable contribution to the Council.

Decision

The Upper Tribunal adopted the Court of Appeal’s approach in National Car Parks Limited v HMRC [2019] EWCA Civ 854. The tariff board showing the hourly rates charged to park included a statement that overpayments were accepted and that no change was given. The Tribunal concluded that this was effectively an offer to provide parking in exchange for coins of not less £1.40. The statutory provisions governing the council’s car parking did not prohibit overpayments. Where a customer chose to insert £1.50, this was the total consideration given by the customer for the supply and so the taxable amount for VAT purposes.

The Borough Council of King's Lynn and West Norfolk v HMRC [2022] UKUT 00326 (TCC)

Best judgement not applied

Summary - With a flawed methodology, HMRC’s assessments were not made by applying 'best judgement', meaning that both the VAT and Corporation Tax assessments were not valid.

Georgiou & Co Limited ran cash only fish and chip shops. Shares in the company were initially owned equally between Mr Georgiou, his wife and his parents but later, following the death of his father in 2014, Mr Georgiou’s shareholding increased to 50%.

The business ceased trading on 18 November 2017 and went into a Creditor’s Voluntary Liquidation on 23 March 2018.

HMRC commenced a VAT enquiry, later concluding through cash reconciliations that cash sales and purchases exceeded the corresponding figures on the `VAT return and till Z readings did not show dates nor times.

Following an enquiry, HMRC issued ‘best judgement’ VAT assessments for periods 03/14 to 03/16. These totalled some £141,000 for under-declared output tax and were based on average transaction values as well as the numbers of transactions. HMRC also issued a deliberate behaviour penalty close to £85,000 and a personal liability notice to Mr Georgiou

Following on from this, corporation tax assessments were issued covering underdeclared profits for the accounting periods ending 31 March 2014, 2015 and 2016 for £230,000 and a determination notice for the period ending 31 March 2017 for £69,000. The Corporation Tax assessments and penalties included amounts attributable to a charge under the “loans to participators” provisions of s.455 CTA 2010.

Mr Georgiou argued that “he inherited a failing and loss-making business, tried very hard to turn it round, but was ultimately unable to do so”.

HMRC argued that Mr Georgiou "systematically and deliberately" supressed sales in order to evade VAT and Corporation Tax and appropriate the undeclared profits for his own use.

Decision

The First Tier Tribunal found that HMRC failed to fulfil their burden of proof to show that their VAT assessments had been made using 'best judgement'.

The Tribunal concluded that it was not reasonable to use HMRC's sampling undertaken on just two nights. These two nights failed to reflect changes that took place in the business over the four-year period, or the seasonal fluctuations that affected the business through each year.

HMRC's calculations included arithmetic errors and overlooked the reduction in the number of shops owned by the company over the period of the assessment. Further, some bank deposits were not queried with the taxpayer and represented rent rather than sales.

The VAT assessments had not been raised with best judgement and so the corporation tax assessments, penalties and personal liability notice were not valid. Further, as HMRC had not provided evidence that the taxpayer took any money for his own use, the s.455 charge did not apply.

The appeal was allowed.

Chrisovalandis Georgiou, Ninos Koumettou (Liquidator) of Georgiou & Co Ltd v HMRC (TC08660)

Works performed by public authority

Summary - The AG's opinions were that certain activities were not carried out in the course of an economic activity, meaning that the supplies would not be within the scope of VAT.

A municipality in Poland (Gmina O) undertook a project to install renewable energy source systems in properties located in its jurisdiction. The works were part funded by an EU grant and part funded by the owners of the properties. The installations formed part of a national strategy in Poland to improve public health. The terms of the installation were that the energy source systems would be owned by the municipality for five years, after which, ownership would transfer to the property owners. The municipality sought an advance tax ruling that its services to the residents were not subject to VAT because they were performed as part of its statutory obligations as a local authority, and not as part of an economic activity. However, the Polish tax authorities disagreed.

In a second case, Gmina L, the municipality in Poland undertook a project, in this case for the removal of asbestos from residential properties. The cost of the works was covered by Gmina L, who in turn had some of the costs subsidised from a central fund. The property owners did not pay for the works. Once again, the Polish authorities argued this was an economic activity within the scope of VAT.

Decision

In the first case, the AG opinion had doubts that the services were being performed in the course of an economic activity. The opinion acknowledged that there were supplies being made to the residents. The fact that they were part grant funded did not change this. However, as the supplies were not being performed under commercial terms with a view to making a profit, they did not have the indicators of economic activity. In addition, the aim of the project being to improve public health also pointed to the conclusion that the supplies were not being performed in the course of economic activity; effectively, Gmina O was only performing the services because of its statutory duty to do so.

In the second case, the AG first identified the nature of the supplies and concluded that there were supplies from the municipality to the residents. The argument that the supplies were in fact between the contractors performing the removals and the residents (as put forward by the Polish tax authorities) was rejected due to a lack of contractual agreements between the contractors and the residents. Again, the AG opinion doubted that the supplies by the municipality were performed in the course of economic activity. The municipality did not receive any compensation for its services of arranging for the contractors to perform the removals and the services were only available to residents of the municipality. In addition, the purpose of the works was not to generate revenue, but to improve local public health.

In both cases, the final decision on the matter has been left to the referring court.

Gmina O (Case C-612/21) and Gmina L (Case C-616/21)

Default surcharge

Summary – With no evidence supplied to support a reasonable excuse for late payment of VAT, the appeal was dismissed.

Kattrak International Limited paid its VAT for the period 06/20 late. As this was the company’s first default, no surcharge was payable, but a surcharge liability notice was issued with a surcharge liability period running until 30.6.21.

For the next three quarters, the VAT was again paid late, but no penalty was charged as the figure calculated was less than £400. Each time the surcharge period was extended.

The VAT due for the 06/21 quarterly VAT period was paid in two parts, both were paid late on 20.8.21 and 25.1.22 respectively. As the fourth default, a surcharge of 10% of the late VAT (£2,850.03) was charged and the surcharge period extended to 30.6.22. Late again in the period to 09/21, the surcharge rate rose to 15% and the surcharge period extended to 30.9.22.

Both parties agreed that the surcharges were properly imposed, but Kattrak International Limited argued that the company had a reasonable excuse for the failure to make the payments for the 06/21 and 09/21 quarterly VAT periods on time. The company stated that as a result of previous issues with an employee committing fraud, there was only one person in the company authorised to make VAT payments. Further, the company stated that it had tried to set up a direct debit to settle the VAT due but the mandate was cancelled, probably by HMRC.

Decision

The First Tier Tribunal concluded that 'on the balance of probabilities, that it was not HMRC that cancelled the direct debit instruction.' It was likely that it had been cancelled by the company or its bankers.

The company should have checked that the direct debit was in place and would operate as intended. Once it was known that the 06/21 direct debit had not worked, surely the problem should have been resolved by the time the 09/21 payment fell due.

Finally, the Tribunal concluded that 'whatever the effect of Covid on the Appellant's business, there was nothing preventing the payment of VAT on time'.

With no reasonable excuse, the appeal was dismissed.

Kattrak International Limited v HMRC (TC08645)