Tolley®CPD

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Personal tax

Gesture of thanks (Lecture P1416 – 16.27 minutes)

Summary – Payments made to employees by the company's former chairman/director were made by reason of employment, meaning that PAYE and NICs were payable.

Orient Overseas Container Line Limited (UK Branch) was an international container shipping company, whose chairman and majority shareholder was Mr CC Tung.

Having received a takeover offer from COSCO Shipping, Mr Tung's shareholding was sold on 24 July 2018. He resigned as director and chairman on 3 August 2018.

In an email to the company's global employees, Mr Tung announced a 'special discretionary payment' would be made to staff, funded by the Tung family but distributed through the company, acting as agent.

In September 2018, UK employees received their payment, which on average represented around half of their annual salary.

Initially their payslip showed:

- the gross sum as a 'bonus';
- PAYE and NICs deducted at source.

Later, believing that the payments were not income 'from' employment, or a cash benefit paid 'by reason of' employment, the company claimed a repayment of the PAYE and NICs. It argued that the payments were 'a simple act of generosity by Mr CC Tung'.

HMRC disagreed, arguing that the payments were made 'as a consequence of the recipients being employees and having contributed to the success of the business justifying the significant premium on share value which benefited Mr CC Tung'.

The company appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal accepted that Mr Tung had made a personal payment:

> "as a mark of appreciation to the UK workforce…..following the successful sale of the business."

The payments were not from past, present or future employment and so were not taxable under s.62 ITEPA 2003. The payments were non-contractual, voluntary and not expected by the recipients.

However, the payments were made through the company's payroll, to an employee by the employer, acting in an administrative capacity. To receive a payment, the individuals had to be an employee, with the sum paid calculated by reference to their length of service and salary.

The Tribunal concluded that the individuals received their payment 'by reason of employment'.

The appeal was dismissed.

OOCL UK Branch v HMRC (TC09007)

Compensation for change in pension rights (Lecture P1416 – 16.27 minutes)

Summary – Facilitation payments made as part of an integrated package of changes were taxable as earnings from employment and subject to Income Tax and NICs. The payments were made to induce employees to work willingly in the future.

Pensions schemes operated by E.ON UK Plc included two categories of defined benefit schemes. In March 2018, to reduce the costs of operating these schemes, the company agreed certain changes with unions. The 'integrated package' comprised a:

- two-year pay deal;
- commitment not to make further changes to pension arrangements for five years as well as certain other commitment; and
- "Facilitation Payment" amounting to 7.5% of salary, subject to a minimum of £1,000.

Employees were warned that, if they did not agree to the changes, they would receive neither the Facilitation Payment nor the pay rises.

One employee, Mr Brotherhood, was used as a test case for all employees whereby E.ON UK Plc did not deduct PAYE or NICs from the facilitation payment made claiming:

- the sum was not earnings from his employment;
- the payment was made to compensate him for the adverse changes made to his pension arrangements.

HMRC disagreed and sort to tax the sum through PAYE, so collecting both income tax and NICs.

The First Tier Tribunal found that the facilitation payment was part of the integrated package which changed the future relationship between the company and its employees. It was part of an inducement for employees to provide future services but on different terms and was therefore taxable.

The Upper Tribunal disagreed, finding for the taxpayer. The facilitation payment was compensation for the detrimental changes made to the defined benefit pension arrangements. The facilitation payment put the employee in the same position as before the changes, meaning that payment was not taxable employment income.

HMRC appealed to the Court of Appeal.

Decision

The Court of Appeal agreed with the First Tier Tribunal that the facilitation payment was an inseparable part of the integrated package that had been agreed.

That package related to future employee rewards and benefits for those working for the company and was therefore taxable as earnings from employment.

The First Tier Tribunal's decision was reinstated.

E.ON UK PLC v HMRC [2023] EWCA Civ 1383

National Insurance and Tax differences (Lecture B1418 – 17.39 minutes)

In the month where primary NICs are being reduced by 2% from 12% to 10% but income tax remains the same, it would seem appropriate to revisit the practical differences between National Insurance and Tax.

May years ago, I collaborated with specialists who had trained with the contributions agency before it was merged into the Inland Revenue (as it then was). They would always stress how different the NIC system was from income tax. Even today, a quarter of a century after the disappearance of the Contributions Agency, tax and national insurance remain substantially different. This article reminds practitioners of some of the important differences.

The first difference is that contributions into the NI system give you potential benefits. Most notable of these is the State Pension where one needs 35 years of contributions or credits to obtain a full State Pension and a minimum of 10 years to achieve any pension at all.

There are also some other contribution related benefits which are listed below:

- Maternity Allowance
- Contribution-based/New Style Jobseeker's Allowance (JSA)
- Contribution-based/New Style Employment and Support Allowance (ESA)
- Bereavement Benefits
- Basic State Pension
- New State Pension

Where people have made voluntary contributions to uphold their entitlements may be disgruntled if the contributions make no difference to their entitlements.

The second important difference which is exemplified by the mid-year change in NI contributions, is that earnings are normally assessed on the payment frequency i.e. weekly, monthly or for Directors annually.

Both the primary threshold below which contributions are not required and the Upper Earnings Limit beyond which contributions fall to 2% are (with the exception of directors and the annually paid) assessed on a weekly or monthly basis.

This is the second year in which the rates have changed. In November 2022 they changed for both primary and secondary NI with a reduction of 1.25%. On the 6th of January 2004, the primary contribution rate changed from 12 to 10% .

National Insurance is levied on a UK wide basis. Unlike income tax, the devolved governments of Wales and Scotland have no powers to change NIC. This is a particularly acute issue in Scotland where the 42% band starts at £43,663; well below the upper earnings limit at £50,270 and therefore creates an effective marginal rate of 53%, which falls to 51% from January 2024.

National Insurance is levied on earnings although this definition has been widened over the years. However, there remain many elements of income such as interest, dividends, rents on which no national insurance is borne. In terms of employment related securities, although income tax is normally levied on any gains national insurance is only levied on gains on shares which are readily convertible assets. Broadly speaking, readily convertible assets are shares which can be traded on a recognised exchange or under arrangements which the employer sets up such as a trust which is set up to hold, buy and sell the shares.

Primary NICs is not due on benefits on kind. The employer pays Class 1A NIC on the P11D value, but the employee suffers no NIC charge. If the benefit is accounted for under a PAYE settlement agreement, the employer pays Class 1B NI contributions on the whole amount. Again, there is no liability on the employee.

Care needs to be taken because the way in which the benefit is procured affects whether there is a Class 1 primary and secondary NIC liability (employer and employee) rather than just an employer charge. If an employee is reimbursed for taxable expenses, or the employer settles the pecuniary liability incurred by the employee, then the reimbursement would be subject to PAYE and there would be both primary and secondary NI due.

There are some limited areas where NI is payable but there is an exemption from income tax. An area which is becoming more common is the bonus payments made by Employee Ownership Trusts (EOT's) which can be tax free up to the first £3,600 but are always subject to primary and secondary NIC.

The national insurance system has a number of incentives built into it as a result of government policies. The letters which appear as suffixes on codes offer a wide variety on NIC differential rates. These can be based on age, work carried out and previous employment.

For example, those above the State Pension Age are no longer required to make primary NIC contributions. The employer should substantiate this with a document that shows the employee's age. At the other end of the spectrum the employer may be relieved from secondary NIC if they employ young persons or apprentices. There is a one-year holiday from employer NIC if the employer takes on a recently discharged veteran from the armed forces. There is a whole list of these variations which affect either the primary or secondary liabilities. There are also reliefs from employer NI for recruitment in Freeport zones,

The self-employed pay different and lower rates of national insurance. These are however worked out on an annual basis, which is why the change to Class 4 NIC from 9% to 8% as well as the abolition of Class 2 contributions is not happening until the end of the tax year. The differential in the NI burden for the employed and self-employed was initially justified by the different levels of benefits that they could obtain. This differential has reduced but the NI advantages for the self-employed, but they remain very wide.

Last but not least to be considered, is the treatment of Internationally Mobile Employees. International tax issues are dealt with under double tax treaties. NIC is dealt with under social security agreements. They allow for international mobile employees to be subject to NIC/social security in only one jurisdiction. Under the Trade and Cooperation Agreement that the UK signed with the European Union, the UK remains effectively part of the European Social Security Agreement. This means that under certain conditions, individuals can become tax resident in the UK whilst remaining subject to social security contributions in their home country and vice versa.

The UK also has social security agreements with a number of other countries outside the European Economic Area. The most notable is the social security agreement with the United States which allows for an individual to remain in their home social security system for up to 5 years whilst paying tax in the country where they perform duties. This final point would be enough of itself to deter any merger of the income tax and NI systems. The countries which have signed social security agreements with the UK would not be satisfied if the advantage of the exemption from UK NIC was negated by its absorption into the income tax system.

In conclusion, tax and NIC's remain different in important aspects and a merger would make the current difficulties with Making Tax Digital seem small beer by comparison.

Contributed by Jeremy Mindell

SEIS denied (Lecture P1416 – 16.27 minutes)

Summary – SEIS compliance certificates were denied for ten companies created by a director as three conditions had not been satisfied.

Mr Doshi was a Chartered Accountant who had many years of experience working in the media and retail industry entrepreneur.

While working as the Chief Operating Officer for the Prime Focus World group of companies he became aware of the demand for more audio-visual content related to religious sites.

Having identified ten places of religious significance (nine in India, one in Nepal), he sought to raise funds from investors under the SEIS to create audio-visual content related to these religious sites.

With the first company, he sought to raise funds from investors subscribing for 150,000 ordinary £1 shares.

However, having raised close to the £150,000, he set up nine further companies, one for each site, and proceeded to raise further sums of £150,000 for each company in the same way.

HMRC refused the SEIS applications of all ten companies.

The ten companies appealed as one to the First Tier Tribunal, claiming that they met the required conditions and that their investors were eligible claim SEIS relief.

HMRC argued that none of the companies satisfied all of the required conditions, stating that the companies:

1. did not satisfy the Risk-to-Capital condition (s.257AAA ITA 2007);

2. did not satisfy the Trading Condition (s.257DA ITA 2007); and

3. were engaged in Disqualifying Arrangements (s.257CF ITA 2007).

Decision

As a reminder, the Risk-to-Capital condition requires that at the time of the share issue, the issuing company must have objectives to grow and develop its trade in the long-term. The Tribunal noted that the company's financial projections showed that the intention was to develop and produce one film, before moving to the next. The Tribunal accepted HMRC's claim that "given the high risk of failure with each film, this sequential process was not a strategy that could easily lead to the appellants' growth".

The Trading Condition requires that throughout the three years immediately following the issue of shares, each company must be carrying on a qualifying trade. However, there was little evidence of trading on a commercial basis.

It was clear that almost all of the work for each company was subcontracted to companies and individuals connected to Mr Doshi and that those persons were prepared to work for little or no money. Without Mr Doshi's connections, none of the companies would have had sufficient funding to pay for the work that was undertaken. This could not be considered to be "trading conducted on a commercial basis".

Finally, Mr Doshi told the Tribunal that he had concluded, through discussions with friends, that it would be best to proceed with one company for each of the religious sites chosen for emotional reasons. However, the Tribunal confirmed that HMRC were correct that this was artificial fragmentation and that "this artificial fragmentation was motivated by the desire to obtain more SEIS relief than would have been possible had just one company been set up in place of the ten appellants".

The appeals were all dismissed.

The Legend of the Golden Temple Ltd and others v HMRC (TC08999)

Capital taxes

Failure to notify property sale (Lecture P1416 – 16.27 minutes)

Summary – Neither the taxpayer's mental health nor ignorance of the law represented a reasonable excuse for failing to report a property sale that the taxpayer knew would result in a chargeable gain.

In 2006, Felicity Harber had bought a property for £135,000 which she had let out since 2007.

As landlord, she was aware of the need for gas safety checks, she collected the rent and paid the mortgage. Believing that her earnings were below the threshold, she had never completed a tax return and had not notified HMRC of her rental income.

From 2014 she had lodgers in her own house but, having checked with HMRC, understood that the related income was covered by the rent-a-room scheme.

In 2018, having instructed estate agents and solicitors, she sold her rental property for £252,000. She was aware that there might be a tax consequence of the sale but took no professional advice about her CGT position as this would have been "expensive". She believed that by reporting the sale on the government's Land Registry site she would hear in due course from HMRC. She did not contact HMRC or check their website to see if she had to notify her CGT liability.

Later, HMRC issued her with a "failure to notify" penalty of £3,265.11, which she appealed on the grounds that she had a reasonable excuse, because of her mental health condition and/or because it was reasonable for her to be ignorant of the law. In her defence, she provided details of nine First Tier Tribunal cases supporting her case.

However, these had been generated by artificial intelligence (AI). She had not checked their validity and so was unaware that none of these authorities were genuine.

Decision

The First Tier Tribunal noted that Felicity Harber had:

- been able to liaise with both solicitors and estate agents regarding her property sale;
- put money aside to cover the approximate capital gains tax that she believed would be payable;
- had previously contacted HMRC about letting rooms in her main residence.

As a result, the Tribunal found that her mental health did not provide a reasonable excuse as she was clearly capable of managing her affairs.

Further, she was not ignorant of the law. Having previously obtained advice from HMRC, and knowing that she had made a capital gain, a reasonable person would not simply have put some money to one side and waited to be contacted by HMRC. They would have contacted

HMRC or spoken to their solicitor or an accountant to discuss and then report the disposal for CGT purposes.

The First Tier Tribunal accepted that Felicity Harber was unaware that the AI generated cases were false and further, she did not know how to check their validity. While not determinative in this case, this did highlight the potential limitations when relying on the use of AI to obtain tax information independently of seeking professional tax advice.

Felicity Harber's appeal was dismissed.

Felicity Harber v HMRC (TC09010)

Undeclared property disposals **(Lecture P1416 – 16.27 minutes)**

Summary – The proceeds from the sale of several properties was used to pay for the care of the taxpayer's wife who was in extremely poor health. Unsurprisingly, capital gains tax was still payable.

Sunday Salokun was an experienced property investor, who was aware of the obligation to pay capital gains tax on a gain made on disposal of a property.

His wife was ill and required 24-hour care. Social services refused to help pay for her care.

Social Services had told him to sell his properties as it was his "responsibility to pay for his wife's medical expenses because he owned multiple properties".

Having sold the properties, he did not declare the gains as he did not believe that he should have to pay the tax on the sale. By funding his wife's medical expenses, he had saved the government "hundreds and thousands of pounds".

HMRC disagreed and raised assessments and penalties accordingly.

Sunday Salokun appealed.

Decision

The First Tier Tribunal sympathised with Sunday Salokun's position. However, the Tribunal found that he knew about his obligation to declare the disposals and pay tax on the gains but chose not to comply.

The Tribunal confirmed that the assessments had been validly issued and were made in time.

Further, the non-declaration of the property disposals and capital gains was deliberate. Sunday Salokun made no attempt to conceal his intention at any point. The penalties were valid.

However, since issuing the penalty assessments, HMRC had reclassified the disclosure to be unprompted rather than prompted and had recomputed the penalties accordingly. As these differed from the penalties assessed and notified, HMRC asked the Tribunal to exercise its right under s 50(6) TMA 1970 to reduce the penalty assessments for those years. The Tribunal agreed.

Mr Sunday Salokun v HMRC (TC08986)

CGT Payments – A chance to beat the system! (Lecture P1419 – 7.08 minutes)

Here is a little idea which could help some clients defer CGT on UK land and property disposals. But first, a bit of a refresher.

When is Capital Gains Tax (CGT) due?

It used to be 31 January following the end of the tax year of disposal. However, things changed a while back in respect of disposals of UK land and property when HMRC decided that:

a) Such disposals were worthy of separate reporting (to add yet another layer of much-needed tax compliance); and

b) The Government could no longer bear to wait until 31 January to collect the tax and instead insisted that CGT on UK land and property disposals should be paid within 60 days of completion.

Note that for UK residents, accelerated payment applies to residential property only (being a property used or capable of being used as a dwelling). Disposals of bare land or commercial property are reported via the self-assessment return with tax payable on 31 January.

A separate return is required for each land and property disposal. The return is due within 60 days of completion. Disposals on the same day can be reported on the same return. For jointly owned properties, a return is required by each joint owner.

Reporting is done via a Capital Gain Tax UK Property Disposals Return. Reporting is online via the taxpayer's digital account on the Government Gateway. Paper returns can be used but only in exceptional cases where the taxpayer has been unable to create an online account.

Non-UK residents have also been dragged into this net by virtue of the Non-Resident Capital Gains (NRCG) regime and must report:

a) Direct disposals of all land and property situated in the UK (whether residential or commercial); and

b) Indirect disposals of UK land and property (being assets which derive their value from UK land and property such as shares in certain property rich companies). Note that as things currently stand, UK residents with indirect disposals only need to report these via the SA return, although it wouldn't be the biggest surprise in the world to see these rules aligned.

Non-UK residents are also required to pay the CGT payment within the 60-day filing period.

Naturally, penalties are charged for the late submission of an online property return. Penalties can also be charged for late payments. Any late (or insufficient) payments of tax will carry an interest charge.

Individuals, Partnerships, Trustees and Executors of deceased estates are within these provisions. The rules do not apply to UK companies who report gains via their corporation tax self-assessment return. Non-UK resident companies are however within the NRCG regime.

The CGT payment

Taxpayers are required to make a payment on account in respect of the disposal within 60 days of completion.

This is a payment towards the CGT liability on the land and property disposal. The payment on account is required to be a best estimate of the CGT due based on information available to the taxpayer at the date of completion.

This means that the estimate can take account of the annual exempt amount and any capital losses made before the date of completion (either in the same tax year or brought forward from previous years). However, the estimate cannot take account of losses made after the completion date as these are unknown at that time.

The taxpayer may also have to make a reasonable estimate of the CGT rate which will apply to the disposal (based on an estimate of UK taxable income for the year and any basic rate band which may be remaining). If the payment on account on insufficient or excessive, any adjustment is made during the self-assessment process.

For non-resident taxpayers, the same process is carried out, albeit with gains calculated under NRCG rules (for example by using April 2015 or April 2019 values to compute the gains). This can in itself be problematic as the taxpayer will have only 60 days post completion to obtain relevant valuations, file the return and pay the tax. Note also that for non-residents, only NRCG losses can be set against NRCG gains.

Exceptions

Certain disposals do not need to be reported on the online property return. These include;

- Inter-spouse transfers which take place at no gain / no loss;
- Grants of leases for no premium;
- Disposals where no CGT is due (for example, gains within the annual exempt amount, disposals giving rise to a loss or gains covered by private residence relief). If a loss arises, it is sensible to report that loss via the Self Assessment return such that the loss is then available to be carried forward and relieved in future years.

For non-residents, the NRCG rules require a return to be submitted even if no CGT is due.

Interaction with self-assessment

For taxpayers who would not otherwise need to file an SA return, if the CGT payment on account made in respect of the UK land and property gains already reported to HMRC is correct (or excessive), no SA return is then required.

For taxpayers within Self Assessment, the SA return requires the reporting of disposals of any chargeable asset in the tax year. This means that disposals which have already been reported to HMRC via the online property return, must be reported again in the CG pages of the SA return. This is the case even if there is no further CGT to pay.

Which brings us to the main point of this article…

A UK land and property disposal does not need to be reported via the online UK Property Service if that disposal has already been reported via a self-assessment return. [Sch 2 Para 5 FA 2019.]

Therefore, even though reporting a disposal on an online UK property return does not absolve the taxpayer from reporting the same disposal under Self Assessment, reporting a gain via the SA return first does remove any obligation to report it again via the UK Property Service. Put simply, this means that if the SA return can be accelerated and filed within 60 days of the completion of the property sale, no online property return is required.

We can then take this exception a stage further because an obligation to make a payment on account of CGT only applies where a person is required to make a return under Schedule 2 FA 2019. Therefore, if there is no obligation to file an online property return under Schedule 2, no payments on account are required. Any CGT on the UK land and property gain is therefore payable on the normal due date - ie 31 January after the end of the tax year.

What all this means is that in the right circumstances, the tactical filing of an early SA return can give the taxpayer an extra eight or nine months to pay their CGT. For large liabilities (as can often be the case for property disposals), this could be worth a few quid.

Illustration

Natasha (UK resident) sold a UK buy-to-let property making a capital gain of £500,000. Contracts were signed on 24 March 2024 making the gain chargeable in 2023/24. The transaction was completed on 21 April 2024. The CGT is estimated to be £138,000.

An online property return is due within 60 days of completion - ie no later than 20 June 2024.

Natasha must also make a CGT payment on account of £138,000 by 20 June 2024.

However if Natasha submits her 2023/24 self-assessment return before 20 June 2024 (disclosing the property gain on the CG pages) then;

- No online property return is required; and
- The CGT due on the disposal is payable by 31 January 2025.

This planning is not easy to manipulate. But if circumstances permit, practitioners should consider taking advantage of it. Not only does it defer payment of CGT, it also avoids the client incurring an extra fee for the preparation of an online property return. So it shouldn't be a difficult sell.

It does of course need the client to be sufficiently organised and motivated to get their SA ducks in a neat row in a relatively short period of time post 5 April, but this is doable if the incentive is there.

You would, of course, do your best to submit a return which is “to the best of your knowledge correct and complete”, but the important thing is that return is filed within the 60-day period and reports the land and property gain. The return can then be amended at a later date if you have inadvertently missed something off or if the odd number needs tweaking.

Practitioners should therefore be alert to their clients making UK land and property towards the end of the tax year. So if any proposed disposals are on the horizon, now is not a bad time to float this idea.

Contributed by Steve Sanders

Gift relief – What to remember (Lecture P1417 – 12.15 minutes)

As we approach the end of the tax year, this article reminds us of the tax consequences of making gifts and highlights the various ‘I’s which need to be dotted and ‘T’s which need to be crossed along the way.

Capital Gains Tax (CGT)

A gift is a disposal at market value by the donor (and to balance the equation, a similar acquisition at that same market value by the recipient).

Do not forget that that this is still the case even where the parties are not connected with each other. That includes transfers from an uncle to a niece or godparent to godson. Any gift which is not at “arm’s length” takes place at market value.

Once a value has been established (more on this later...), we simply deduct CGT base cost and any expenses of transfer to arrive at the chargeable gain.

In the absence of any claim, the gain is chargeable to CGT in the usual way, meaning that there is a potential ‘dry’ tax charge with no cash to meet the liability.

Gift relief

Gift relief (or “holdover relief”) may be available to help us out of this dry tax charge. However, gift relief is not a panacea and is not always available.

The tax code only provides for gift relief to be available to defer (‘holdover’) the gain in the following situations:

- On the gift of a business asset falling within TCGA 1992, S.165;
- On the occasion of a chargeable transfer for Inheritance Tax (most commonly a gift into a trust), s.260; or
- On a transfer of agricultural property (farmland) qualifying for agricultural property relief, Schedule 7, para 1.

Business assets

A “business asset” within TCGA 1992, S.165 includes:

- Shares in an unlisted trading company;
- Shares in the donor's personal trading company (being a company in which the donor holds 5% or more of the voting rights);
- Assets used in a trading business (for example, a sole tradership or partnership);
- Qualifying furnished holiday lets.

If the gift does not fall into any of the above categories, no gift relief is available, and CGT may fall due. This is typically the case for assets such as quoted shares, shares in non-trading companies or land and buildings used in a property investment business.

HMRC use the same test as for Business Asset Disposal Relief (BADR) to determine whether a business is "trading". Remember here that we have now moved away from the blanket "20% test" which we previously applied to factors such as non-trading income and the value of non-trade assets and instead we take a more holistic approach to see whether any non-trading activities are "substantial" in the context of the activities of the business as a whole. If in doubt, HMRC can be approached for a non-statutory clearance.

Making a Gift Relief claim

Once it is established that gift relief is available, the next step is to make a claim.

The effect of the claim is (usually) to reduce the donor's gain to zero and similarly reduce the donee's CGT base cost by the same amount. In effect, the donor's gain is rolled over and transferred to the donee meaning that the donee will take over the historic CGT base cost for a future disposal. No tax is saved here. We're just kicking the can down the road by giving the inherent gain to the recipient.

But remember here that:

- Gift relief is not mandatory. Therefore, if the resulting gain is covered by capital losses or the annual exempt amount, not making a claim may be the correct call; and
- Gift relief is not available where a loss arises (only gains can be deferred).

Note also that where a gift to a connected person triggers a loss, that loss may only be used against gains on disposals to the same connected person in the same or future tax years. There is no sideways offset against general gains. In these cases, it may be better either retaining the asset, or selling it to a third party and gifting the cash (as these options will release the resulting loss for general use).

Gift relief claims generally require the consent of the recipient (the only exception to this being a gift into trust when the consent of the trustees is not needed).

To this end it is often good practice to get one's ducks in a row before the asset in question is formally signed over by organising the gift relief claim forms to be signed and placed on file pending submission to HMRC. Indeed, making consent to a gift relief claim a condition of the asset transfer is never a bad idea.

Claims are typically made on the hold-over claim form which you will find on the HMRC website alongside HMRC Helpsheet 295. A separate claim is needed for each gifted asset. The form is self-explanatory and is typically printed off and completed by hand, then scanned-in along with the self-assessment return for the year in which the gain is made. Or you can go "old school" and pop it in the post.

The formal deadline for making a gift relief claim is four years from the end of the tax year in which the gift took place. However, this time limit is rarely relevant as failing to make the claim by the normal SA deadline will trigger a demand by HMRC for the tax.

Page 2 of the claim form contains a "request for valuations to be deferred". We all know that obtaining an open market value for an asset can be a difficult, painstaking and tiresome process, particularly where assets such as family company shares are concerned. And professional valuation fees are rarely cheap.

To this end HMRC SP 8/92 recognises that where a gain arises on a gift and that gain is to be fully deferred, the value of the asset transferred is largely immaterial since the donee will simply take over the asset at its historic CGT base cost. Therefore, in these cases, no formal valuation is required. All the donor needs to do is provide details of the date of the transfer and the CGT base cost of the asset together with the names, addresses and UTRs of the transferor and transferee.

Oddly box 4 does ask us to provide the "Value of asset at date of transfer" which seems strange given that we are asking for a valuation to be deferred.

However, HMRC are just wishing to content themselves here that the value in box 4 is above the CGT base cost of the asset gift such that a gain of some sort arises. They nor we care what that gain is. This value can therefore be no more than a "best guess" and is by no means binding on the taxpayer going forward.

Gift relief restrictions

Sometimes a gift relief claim does not reduce a chargeable gain to zero. This will be the case where either:

a) The donor gives away shares in a personal trading company and the company holds chargeable assets which are not used in its business;

b) The donor gives away an asset used in a sole trade or partnership business which has either been previously used for a non-trade purpose or partly used for a non-trade purpose; or

c) The donee pays the donor for the asset and the amount of consideration exceeds the donor's CGT base cost.

In each of these cases the donor is likely to be left with a chargeable gain (and accordingly the amount of the holdover gain is also reduced). In the case of c) above, the passing of consideration could also bring with it a charge to Stamp Duty / SDLT depending on the asset in question (which is again easy to miss in all the excitement).

In these cases, HMRC will not allow a valuation to be deferred under SP 8/92 on the basis that they will need to know the chargeable gain before holdover relief is applied.

CGT by instalments

One often overlooked point here is that if a gift takes place and either gift relief cannot be claimed (due to the nature of the asset gifted) or a gift relief claim is made but relief is restricted and a chargeable gain arises, CGT can in some cases be paid by instalments.

The instalment option is only of limited use because:

a) it only applies to gifts of land and buildings and shares in unlisted companies and

b) the instalments are interest bearing.

But it can help alleviate the cash flow difficulties of a dry tax charge. If a claim is made, the CGT is paid in ten annual instalments.

Post transaction valuation check

You should also be aware of the CG34 "post transaction valuation check" procedure here if a valuation is required. This permits the taxpayer to approach HMRC to agree a valuation after the transfer has taken place but before the SA return is filed in order to provide certainty over the resulting tax liability by the date of payment.

Google the form, download it, fill in it and make sure it is with HMRC at least three months before the filing date for the relevant return. A separate form is required for each valuation. And as long as you have disclosed all the relevant details, HMRC's opinion on the valuation will be binding.

Gifts to Trust

If a client has an asset which is to be the subject of a gift but does not tick any of the "business asset" boxes in S.165, the gain can still be deferred with a transfer into trust. This is because TCGA 1992 S.260 provides general holdover relief where a transfer gives rise to an immediate charge to Inheritance Tax (IHT).

Nowadays it does not normally matter what type of trust you choose as long as it's not a bare trust (which isn't a trust for CGT) or a qualifying disabled person's trust (as gifts into these are potentially exempt transfers which are not immediately chargeable). But otherwise, a gift of any asset into a discretionary or interest in possession (IIP) trust will open up a claim to gift relief. Well…most of the time.

There are a couple of caveats to this you need to be aware of:

1. Your trust needs to be UK resident (in simple terms in should have UK trustees). There is an exception for gifts of UK land and buildings where gains can be deferred on a gift to a non-UK trust on the basis that the asset will remain within the charge to UK CGT under the Non-Resident Capital Gains (NRCG) rules;

2. There is no gift relief is the trust is "settlor interested". Be careful here as the definition of a 'settlor interest' for CGT is wider than it is for income tax and includes not only the settlor and their spouse but also any minor unmarried children of the settlor. And you can't swerve the rules by excluding minor children then sneakily adding them in as beneficiaries once the dust has settled. If the trust becomes settlor interested within six tax years, the heldover gain becomes chargeable.

Note that for a S.260 claim to be made, the transfer needs to be chargeable to IHT although there is no requirement for an IHT liability to arise. This means that transfers falling within the settlor's nil rate band or transfers covered by IHT reliefs (such as BPR and APR) would still qualify for gift relief. The good old 'nil band discretionary trust' here defers CGT without creating an IHT charge.

If an IHT liability does arise, the CGT base cost of the asset in the hands of the trust can be increased by the IHT attributable to that asset (this applies whether or not a holdover claim is made). Effectively the IHT is treated as an incidental cost of acquisition for CGT. Again, this is a valuable relief which is often overlooked.

Private residences

Finally, be careful with private residences going into trust. This is not a CGT point per se, but if there is a mortgage on the property, you are likely to get push back from the lender if you want to transfer that asset into trust and take the mortgage along with it. Computer invariably says 'no'.

Also, if you do gift a property into trust and take the S.260 gift relief on offer, on a subsequent sale of that dwelling house by the trustees, no private residence relief will be available.

Therefore, if the property going into trust is likely at some point to become the main residence of one of the beneficiaries, it is prudent to forsake the CGT holdover on entry in return for much more valuable private residence relief further down the line.

The same principle applies for a dwelling house gifted to a beneficiary by a trust as a S.260 claim at that point will preclude a later private residence relief claim by the beneficiary.

Again, this underlines the principle that just because gift relief is available, it doesn't always mean you have to take it.

Contributed by Steve Sanders

Beneficial CGT treatment on EMI share sale (Lecture P1418 – 11.37 minutes)

The legislation for EMI share option schemes is found in ss.527 – 541 and Sch 5 ITEPA 2003.

For many employers, this arrangement is the scheme of choice, given that it provides significant tax and NIC advantages for qualifying share options granted by companies with gross assets not exceeding £30 million.

The scheme seeks to assist employers in recruiting and retaining key members of staff.

As well as having to satisfy the gross assets test, the EMI regime is restricted to companies or groups which are independent and whose trade does not consist of certain excluded activities.

Two of the most important attractions of the scheme are the CGT amendments made to the rules by FA 2013 in connection with the sale of EMI shares – see s.169I(7A) – (7R) TCGA 1992.

For business asset disposal relief purposes:

- EMI option holders do not have to meet the various 5% tests which normally apply for shareholders (a typical EMI holding will be significantly less than a 5% stake);

- The date when an EMI option is granted marks the start of the two-year qualifying period. This is particularly helpful in the context of exit-based schemes where the options are normally exercised shortly before the company is sold.

  Therefore, as long as employees sell their EMI shareholdings when two or more years have elapsed since the grant of the options, they will qualify for the 10% CGT rate. Another consideration is that payment for the exercise of the option can effectively be funded from the employee's share of the sale proceeds.

Illustration

Cricketworld Ltd is a UK-resident company which is involved in the promotion of all forms of cricket throughout the world. It meets the criteria to be a qualifying EMI company.

In April 2017, Eoin was granted an EMI option to acquire 10,000 ordinary shares in Cricketworld Ltd at £3.40 each (which was the agreed market value of the shares at that time). Eoin's 10,000 shares under option represent 1% of the company's fully diluted share capital. Eoin understands that his options can only be exercised when an offer has been accepted for the sale of Cricketworld Ltd.

At the end of November 2023, the directors of Cricketworld Ltd agreed to accept an offer from Virat Industries plc to purchase 100% of the company's shares for £48,000,000 (ie. at £48 per share).

The EMI option holders (including Eoin) were permitted to exercise their options on 15 December 2023 and the sale of the company was completed one week later.

Eoin is able to claim business asset disposal relief on the sale of his 10,000 EMI shares since all the relevant CGT requirements have been satisfied. It does not matter that Eoin's stake represents just 1% of Cricketworld Ltd's ordinary share capital nor that he only owned his shares for seven days – Eoin's EMI shares have been under option or owned by him for well over two years before they were sold.

Eoin's CGT liability on the sale of his 10,000 ordinary shares on 22 December 2023 is:

	£
Sale proceeds (10,000 x £48)	480,000
Less: Cost (10,000 x £3.40)	34,000
	446,000
Less: Annual CGT exemption	6,000
	£440,000
CGT @ 10%	£44,000

Contributed by Robert Jamieson

SDLT on farm and granary (Lecture P1416 – 16.27 minutes)

Summary – A granary bought at the same time as a farm was found to be part of the grounds relating to the farm, meaning that this was the purchase of residential, rather than mixed use property.

In 2019, Steven Bowen and his wife bought two leaseholds, Old Valley Farm and The Granary, registered under two title numbers at the Land Registry but bought together for a single price of £1,625,000:

- Old Valley Farm leasehold consisted of a farmhouse, outbuildings and over 14 acres of land;
- The Granary leasehold consisted of the granary building and land of less than an acre.

There was a single approach from the main road to the buildings. The Granary was not connected to any of the Old Valley Farm buildings but was sited on a small triangular plot of land, bordered on two sides by Old Valley Farm.

A single TR1 was completed for the transfer, and a single SDLT return stating that the two properties had been purchased in a single, mixed-use transaction.

Following an enquiry, HMRC issued a closure notice calculating the SDLT payable on the basis that the transaction was of entirely residential property.

Following a review, Steven Bowen appealed arguing that the purchase was of mixed used properties as The Granary:

- was separate to the farm, and its land was commercially farmed by a third party;
- did not form part of the garden and grounds of Old Valley Farm;
- had been marketed and sold separately with full planning permission for development.

Decision

The issue for the First Tier Tribunal to decide was whether The Granary was part of the grounds of Old Valley Farm, meaning that this was a single purchase of residential property.

The Tribunal took a multi-factorial approach as set out by the Upper Tribunal in Hyman [2021] UKUT 68 (TCC), concluding that The Granary and its land were part of the grounds of Old Valley Farmhouse.

The Tribunal concluded that The Granary and its land were not in agricultural or other commercial use. At the time of purchase, The Granary building was derelict. Although its land had been used for grazing in the past, there was no binding agreement to that effect in place at the effective date of the transaction.

Further, the lease:

- prohibited the use of the property for commercial purposes;

- indicated a link between The Granary and Old Valley Farmhouse.

The Granary shared two out of its three boundaries with Old Valley Farmhouse and was sufficiently close to Old Valley Farmhouse to be capable of being grounds.

The final nail in the coffin was that Steven Bowen stated that, given its proximity to the farmhouse, he had acquired The Granary to prevent someone else from purchasing it.

The Tribunal concluded that this made it clear that "the use or function of that property, at the effective date of the transaction, was to support the use of Old Valley Farmhouse as a dwelling".

With The Gramary forming part of the grounds at the effective date of the transaction, the purchase was one of residential property and not mixed-use property.

The appeal was dismissed.

Steven Bowen v HMRC (TC09003)

Administration

Late submission of corporation tax returns

Summary – The company did not have a reasonable excuse for failing to file tax returns for three consecutive years, despite the owner suffering ill-health.

White Breeze Limited traded to 31 July each year. Due to the ill-health and subsequent death of its director in November 2017, Mr Phillimore, its corporation tax returns for the periods ended 31 July 2013, 2014 and 2015 were all submitted late, on 12 June 2018. No corporation tax was payable.

Where a company fails to deliver its company tax return by the filing date, it is liable to a flat-rate penalty under para. 17 Sch 18 FA 1998 which states that the penalty is:

- £100, if the return is delivered within 3 months after the filing date, and
- £200, in any other case.

The amounts are increased to £500 and £1,000 for a third successive failure, that is, where:

- the company is within the charge to corporation tax for three consecutive accounting periods (and at no time between the beginning of the first of those periods and the end of the last is it outside the charge to corporation tax);
- a company tax return is required for each of those accounting periods;
- the company was liable to a penalty under this paragraph in respect of each of the first two of those periods; and
- the company is liable to a penalty under this paragraph in respect of the third period.

HMRC issued flat rate penalties for each of the periods concerned. However, prior to the hearing, HMRC realised that the conditions for issuing the higher rate penalty of £500 for the year to 31 July 2014 had not been met as there had not been three consecutive late filings at this point, Therefore, they should have been issued at £100. HMRC requested that the Tribunal use their powers under s.100B(2)(iii) TMA 1970 to reduce the amount of the penalties for that period.

The company argued that it had a reasonable excuse for the late filing of all three tax returns as Mr Evans, the Company Secretary, stated that due to Mr Phillimore's health issues, including his dementia, he had not been able to sign off on the accounts. The returns that were eventually submitted in 2018, were signed off by Mr Phillimore's daughter, who following her father's death, had taken on the day to day running of the company.

Decision

Having amended the penalty for the period to 31 July 2014 as requested by HMRC, the Tribunal concluded that the penalties had been issued in accordance with the law.

The First Tier Tribunal considered whether the company had a reasonable excuse for the late submission of its returns by using the four-stage test in Perrin v HMRC [2018] UKUT 156 TC.

1. Establishing the facts – Mr Phillimore's ill health and subsequent death was the argument being presented as the reasonable excuse.

2. Deciding which of those facts were proven – The evidence submitted confirmed that Mr Evans had been effectively running the company, as Mr Phillimore was not capable of making decisions. However, the Tribunal agreed with HMRC that no further evidence of what the impact of this was on the company was provided.

3. Viewed objectively, did Mr Phillimore's ill health amount to a reasonable excuse? Mr Evans failed to explain why the tax returns were not submitted for so many years or why they could not be submitted by him as agent or secretary. It was not reasonable, with the company still trading, to allow the non-submission of the returns to continue for so long.

4. Remedy without delay - Having found that there was no reasonable excuse at step 3, there was no need for the Tribunal continue to step 4 and see if, once the reasonable excuse no longer applied, the issue was remedied without delay. However, for completeness, it did so. In a letter dated January 2017, the Tribunal found that the company was able to calculate its tax and that same information would have enabled tax returns to be submitted at that time. The additional 18 months actually taken was not considered to be a reasonable timeframe to remedy the situation.

The appeal was dismissed.

White Breeze Limited v HMRC (TC08963)

Parental Leave Entitlement (Lecture B1419 – 23.02 minutes)

Antenatal Appointments

Pregnant mothers have the right to reasonable paid time off work to attend antenatal appointments. This right will be extended to apply to fathers, or the mother's partner, for attendance at two appointments, 6.5hrs each although this time off will unpaid. Similar provisions will apply for adoptive parents. The adopter will be given paid time off for five appointments and their partner will be able to attend two meetings, but this time off will be unpaid.

Surrogacy

Person carrying the baby - The surrogate is entitled to the full maternity leave, and SMP, as if she were having her own child. However, the partner is not eligible for paternity or parental leave as these are based on the person having caring responsibilities for the child.

Intended parents of baby - Parents who have a child through a surrogacy arrangement will be entitled to take ordinary paternity leave and pay and adoption leave and pay and shared parental leave and pay provided they meet the eligibility criteria. Only one of the parents will be allowed to take time off, unpaid, to attend two ante natal appointments, up to 6.5 hours, with the mother of the child. The employer cannot ask for proof of the appointment but may ask for a written declaration confirming the time is being used for an antenatal appointment.

Keeping in Touch Days (KIT)

Employees on Statutory Maternity Leave or Statutory Adoption Leave can come into work for up to ten KIT days during their leave to retain contact with their workplace and be paid. If on a KIT Day the employee only works for part of the day, it counts as a full KIT Day.

The payment made to the employee for KIT days is not set out in regulations but employers are expected to pay the employee's normal pay rate, based on their contracted remuneration, not the Statutory Maternity Pay (SMP)/Statutory Adoption Pay (SAP) rate. There is no loss of statutory pay and SMP/SAP can be offset against the contractual salary. Whatever amount is paid for the day only the SMP/SAP part can be reclaimed by the employer from HMRC.

The employer can offer KIT days to the employee but does not have to do so. The employee can agree to work the days or refuse to take them. It is a matter for the two parties to agree and if an employee says no the employer cannot penalise them.

Shared Parental Leave in Touch (SPLIT) Days

An employer can offer, and the employee can work up to 20 SPLIT days during SPL without bringing the leave to an end. These days are in addition to the 10 KIT days available to employees on maternity or adoption leave. But as with KIT days the employee can accept or refuse to work the SPLIT days.

Unpaid Parental Leave

All eligible employees can take unpaid parental leave in order to care for a child's welfare, e.g. look at new schools, settle children into new childcare arrangements, spend more time with child. Their employment rights are protected during this parental leave and all contractual terms are unchanged. The employee continues to accrue their annual holiday entitlement.

The rules for unpaid parental leave are as follows:

- employee must have one year's continuous service with the employer;
- the child is under 18;
- parental leave will be unpaid and the employment contract will continue;
- parental leave will apply on the birth or adoption of a child;
- parental leave is 18 weeks in total for each child and adopted child;
- leave must be to care for the child;
- leave can be taken any time up to the child's 18th birthday;
- leave that can be taken each year is 4 weeks per child, unless employer agrees otherwise;
- the leave must be taken in whole weeks, not individual days, unless employer agrees or the child is disabled;
- employer can ask for proof of responsibility – birth or adoption certificate;

- employee must give 21 days' notice of starting a leave period, with start and end date.

Time off for Dependents - emergencies

The rules on an employee taking time off to assist a dependent in an emergency are defined in the Employment Relations Act 1999. Employees are entitled to a "reasonable" amount of unpaid time off work for such emergencies. This would include:

- providing assistance when a dependent falls ill, gives birth or is injured or assaulted;
- to arrange for care for a sick or injured dependent;
- following the death of a dependent;
- because arrangements for the care of a dependent have been disrupted or terminated;
- to deal with an incident involving the care of a child during school hours.

The emergency must involve a dependent, being the employee's spouse, civil partner, partner, their child or parent or any person living in the same household, but not as tenants, lodgers or an employee and a person who relies on them such as elderly neighbour.

The employee is required to give the employer reasons for the absence as soon as reasonably practicable or where this is not possible inform the employer of how long the period of absence is expected to last.

An employer can voluntarily choose to pay the employee when they take time off for this leave but they are not required to do so by law.

Carer's Leave Act 2023 - New Right for Unpaid Leave for Carers

The Carer's Leave Act received Royal assent on 24 May 2023 and is effective from 6 April 2024.

Carers leave will be a right, from day one of employment, for unpaid carers allowing them to take up to one week, 5 working days, unpaid leave each year to look after the person for whom they care.

Employees, where eligible, will be able to take the leave either as individual day or half days up to a block of one week.

The employee will be required to give notice of the leave the same as for annual leave being twice the length of the leave required plus one day.

It is likely the employer will have limited scope for rejecting requests for the leave.

The entitlement to statutory carer's leave will:

- Be available to employees regardless of length of service so from day one;
- Depend on the carer's relationship with the person being cared for:

  - spouse, civil partner, child or parent of employee
  - living in the same household of the employee but not as lodger/tenant
  - relies on employee to provide or arrange care

- Depend on the person being cared for having a long-term care need:
  - long term illness or injury (mental or physical) needing care for > 3 months
  - a disability as defined by Equality Act 2010 or
  - issues related to old age.

Neonatal Care (Leave and Pay) Act 2023

The Neonatal Care (Leave and Pay) Act 2023 received Royal assent on 24 May 2023. It is anticipated it will be effective from April 2025.

This Act will allow parents, from day one of employment, to take up to 12 weeks of paid leave in addition to the usual statutory maternity and statutory paternity leave and pay periods. This will be an employment right from day one of employment.

The criteria are:

- the admission to hospital lasts for a continuous period of 7 days or more;
- the baby is neonate - aged 28 days or less.

Flexible Working Requests

Under the current regulations all employees, including parents, carers and someone returning from maternity/adoption leave, can make a "flexible working" request so as to:

- Reduce hours;
- Change start and finish times;
- Work same hours but over fewer days;
- Work from home on some days and the office on others;
- Job share with another employee.

An employee who is disabled can also make a reasonable adjustment request, relating to their disability.

In order to be eligible to make a flexible working request the employee must have at least 26 weeks continuous service with the employer and have not made a previous flexible working request in the last 12 months. The request must be made in writing – a letter or an e-mail – stating it is a "statutory flexible working request". The request must include:

- Date it is being sent;
- The change the employee would like to make;
- The date from when the employee would like the change to start;

- How the employee, or the employer, might deal with any effects of the change could have on their work or the organisation;

- Date of previous flexible working requests.

The employee could also explain to their employer how the proposed change may benefit the employer and/or other employees.

On receipt of the request the employer must consider it fairly and make a decision within a maximum of 3 months. The employer should meet with the employee, within 28 days, to discuss the request. The employee could take a colleague or trade union rep to that meeting if the employer agrees.

Within 14 days of the meeting the employer must give a written decision either agreeing to the change or giving reasons as to why the change is not accepted.

The employer may refuse the change of contractual terms based on business grounds, such as additional costs, not meeting customers needs, detrimental effect on quality or performance.

The employee can appeal against the decision, in writing, within 14 days.

The employer must again give a final written decision within 14 days of any further meeting.

The employee can take a complaint to an Employment Tribunal if the employer does not follow the procedure correctly.

They cannot challenge through the tribunal the employer’s business case for refusing the change of contract unless it is based on inaccurate facts.

Where the flexible working request is agreed there will be a change to the terms of the employee’s contract. So, the employer must state, in writing, the agreed change, the date when the change will take place, how long the change will last, if not permanent and a review date if agreed by both parties to see how the change is working.

Update – Employment Relations (Flexible Working) Act 2023

ACAS guidance will be updated in 2024 when this act into force. The Act makes changes to the Employment Rights Act 1996 to give the employee more flexibility over where and when they work:

- Employer must consult with the employee before rejecting the request;

- Employee can make two applications during any 12 months, rather than the current one request;

- Employer will have 2 months in which to respond - currently they have 3 months;

- Employee does not have to explain the effect, if any, their request would have on the employer.

The government announced this would be a right from day one of a new job. However, the day one right was not stated in the Act so further legislation is expected to implement that right.

Miscarriage Leave Bill - amendment of Employment Rights Act 1996

This bill proposes to make provision for not less than 3 days leave for people who have experienced a miscarriage, molar pregnancy or ectopic pregnancy prior to 24 weeks. T

his may be paid as statutory bereavement pay to parents.

This bill is with the House of Commons and was due for the 2nd reading in November 2023.

The Fertility Treatment (Employment Rights) Bill

This bill proposes to give employees, who are receiving fertility treatment, the right to paid time off from work to attend fertility treatment appointments.

Partners would have a similar right to unpaid time off to go along to the appointments.

This bill is with the House of Commons and was due for the 2nd reading in November 2023.

Contributed by Alexandra Durrant

Partial closure notices (Lecture P1420 – 12.42 minutes)

This article will consider various issues relating to partial closure notices, which can be used by HMRC to settle aspects of an enquiry into a taxpayer's tax return (whether under Income Tax Self-Assessment or Corporation Tax Self-Assessment), and which can be requested from the tax tribunal by a taxpayer. Reference should be made to the separate session on closure notices, which focused on final closure notices, and which help bring a resolution to a HMRC enquiry.

Background

Closure notices are one of the ways in which an enquiry into a taxpayer's return may be concluded and have been an integral part of HMRC compliance checks since the beginning of Self-Assessment. Partial closure notices permit the resolution of a particular matter, or matters, that are being enquired into.

The provisions relating to partial closure notices were introduced in Finance (No. 2) Act 2017 (s 63 and Sch 18), and relate to the completion of compliance checks that were already open at 17 November 2017, or opened on or after that date.

The issue of a partial closure notice is covered by the following legislation:

- Taxes Management Act 1970, s28A and s28B (partial closure notices for personal, trustee, non-resident CGT and partnership enquiries);

- Finance Act 1998, Sch 18, paras 32 and 33 (partial closure notices for corporation tax).

The provisions relating to final closure notices have been covered in a separate session, as noted above.

Partial closure notice issued by HMRC

The issue of a partial closure notice by HMRC requires the authority of an approving officer, unless the tribunal has directed that such a notice be issued. The approving officer is an HMRC officer who is not, or has not been, involved in the subject case.

HMRC's policy is that partial closure notices should be used selectively, and not routinely, particularly if there is the likelihood of an appeal. Where the taxpayer agrees with HMRC's view on a matter, that matter can be finalised by the issue of a partial closure notice. HMRC's guidance indicates, at CH279600, that they will not issue a partial closure notice where the taxpayer does not agree with their view of the matter unless:

- The tribunal has issued a direction for a partial closure notice to be issued:
- The compliance check involves one or more of the following:
  - Tax avoidance
  - Multiple complex issues
- There is a large amount of tax at risk

HMRC will calculate the tax due as a result of amending a return by issuing a partial closure notice based on the information known at that time. Any discrepancy can be resolved when the final closure notice is issued. HMRC officers are advised not issue a partial closure notice when they are close to issuing a final closure notice.

When a partial closure notice is issued by HMRC, the notice must, in accordance with TMA 1970, s 28A, para 2, "state the officer's conclusions and:

a) state that in the officer's opinion no amendment of the return is required, or

b) make the amendments of the return required to give effect to his conclusions".

There is a similar provision at FA 1998, Sch 18, para 34 in relation to CTSA enquiries.

The same appeal rights apply to partial closure notices as they do to final closure notices, and the client has the right of appeal against the partial closure notice. The client may seek a statutory review of the decision, or follow other formal channels (Alternative Dispute Resolution or the tribunal) for resolution of the position. As the HMRC will,

Closure notice application by client

The statutory provisions noted above permit taxpayers to apply to the tax tribunal for the issue of a partial closure notice (in the same way as for a final closure notice). An application can be made at any stage of an enquiry, and there isn't a limit on the number of applications that can be made.

HMRC's Enquiry Manual anticipates particular occasions when a taxpayer might seek the issue of a closure notice from the tribunal:

- Following the issue of the opening letter and request for information (see EM1981);
- Following the issue of a formal notice (see EM1982);
- Following contact with the taxpayer (see EM1983);
- Following delay by the enquiry officer (see EM1984).

There may be other instances where an adviser considers that it would be appropriate to seek a partial closure notice from the tribunal. Each case must be considered on its merits, and the tribunal will consider the particular facts of the case before reaching their decision.

HMRC officers are advised that, when a closure application is made, they should review the enquiry to date, and consider whether requests for information are reasonable and justified. Officers are also advised to consider whether a partial closure notice is appropriate (see EM1980).

Advisers should note that making an application for a partial closure notice, or indicating to the officer that one will be made, may focus the officer's attention on the case, such that he issues a partial closure notice, or takes other action which moves the case forward. A discussion with the enquiry officer to establish why they have not been able to close the enquiry, or to conclude a particular aspect of a case, may prove fruitful. However, that will not always be the case.

Where the application proceeds to the tribunal, the legislation provides that "The tribunal shall give the direction applied for unless satisfied that there are reasonable grounds for not issuing the partial … closure notice within a specified period" (TMA 1970, s28A (6), with a similar provision in FA 1998, Sch 18). Thus, the onus is firmly on HMRC to convince the tribunal why the partial closure notice should not be issued.

Outcome at the tribunal

There are various potential outcomes when a partial closure notice application is made.

The tribunal may direct that a partial closure notice should be issued within a specified period, and, as noted above, this is the default outcome under the legislation if HMRC are not able to persuade the tribunal otherwise. The period granted to HMRC will vary from case to case, and the officer could, potentially, be given several months to issue the partial closure notice. The officer must base their conclusion and figures on whatever information is held.

Advisers should note that the issue of a partial closure notice does not necessarily mean that the particular matter is settled, as the officer will issue the notice based on his conclusions, which may not be the same as those of the adviser or client. In such circumstances, the taxpayer can appeal when the partial closure notice is issued, so that the substantive issues can be resolved (whether by ADR or at the tribunal).

The client can appeal a point of law against the tribunal's decision if they do not direct that a partial closure notice is issued. Similarly, HMRC can appeal against the tribunal's decision to issue a partial closure notice if they consider that the tribunal has made an error in law in its judgment.

Where the tribunal does not direct that a partial closure notice be issued, the taxpayer can make further applications for a partial closure notice, or, if appropriate, a final closure notice. Advisers should consider whether the circumstances have changed sufficiently to improve the chance of success. A succession of applications for a partial closure notice in a short period of time, particularly when in relation to the same matter, is unlikely to be a prudent, or cost-effective, approach.

Practical considerations

There are various issues that the agent should consider when dealing with a partial closure notice issued by HMRC, and these include the following:

- Check the conclusions, and any figures, contained in the partial closure notice, and associated assessments or formal notices, to ensure that they agree with the outcome of negotiations with HMRC;
- Where the officer has used his own figures in the partial closure notice, the agent should consider the appropriate remedy (usually this will be one or more of the following - statutory review, Alternative Dispute Resolution or the tax tribunal);
- Where HMRC consider there is liability to a penalty following the issue of a partial closure notice, the officer is instructed to start formal penalty proceedings.

As noted above, HMRC will usually only issue a partial closure notice where there is agreement with the agent on the particular matter, except in limited circumstances.

Where the agent is considering whether the client should seek a direction from the tribunal for the issue of a partial closure notice, the following points should be borne in mind:

- Advise the client as to the potential outcomes;
- If the tribunal direct HMRC to issue a partial closure notice, that is not necessarily the end of the matter. It may be necessary to appeal against the notice, when issued, so that the substantive points relating to that matter can be heard at the tribunal;
- Timing of the application is crucial, as seeking a partial closure notice too early will reduce the chance of success;
- Where information has been submitted to the officer, it is prudent to allow a reasonable time for that information to be reviewed, before seeking a partial closure notice direction;
- What is reasonable will vary from case to case;
- Consider a partial closure notice if the enquiry officer continues to ask questions beyond what is considered reasonable and has embarked on a ‘fishing expedition’;
- Consider seeking a partial closure notice where there are multiple matters being reviewed, and progress into resolving them is being made at a different pace;

- Speak to the enquiry officer, if possible, before making an application to the tribunal, as that may help to focus his mind on the enquiry, and to move the case forward;
- There is a risk that if a partial closure notice is sought prematurely, and HMRC subsequently establish a significant tax irregularity, your client may be exposed to higher penalties than would otherwise be the case;
- Consider whether an application for a final closure notice may be more appropriate than a partial closure notice (see separate session).

Contributed by Phil Berwick (Director at Berwick Tax)

Deadlines

1 February 2024

- £100 penalty and extended enquiry window if 2022/23 SATR not filed by 31 Jan 2024
- Corporation tax for periods ended 30 April 2023 for SMEs not liable by instalments.

2 February 2024

- Form P46(Car) for quarter ended 5 January 2024

5 February 2024

- Employment intermediaries report for quarter to 5 January 2024

7 February 2024

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

14 February 2024

- Quarterly corporation tax instalment for large companies (depending on year end)
- Monthly EC sales list (paper return) – businesses in Northern Ireland selling goods
- Application to defer class 1 NICs (leaflet CA72A) for 2023/24

19 February 2024

- PAYE, NICs, CIS and student loans for month to 5 Feb 2024 if not paying electronically
- File monthly construction industry scheme return

21 February 2024

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

22 February 2024

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

28 February 2024

- Corporation tax self-assessment returns for periods ended 28 February 2023

News

Mandating the payrolling of benefits in kind

From April 2026, looking to reduce the administrative burden by removing the need to file P11D returns and forms P11D(b), the government will mandate the reporting and paying of Income Tax and Class 1A National Insurance Contributions on benefits in kind via payroll software.

HMRC has stated that it will:

- discuss their plans and publish draft legislation later this year;
- work with industry experts to produce guidance.

https://www.gov.uk/government/publications/tax-simplification-update-january-2024

Business taxes

The Post Office Horizon scandal (Lecture B1416 – 19.02 minutes)

You may well have watched the recent ITV drama 'Mr Bates vs The Post Office'. This was a four-part drama looking at the Post Office scandal where, between 1999 and 2015, hundreds of sub-postmasters and mistresses were accused of false accounting, theft and fraud, when in fact it was Fujitsu's Horizon software issues incorrectly showing money missing from their accounts.

Prime Minister's announcement

On 10th January 2024, Rishi Sunak announced that a new law would be introduced clearing the names of hundreds of postmasters and mistresses who were wrongly convicted because of faulty IT software; we wait to see how quickly this is achieved.

Free advice available

Unfortunately, the tax treatment of the compensation sums agreed to date are not straightforward, with some amounts taxable, while others are exempt. To further complicate matters, some such sums have yet to be paid.

AccountingWeb has reported that "a team of philanthropic accountants is offering free advice and support to affected sub-postmasters to help them get their tax affairs in order." Initiated by Rebecca Benneyworth, the team are offering free tax advice to sub-postmasters and mistresses who have received compensation from the Post Office.

A website has been set up at https://subpostmasterstax.org.uk/tax-on-your-compensation, that includes a contact form for concerned individuals to complete and so link up with advisers. This form can also be used by volunteers who wish to join the team and offer their help for free. The link to this site is repeated at the end of this article.

Further, there is a useful general advice page "Tax on your compensation" that summarises how compensation payments are taxed under the two existing compensation schemes. This can be found at https://subpostmasterstax.org.uk/tax-on-your-compensation.

Group Litigation Order compensation scheme

This scheme applied to the group of postmasters, who did not have a Horizon-related conviction, and pursued their case (Alan Bates and Others v Post Office Ltd) through the courts under a Group Litigation Order.

Payments under this scheme related to loss of earnings and interest where the loss of earnings was calculated based on net pay. As a result, the loss of earnings element was not taxable and any interest paid was exempt from tax under an exemption introduced by HMRC.

Horizon Shortfall Scheme compensation scheme

This scheme was put in place by Post Office Ltd to compensate postmasters who, while not subject to criminal conviction, made good their apparent losses caused by the Horizon system from their own pockets.

In June 2023, the Government announced that postmasters in this scheme would receive:

- top-up payments to ensure that the amount of compensation they received was not unduly reduced by tax;
- £300 to pay for independent advice on filing their tax return.

However, not all top-up payments and tax advice grants have yet been made by the Post Office.

HMRC guidance

On 8th January 2024, HMRC published its guidance to help individuals complete their 2022/23 tax returns. The link to this guidance is given below.

Compensation payments under the Horizon Shortfall Scheme relating to 2022/23 needed to be reported, and any related tax due paid, by 31 January 2024.

Where individuals have not been able to file their return by the due date, or where they have not paid the tax due to not receiving their top up payment, HMRC has confirmed it will cancel any related interest and penalties.

Further, HMRC has set up a dedicated specialist support team that can be contacted on 0300 322 9625, Monday to Friday between 8am and 6pm.

https://www.gov.uk/government/publications/get-help-with-self-assessment-filing-if-youre-a-sub-postmaster

https://subpostmasterstax.org.uk/tax-on-your-compensation

Incorrect tax treatment by the Post Office

Payments made are deductible for tax if incurred "wholly and exclusively" for the purpose of trade.

Tax Policy Associates has stated:

> "The Post Office has claimed a £934m tax deduction for its compensation payments to the victims of the Post Office scandal."

It seems unlikely that the Post Office compensation payments made to sub-postmasters and mistresses is likely to satisfy this rule.

Tax policy Associates continue:

> "The consequence is that the Post Office has underpaid its corporation tax by over £100m over the last five years and may no longer be solvent."

Further, they state:

> "We understand that HMRC are actively pursuing this point – and it's just one of five major Horizon scandal matters where the Post Office has, we believe, materially underpaid its tax. The Post Office failed to declare these issues in its accounts until this year, when it included an obscure reference which failed to adequately disclose the point."

The other tax liabilities referred to by Tax policy Associates are:

1. Tax on the "shortfalls" recovered from postmasters for supposed stolen funds, which it now seems were "a windfall for the Post Office";

2. Adjustments needed where the Post Office has claimed non-deductible costs "including the costs of falsely prosecuting postmasters …… carried on outside the course of the trade";

3. Adjustments for costs claimed, including legal fees, for fighting the postmasters' claims";

4. Funding received by the Post Office from the Government which may be taxable as "if the shareholder just gives money to a company, to supplement its trading receipts and enable it to carry on in business, then that will be a taxable trading receipt."

https://www.taxpolicy.org.uk/2024/01/12/934m/

Not A Going Concern

Summary – Research and Development Expenditure Credit (RDEC) was denied as the company's accounts had not been prepared on a going concern basis.

MW High Tech Projects UK Ltd was an engineering and construction company. Apparently, "all of its projects involve considerable risk, because the related technology is expensive and requires significant research and development".

By the end of 2016, the company had suffered, and was continuing to suffer, considerable losses and its accounts for the years ended 30 December 2017 and 2018 were filed on the basis that the company was not a going concern.

When filing its corporation tax return for the year to 30 December 2017, MW High Tech Projects UK Ltd included a RDEC claim of just under £2 million.

Following an enquiry, HMRC denied the claim on the basis that it was invalid as its statutory accounts for the years ended 30 December 2017 and 2018 both stated that the company was not a going concern (s.104S Chapter 6A CTA 2009).

MW High Tech Projects UK Ltd appealed to the First Tier Tribunal on a number of grounds including that s.104S/T CTA 2009 applied. RDEC would be available if the company became a going concern "on or before the last day on which an amendment of the company's tax return for the accounting period could be made under paragraph 15 of Schedule 18 to FA 1998".

The company argued that as it accounts for the year to December 2019 were prepared on a going concern basis, RDEC should be available.

The First Tier Tribunal found that:

> "The 2017 accounts were received by Companies House on 1 April 2019.
>
> The Appellant claimed the RDEC in its 2017 CT return which was filed on 4 April 2019.
>
> On that date, the "latest published accounts" were those for the year ended 30 December 2017, and those accounts had been filed on the basis that the Appellant was not a going concern."

The filing date for this period's tax return was 30 December 2018 (twelve months after the end of the period for which the return was made).

A company is still entitled to RDEC if it becomes a going concern on or before the last day on which it could amend its Corporation Tax return. The return could be amended up to 12 months after the filing date, making the last date 30 December 2019.

By that date, the company's latest filed accounts were those for the year to 30 December 2018, which were not on a going concern basis.

The going concern basis accounts for the following year could not be taken into account. The company argued that a prior period adjustment made at that time meant that the company was indeed a going concern in the earlier periods. However, the Tribunal found that there was no prior period adjustment in the 2019 accounts and "even had there been, it would have had no effect on the 2017 and 2018 published accounts".

The appeal was dismissed.

MW High Tech Projects UK Limited v HMRC [2023] TC09011

Partnership incentivisation plan payments

Summary - Profits allocated to a corporate partner under a partner incentivisation plan could not be treated as income of the individual partners, but the payments eventually made to those partners were subject to income tax as miscellaneous income.

BlueCrest Capital Management LP was a limited partnership operating as an investment manager.

It established a partner incentivisation plan under which a corporate partner was introduced and was awarded a portion of the limited partnership's profits on a discretionary basis.

It then reinvested those profits into the limited partnership as a capital contribution (so-called 'special capital') and shares in that capital were awarded to other partners according to their performance in the business.

It was accepted that the partner incentivisation plan had both a commercial purposes and a perceived tax advantage.

- The commercial purpose was to incentivise the partners to remain with the firm and to permit account to be taken of subsequent performance before awards were finalised;

- The fiscal advantage arose from the difference between the income tax rate and corporation tax rate on the profits awarded to the corporate partner. The intention was that an award of special capital to an individual partner would escape liability to income tax.

Decision

Before the Court of Appeal there were two issues.

The first was whether, as HMRC argued, the profits allocated to the corporate partner should be treated as profits of the individual partners participating in the plan in the proportions in which they were intended to benefit from the special capital.

The Court of Appeal rejected this argument. The purpose of the legislation was to determine the partners' share in the actual profits and this could only be done by examining the rights of the partners, including the corporate partner. There was 'nothing illusory, or unreal, about the share allocated to the corporate partner'.

The Court of Appeal then considered whether the awards of special capital to the individual partners were taxable under the 'sweep-up' charge as miscellaneous income.

There were three requirements. The amounts must be:

1. income in nature;

2. of a kind analogous to another head of charge; and

3. derived from a source.

The Court of Appeal held that all three requirements were met, so that the miscellaneous income charge applied.

Viewing the scheme as a whole, the final awards were a form of deferred reward for the work done by the partners and so were income in nature, and also analogous to deferred awards of employment income. A source of the income could be found in the exercise by the corporate partner of its discretion whether or not to make the award.

BlueCrest Capital Management LP and others v HMRC [2023] EWCA Civ 1481

Adapted from the case summary in Tax Journal (12 January 2024)

Directors loan account s.455 charges after an enquiry (Lecture B1417 – 14.06 minutes)

Background

Most business owners are scrupulously honest. However, even for the most honest business owner, tax return adjustments sometimes occur. At the other end of the spectrum, there are dishonest business owners who seek to evade tax by misappropriating the company's income.

In company enquiries, HMRC categorises business profit irregularities as 'non-extractive' or 'extractive'.

Non-extractive adjustments

'Non-extractive' irregularities are understatements of profits (or excess tax relief claims) that do not involve funds being taken out or diverted away from the company. For example, non-extractive amendments to reported profits may arise through private use adjustments (for sole traders or partners), or disallowances due to innocent misunderstandings about complex tax law.

Where a non-extractive understatement of corporation tax has arisen, the company's tax liability is reduced or deferred. HMRC considers this to give the company's owners an unfair advantage over other company owners, on the basis that it increases the company's worth.

Extractive adjustments

'Extractive' irregularities occur broadly where money or value is taken out or diverted from the company by or on behalf of the company's owners. In extractive cases, HMRC might seek a settlement of the evaded tax in various ways, depending on the circumstances.

For example, omitted turnover will generally be charged to corporation tax on the company as additional profits. In addition, a director shareholder who has benefited from receiving the omitted turnover, or from having company funds diverted to them, might have an existing directors' loan account (DLA) with the company. HMRC could propose that the omissions are debited to the individual's DLA. Rewriting the DLA in this way could result in it moving from a credit balance to an overdrawn balance. If so, a close company will also be faced with a potential liability under the 'loans to participators' legislation. If so, the company would generally be chargeable under CTA 2010, s 455 (at a current rate of 33.75%). Furthermore, an income tax liability may arise for the director under the beneficial loan provisions (ITEPA 2003, s 175).

HMRC's view (in its Enquiry Manual, at EM8601) is that where a settlement at the end of an HMRC enquiry concerns extractive adjustments involving the company's directors, the debt incurred by the director in respect of the extractions is not a loan until there is an intention that it be repaid. In other words, a liability under ITEPA 2003, s 175 attaches to the directors in extractive settlements from the date the intention to repay the debt can be shown to exist, until such time as the debt has been repaid. In practice, it would be unusual to find evidence that the company or director agreed at the time the funds were taken, that it would be repaid; an intention to repay will normally occur when the settlement terms are being discussed.

If the director does not have a loan account with the company, HMRC may seek to tax the omitted company turnover as undisclosed employment income instead. However, in cases where there is little evidence about the misappropriations and the circumstances surrounding them, HMRC's preference is normally to treat money extracted from the company as loans to participators; but the tax treatment will depend on the circumstances.

An HMRC enquiry will eventually be settled by contract or assessment. In terms of the three potential tax charges mentioned in enquiries involving extractive adjustments, (i.e., corporation tax, section 455 and section 175). HMRC will generally address each charging provision separately (EM8610). Interest and penalties will also need to be considered.

If the DLA is being released or written off, the company will normally be able to make a claim for relief from the section 455 charge (under CTA 2010, s 458), and HMRC may allow the relief under a contract settlement, so that there is only interest and penalties to consider in respect of the understatement. However, the director shareholder will normally be liable to an income tax charge on the release or write off (under ITTOIA 2005, s 415).

Recent section 455 cases

In *Gopaul v Revenue and Customs* [2023] UKFTT 728 (TC), the company operated a take-away pizza business, of which the appellant taxpayer was the only shareholder and director. In June 2017, HMRC issued the company with 'best judgement' VAT assessments because HMRC considered that the company's turnover had been systematically suppressed. In addition, HMRC issued the company with a penalty on the basis that the behaviour had been deliberate. HMRC also issued the taxpayer with a personal liability notice (PLN) (under FA 2007, Sch 24, para 19) making him liable for 100% of the penalty on the basis that the inaccuracies were attributable to him. In September 2017, HMRC opened enquiries into the company's tax returns, and subsequently issued closure notices and amended assessments for 2016 and 2017 and discovery assessments for 2014 and 2015. The assessments were made up of: (a) corporation tax on undisclosed profits; and (b) section 455 charges. HMRC had treated omitted company sales as funds misappropriated by the taxpayer and treated them as loans or advances to participators for section 455 purposes. HMRC later issued the company with a penalty representing 56% of the total extra corporation tax, on the basis that the behaviour had been deliberate. HMRC later issued the taxpayer with a PLN for the same amount. The taxpayer appealed, but the First Tier Tribunal (FTT) upheld the VAT, corporation tax and section 455 PLNs.

With regard to penalties, the FTT upheld HMRC's corporation tax penalty, on the basis that the company had acted deliberately in suppressing profits. On the penalty relating to the section 455 liabilities, HMRC needed to prove the taxpayer knew that the company had a liability under section 455 and deliberately omitted it from the company's tax return. However, the FTT found that HMRC had failed to discharge their burden of proof, and allowed that part of the taxpayer's appeal.

In *New Claire Wine Ltd v Revenue and Customs* [2024] UKFTT 00014 (TC), the appellant company was owned by two directors (B and P). The company was VAT registered, and according to P traded "…in the wholesale of wine, beer, spirits and other alcoholic beverages [and] does business with many wholesalers and cash & carry shops". During an enquiry, HMRC identified significant differences between the stock reported in the company's accounts and the figures that should have been held. There were also instances of product lines being sold where no purchase invoices could be found or where they were not included in the opening stock analysis. HMRC subsequently issued: (a) corporation tax and section 455 discovery assessments in October 2019 for the company's accounting periods ended 31 January 2013 to 2017; (b) VAT assessments for the periods ended June 2012 to March 2017; and (c) a penalty notice for deliberate tax return errors. The company appealed.

For section 455 purposes, HMRC considered that the 'Other Creditors' figures in the company's accounts was the two DLAs. HMRC subtracted the additional profits in its stock flow exercise from the closing balance on the DLA at 31 March 2013 to determine the revised balance. HMRC then determined the revised balance in each year, and the balance reported in the accounts was added back to the previous year's revised balance, before the potential additional profits were subtracted. The section 455 charge was then applied to the increase in the level that the DLA was overdrawn in each year.

The FTT accepted HMRC's approach to establishing the quantum of the assessments, which was based on a 'presumption of continuity' (from *Jonas v Bamford* 1973 51 TC), so HMRC's stock flow exercise could be extrapolated to other accounting periods. The tribunal also rejected the company's argument that HMRC's analyses were so flawed that they were unreliable. Furthermore, deposits into the directors' private bank accounts had not been adequately explained or supported by documentary evidence. The tribunal found that the company (through its directors, who diverted funds to themselves) advanced the monies to the directors. Looking at the totality of the evidence, the tribunal found that the company's behaviour was deliberate. The company's appeal was dismissed.

A little knowledge?

The success of the taxpayer's appeal on section 455 penalties in *Gopaul* turned on his knowledge (or rather, his lack of knowledge) about how section 455 liabilities arise. The tribunal commented: "…there is no evidence that Mr Gopaul even knew at the time the returns were made, that the extraction of money from his own company could trigger a corporation tax charge: nothing in the correspondence discusses his knowledge or understanding, and he was not cross-examined on this point. We agree…that HMRC have failed to meet their burden of showing that the Company acted deliberately in omitting the section 455 liabilities from its corporation tax returns."

The tribunal's decision in *Gopaul* offers hope that some taxpayers may be able to escape penalties on section 455 liabilities in appropriate circumstances, although of course *Gopaul* does not set a binding precedent and may be subject to appeal by HMRC.

Contributed by Mark McLaughlin

Introduction to Pillar 2 taxes (Lecture B1420 – 29.39 minutes)

Interaction and order of precedence

Subject to tax rule (STTR) is a withholding tax levied by developing nations on certain payments to connected parties. This does not affect UK companies but they may see it being applied to intra-group transactions in other territories.

Domestic in-scope companies or groups that have an effective tax rate of less than 15% will be taxed under the Qualified Minimum Domestic Top-up Tax (QMDTT).

Foreign activities of in-scope group companies that have an effective rate of less than 15% will generally be collected under the Income Inclusion Rule (IIR – aka Multinational Top-up Tax). In calculating the effective rate of tax, any domestic top-up tax payable in the jurisdiction is added to the 'covered tax' balance.

Foreign profits taxed at an effective rate of less than 15% which are outside the scope of the IIR can be taxed in the UK under the proposed Undertaxed Profits Rule (UTPR).

STTR arises on payment, so takes precedence over QDMTT. QDMTT is taken account of when computing IIR tax, so takes precedence over it. IIR tax takes precedence over the UTPR.

Subject to tax rule (STTR)

This is targeted at developing countries (Gross National Income per capita of USD12,535 or less in 2019) that have ceded taxing rights in a tax treaty (e..g. many sub-Saharan African countries).

It is a tax treaty-based rule (via a multi-lateral instrument introduced by the OECD) that specifically targets risks to source jurisdictions posed by basis-erosion and profit-shifting (BEPS) structures.

It will apply to payments between connected persons that take advantage of low nominal rates of taxation in the other contracting jurisdiction (i.e. the jurisdiction of the payee). It will cover payments like royalties, interest, mobile assets.

STTR is a 'covered tax' for the purpose of computing the effective tax rate for QDMTT, IIR and UTPR purposes.

QMDTT (domestic top-up tax) and IIR

Part of the OECD action on Global Anti-Base Erosion (GloBE), the domestic top-up tax legislation is in Part 4, F(No.2)A 2023. The IIR legislation is in Part 3, F(No.2)A 2023.

Substantial amendments have been proposed in Finance Bill 2023-24 in line with the latest guidance issued by the OECD.

The legislation (including the proposed amendments) first apply to accounting periods beginning on or after 31 December 2023. Many other jurisdictions have introduced similar legislation to the UK.

The UK QMDTT is focused on UK operations of any company or group, where the effective rate of tax of the operation is less than 15%.

The UK IIR is focused on foreign operations of a UK in-scope holding company ('responsible member') where the effective rate of tax in any jurisdiction where the group operates is less than 15%.

If so, a top-up UK tax is payable by the responsible member, but only to the extent of its ownership interest in the foreign operation.

The effective rate = tax expense ÷ accounting profit before tax

The tax expense known as the 'covered tax balance' in the legislation and includes deferred tax but not necessarily the amount included in the financial statements.

Accounting profits need to be adjusted for the provisions of the legislation which be covered in a later part.

There are transitional provisions that can defer application of the rules until later ('safe harbour' provisions) which will be covered in the next part of this series.

Undertaxed profits rule

Draft legislation was issued by the government on 27 September 2023.

It acts as a backstop for situations where profits are subject to tax at an effective rate of less than 15% but cannot be collected by the IIR. The most common example is likely to be where the profits of the ultimate parent entity are undertaxed, but the parent is not in a jurisdiction that has adopted Pillar 2 taxes.

It will apply to accounting periods beginning on or after 31 December 2024.

Example

ABC Group is a very large group headquartered in Jersey which has no corporate income tax.

It has a UK holding company under the ultimate parent which has ownership interests of operations in several low-tax jurisdictions.

The IIR does not apply to the HQ jurisdiction (Jersey), only those of group members below it.

What taxes might the UK holding company have to deal with?

- STTR – if group members make certain payments to connected persons in low-tax jurisdictions (if the tax treaty has been updated to provide for STTR).
- UK QDMTT – if there are UK activities with an effective rate of less than 15%
- UK IIR – if the UK holding company has ownership interests in foreign operations with an effective tax rate of less than 15%
- UTPR – on the profits of the Jersey ultimate parent entity

QMDTT overview

Applies to UK scoped-in entities whose rate of tax is less than 15%.

Scope (s.266)

Non-excluded and non-investment entities meeting 2 conditions:

1. The entity is located in the UK for an accounting period, and
2. If not a group member, revenue exceeds €750 million p.a. pro-rata (if the accounting period is not 365 days) or if it is a group member, consolidated revenue exceeds €750 million p.a. in at least 2 of the previous 4 accounting periods

The QDMTT is based on the criteria used in the IIR rules (including the turnover threshold to be within the scope).

QDMT has the same safe harbour transition exemptions as for IIR (s.276), but ignoring reference to CbCR where all group members are located in the UK (see the next part for details of the Safe Harbour CbCR provisions).

The ultimate UK parent will not have a top-up amount for a territory where there is a local QMDTT that meets the three tests, HMRC will issue a list of QMDTTs in other jurisdictions in due course – but probably not until close to filing deadlines.

When could QDMTT apply in the UK?

The UK effective tax rate would have to be less than 15%. This could be caused by use of the patent box regime, or enhancement reliefs (like the 130% super-deduction for new plant and machinery, or 86% relief for SME R&D relief).

It could also be caused by a lot of exempt income (e.g. QDMTT non-excluded dividends).

IIR Impact

If a jurisdiction's tax laws are such that an operation has an effective rate below 15%, the legislation ensures that 15% is the minimum rate the owner/part-owner of the operation will bear.

This could and has encouraged low-tax jurisdictions to introduce corporate income tax, or increase CT rates. E.g. UAE, at 9% from 1 January 2024

Example (simplified to illustrate the point)

A UK-headquartered multinational group has operations in the UAE with adjusted profits of £100 million.

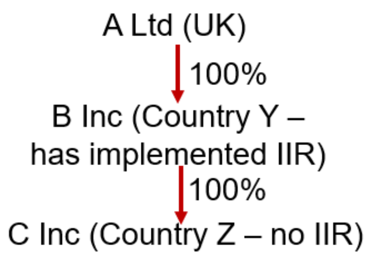
If the UAE charges 0% tax, the responsible member will have to pay 15% (£15 million) UK top-up tax to HMRC.

If the UAE charges 9% tax, then £9 million is paid in the UAE, so £6 million would be payable as a top-up tax.

The total tax is the same, so the UK hold-co would be indifferent to UAE charging up to 15% CT.

The UAE has said it will introduce a different (as yet unspecified) rate for multinationals with UAE operations within the scope of Pillar 2.

Interaction of Pillar 2 taxes - example



C Inc has £100m profits in an accounting period, on which it pays tax at an effective rate of 13%.

1. Who is responsible for the reporting and collection of top-up tax from C Inc's operations (if anyone)?

2. How much top-up tax will be paid (if any)?

3. How would your answer differ is the UK had not implemented IIR?

4. How would your answer differ if country Z had implemented both a domestic and multinational top-up tax?

Analysis

Top-up tax will be collected by the UK, through the multinational top-up tax, as the UK is the jurisdiction in which the ultimate parent is located and it has implemented IIR rules.

Under the IIR rules, a top-up amount of up to (£100m x [15% - 13%]) £2m will be charged to bring it to the effective rate.

If the UK had not implemented MTT, the amount would have instead been collected by Country Y, the jurisdiction of the intermediate parent.

If Country Z had implemented the IIR rules, including a QDMTT, it would have been able to collect the top-up amount itself. In which case, A Ltd would not have a IIR tax liability.

Reporting in 2023/24 financial statements

There is an exemption from deferred tax accounting for the impact of top-up tax under both under UK GAAP and IFRS for 12 month accounting periods beginning on or after 1 January 2023 and ending in 2023 or 2024.

The entity must disclose information that is known or can be reasonably estimated and that helps users of its financial statements to understand the exposure to Pillar 2 taxes at the reporting date. This does not need to reflect all the specific requirements in the legislation. Companies can provide an indicative range.

Disclosures may include quantitative and qualitative information.

Qualitative information

How the company is affected by Pillar 2 taxes and in which jurisdictions the exposure arises e.g., where the top-up tax is triggered and where it will need to be paid.

Quantitative information

The proportion of profits that may be subject to Pillar 2 taxes and the average effective tax rate applicable to those profits, or how the average effective tax rate would have changed if Pillar 2 legislation had been effective.

If information is not known or cannot be reasonably estimated at the reporting date, the company must make a statement to that effect and information about its progress in assessing the Pillar 2 exposure.

Contributed by Malcolm Greenbaum

VAT and other indirect taxes

Equity release and estate planning (Lecture B1416 – 19.02 minutes)

Summary – Input VAT on advertising was directly attributable to the equity release services and the Partial Exemption Special Methods proposed by the group were rejected.

KRS Finance Ltd is the representative member of a VAT group and brought four related appeals on behalf of that group.

The group offered advice and related services to individuals aged 55 in two main areas:

1. Equity Release Mortgages which are treated as exempt financial services; and
2. Estate Planning which is standard rated.

As a partially exempt trader, KRS Finance Ltd used the Standard Method to recover residual input tax at a rate of approximately 10%.

Believing that this did not give rise to a "fair and reasonable" recovery rate the group instructed KPMG LLP to carry out a review of its business to see if a Partial Exemption Special Method would produce a better result.

1. Following this review, in 2018 KPMG LLP submitted a proposal to adopt a "Transactional Count Method" which was rejected by HMRC.
2. In December 2019 KRS Finance Ltd proposed an alternative approach referred to as the "Income Adjusted Method". This too was rejected by the HMRC.
3. Between November 2018 and April 2021 KRS Finance Ltd submitted four Error Correction Notices seeking to amend earlier returns based upon use of these methods, which not surprisingly HMRC also rejected.
4. In March 2022 HMRC carried out a review of the group's marketing expenditure, concluding that input VAT on advertising was all directly attributable to the equity release services, rather than general overheads of the group to 'promote the business as a whole', meaning that input tax recovery had been overstated.

The group appealed all four areas.

Decision

The Tribunal agreed with HMRC's view on the marketing expenditure, observing that the wording used in the advertisements made reference to Equity Release. They made comments such as "staying in your home for longer and not having to downsize". Typically, initial enquiries would relate to Equity Release, which may or may not lead to Estate Planning work at a later stage. The Tribunal found that the advertising focused on Equity Release, with no 'direct and immediate link' with the Estate Planning services that were offered.

The Tribunal agreed with HMRC that KRS Finance Ltd had failed to show that the “Transactional Count Method” proposed by KPMG LLP was fair or reasonable and was guaranteed to produce a more precise result than by applying the standard method already in operation.

Further, the First Tier Tribunal agreed that the changes made in the “Income Adjusted Method” did not solve the defects identified with KPMG’s method. This method continued to use a transaction-based approach “grouping together a diverse range of transactions” without any objective evidence that the transactions in each sector used “broadly the same inputs”.

Having rejected the two special methods, the Error Correction claims were bound to fail. In fact, the First tier Trier Tribunal stated that there was scope for the group to suggest amendments to the special methods and it should be left for HMRC to consider these. If agreed, this would solve the correction notice issue. However, if agreement could not be reached, the matter should then revert to the First Tier Tribunal.

The group’s appeal was dismissed.

KRS Finance Ltd v HMRC (TC08956)

Refer a friend scheme **(Lecture B1416 – 19.02 minutes)**

Summary – Referral credits received by existing customers represented non-monetary consideration, with VAT due on the gross amount, including the credit received.

Bulb Energy Limited, a member of the Simple Energy VAT group, supplied energy to UK business and retail customers.

Under its “refer a friend” scheme, whenever a new customer joined Bulb Energy Limited, the company would provide them with an electronic referral link which the customer could give to potential new clients. If, having used the link, the new person switched to use Bulb Energy as their supplier, both the referrer and the new customer received a credit against their energy charges.

The issue in this case was whether the referral fee received by the existing customer was:

- the provision of a service to Bulb Energy Limited, with the credit constituting non-monetary consideration for the supply of energy and so subject to VAT, as contended by HMRC.

- a discount that reduced the value of the energy supplied by Bulb Energy Limited to the existing customer. The credits were simply a reduction in the price payable rather than consideration for delivering a service. If correct, VAT was only due on the net amount actually paid by the customer.

In July 2021, HMRC issued an assessment charging output VAT on the gross value of energy supplied so including the monetary referral fees paid.

The group appealed.

Decision

The referring customer only received their energy credit as a result of the additional actions taken, by passing on the electronic link.

Consequently, the First Tier Tribunal found that there was a direct link between the customers passing on their electronic link and the referral credits received from Bulb Energy Limited.

The referral credits represented non-monetary consideration, with VAT due on the gross amount, including the value of the non-monetary consideration.

The First Tier Tribunal noted that the treatment of the fee received by the new account holders was different. While referring customers received a financial reward, new account holders earned a discount as all they did was open their account with Bulb Energy Limited.

Simple Energy Limited v HMRC (TC08995)

Online sale of contact lenses **(Lecture B1416 – 19.02 minutes)**

Summary – The supplies made by the taxpayer were standard rated supplies and not exempt medical care.

Vision Dispensing Limited supplied services connected to the online sale of contact lenses.

This appeal looked at whether those supplies should be treated as:

- standard rated, as contended by HMRC; or
- exempt medical care (Item 1(b) Group 7 Sch. 9 VATA 1994).

Vision Dispensing Limited worked together with a Dutch company, Vision Direct BV, that was part of the same group. When a customer ordered contact lenses online, they entered into two contracts:

1. A contract with the Dutch company that sold the contact lenses;
2. A contract with Vision Dispensing Limited that:
    - selected and dispatched the lenses from a UK warehouse on behalf of the Dutch company;
    - dealt with online customer enquiries.

Of the monies received from the customers, 82% of the consideration was for the supply by the Dutch company of prescription contact lenses or other products and 18% was for the UK company's services.

HMRC argued that the supplies were standard rated as the company was not providing professional medical advice or therapeutic care via its online customer facility.

Decision

The First Tier Tribunal highlighted two questions to answer:

1. Did the company’s services constitute medical care?

2. Were the company’s services wholly performed or directly supervised by appropriate persons?

The First Tier Tribunal stated that medical care involves “the diagnosis, treatment and…..cure of diseases or health disorders”.

The Tribunal disagreed with HMRC, finding that the content of the group’s website could amount to the provision of “medical care”. Indeed, the website content was comprehensive and sought to deal with every conceivable question about contact lenses. However, the information on the website was provided by the Dutch company. Even if Vision Dispensing Limited had provided the website information, the website information was accessible for free by anyone who chose to visit that site. The Tribunal concluded that it was “wholly unrealistic to regard the payment customers make for “dispensing services” as having any link at all … to the website”. The website content was not part of any supply made by the company and so should be ignored when characterising the supplies that it did make.

When considering the supplies made, 92% of customers did not seek clinical advice through the company’s helpline. Of those that did, very few customers asked for their prescriptions to be verified and the Tribunal confirmed that even if they did ask, it would not be possible to do this for many of those who did. The Tribunal concluded that the company provided a customer support facility, with limited clinical advice, and selected, packed and posted goods, all of which were standard rated.

Although not needed, the First Tier Tribunal did consider whether the services were wholly performed or directly supervised by appropriate persons, concluding they were not. There was no evidence to show that the small number of opticians that were employed, delivered the level of supervision required.

Vision Dispensing Limited v HMRC (TC09002)

Freemason membership fees

Summary – Subscriptions paid by members to the governing body of freemasonry in England were not exempt from VAT.

The United Grand Lodge of England, the governing body for Freemasons in England and Wales had charged VAT to its members on membership fees.

However, it later made claims totalling for £2.8 million of VAT to be repaid, on the basis that between April 2010 and March 2018, its supplies were exempt from VAT.

HMRC rejected the claims.

Where an organisation has aims of a philosophical, philanthropic or civic nature, subscription fees paid to it by its members are exempt from VAT.

How does this rule apply to subscriptions paid by members to the governing body of freemasonry in England?

The First Tier Tribunal had found in favour of HMRC, concluding that while the organisation did have philosophical aims, it also had another, more important, aim of supporting freemasons and their dependents in distress. That was not a philanthropic aim but was more akin to 'self- insurance'.

The case moved to the Upper Tribunal.

Decision

The Upper Tribunal considered that the First Tier Tribunal had not given adequate reasons for one part of its decision but proceeded to remake the decision and came to the same conclusion. As a result, the Lodge's claim that the subscriptions were exempt was refused.

Although the circumstances here are unique to the organisation, the case is of broader interest to all dealing with membership bodies because of its discussion of the nature of philanthropy but also in its analysis of how the exemption applies (or does not apply) where an organisation has a number of different aims.

United Grand Lodge of England v HMRC [2023] UKUT 00307 (TCC)

Adapted from the case summary in Tax Journal (12 January 2024)