Tolley®CPD

January 2021

Disclaimer

Tolley CPD takes every care when preparing this material. However, no responsibility can be accepted for any losses arising to any person acting or refraining from acting as a result of the material contained in these notes.

CONTENTS

Personal tax

Antigen testing exempt

The Income Tax (Exemption of Minor Benefits) (Coronavirus) Regulations 2020 came into effect on 8 December 2020 for COVID-19 antigen tests provided on or after that date and will apply up to the end of the tax year 2020/21. Where an employer pays for employees to have COVID-19 tests to test the virus' presence, this will not be a taxable benefit.

Although not specifically stated in the Regulations, HMRC's policy paper states that for any such tests provided earlier in the tax year, HMRC will exercise its collection and management discretion and will refrain from collecting any Income Tax or Class 1A National Insurance contributions due on the provision of a test. Consequently, antigen testing is exempt for the whole of 2020/21.

However, antibody tests, testing whether an individual has previously been infected by COVID-19, remain a taxable benefit.

https://www.gov.uk/government/publications/income-tax-and-national-insurance-contributions-exemption-for-employer-provided-coronavirus-antigen-tests

Settlement of Metropolitan Police over-time payments

Summary – Settlement of claims for unpaid overtime and allowances was taxable as employment income, despite the fact that the settlement agreement required significant amounts to be paid to the lawyers and insurers involved in the case.

Keith Murphy was a police officer with the Metropolitan Police Service (the MET). Together with a number of other officers, he brought a group litigation action against the MET in respect of alleged unpaid overtime and for failure to pay Away from Home and Hardship allowances. The MET denied any and all liability for overtime or Hardship allowances claimed by the Claimants.

The Claimants won their case and under the Settlement Agreement the MET agreed to pay the Claimants £4.2m out of which would be paid:

- A "Success Fee" of £1.2 million to the solicitors and counsel under an arrangement whereby the amount payable would be calculated as a percentage of any sum paid by the MET to settle the claim or any damages awarded to the Claimants by the High Court;
- An insurance premium of £50,000 paid by the Claimants to insure against the risk of having to pay the MET's legal costs if they lost all or part of their claim.

HMRC argued that the entire payment had arisen from employment and raised discovery assessments on the Principal Settlement Sum, so including the "Success Fee" and insurance premium, covering the tax years ending 2009 to 2016.

Keith Murphy appealed, arguing that the amount paid on settlement to cover the Success Fee and insurance premium paid were not earnings.

Decision

The First Tier Tribunal stated that had the MET paid the overtime and allowances in the first place, it was agreed that these would have constituted taxable earnings.

Clause 3.1 of the Settlement Agreement provided that the Principal Settlement Sum of £4.2 million plus “Agreed Costs” was paid in full and final settlement of the Settled Claim.

The “Agreed Costs” were defined in the settlement Agreement as the legal costs and disbursements plus VAT of the Claimants’ solicitors and counsel as assessed by the Court or as agreed with the MET.

The Tribunal concluded that the whole £4.2 million constituted a payment in settlement of the claim for unpaid allowances and overtime and so was taxable in full. The Settlement Agreement stated the order in which payments should be made from the £4.2 million and included both the £1.2 million “Success Fee” and insurance premium paid. These were not the separate Agreed Costs referred to above.

The appeal was dismissed.

Keith Murphy v HMRC (TC07936)

Lifetime allowance enhanced protection

Summary – Having no expertise in tax and pensions, the taxpayer had a reasonable excuse for failing to apply for enhanced pension protection, and that excuse lasted until his new advisers made a retrospective protection application on his behalf.

Dr Gibson was an NHS gastroenterologist for all of his working life and in 2006 he became a self-employed consultant with the NHS. He had an NHS pension, a private pension and four other pension plans. In total his pension pot was worth in excess of £2 million. He retired in 2011.

With no knowledge of pensions himself, and on a friend’s recommendation, he appointed Openwork as his financial adviser. This adviser failed to tell him that his funds exceeded the lifetime allowance and that he should claim enhanced protection by 5 April 2009. In fact, a letter from his adviser confirmed to him that:

> “Based on the calculation of the value of all your existing pension arrangements your total fund value does not exceed the lifetime allowance”

Later, Dr Gibson became aware of the lifetime allowance issue when he received a letter from a pension provider. Following completion of Openwork’s complaint procedure, he appointed a new adviser, who on 23 January 2017 made a retrospective claim for the protection needed but HMRC refused the claim.

Dr Gibson argued that he had a reasonable excuse and that this excuse ended in November 2016 when he asked for further guidance on how to make a claim for retrospective protection. By this date, there was objective evidence he was then aware of the need for protection and that steps could have been taken. Alternatively, this could have been slightly later in December 2016, when he was advised that he needed specialist advice to submit a retrospective claim for enhanced protection.

Decision

The First Tier Tribunal concluded that it was reasonable for Dr Gibson to rely on advice provided by his financial advisers, as he was a layperson with no expertise in tax and pensions. Further, he had a reasonable excuse for failing to apply for protection on or before 6 April 2009.

The Tribunal found that his reasonable excuse ended in December 2016 when he was advised to seek specialist advice to make an application for retrospective protection. The new adviser notified the claim to HMRC in February 2017, a delay of nine weeks. The Tribunal concluded that this delay, which included the Christmas period, was reasonable as the adviser had to carry out client acceptance procedures, obtain papers, verify facts and prepare the claim.

Dr Gibson's appeal was allowed.

Dr J Gibson (deceased) v HMRC (TC7916)

Spending Review 2020

Personal Allowance and thresholds increase

Section 2.8 of the policy paper "Spending Review 2020" stated that the government will use the annual increase in the September CPI figure as the basis for increasing the 2021/22:

- Income Tax Personal Allowance;
- Higher Rate Threshold;
- National Insurance limits and thresholds;
- Rates of Class 2 & 3 National Insurance contributions.

National Living Wage (NLW)

The government will increase the NLW for individuals aged 23 and over by 2.2 per cent from £8.72 to £8.91, effective from April 2021.

National Minimum Wage (NMW) rates

The National Minimum Wage (NMW) rates from April 2021 increase as follows:

21 to 22-year-olds	£8.20 to £8.36 per hour
18 to 20-year-olds	£6.45 to £6.56 per hour
16 to 17-year-olds	£4.55 to £4.62 per hour
Apprentice rate	£4.15 to £4.30 per hour

https://www.gov.uk/government/publications/spending-review-2020-documents/spending-review-2020

Capital Taxes

Short period of residence (Lecture P1231 – 13.59 minutes)

In Core v HMRC (2020), the First Tier Tribunal accepted that, on the facts of this particular case, a period of occupation of some six to eight weeks was sufficient to demonstrate 'residence' for CGT main residence relief purposes.

Mr Core and his wife, a married couple with school-age children, lived in Merseyside. Mr Core was a builder by trade, operating the business through his own company.

Mr and Mrs Core purchased Green Lane on 22 March 2013. At that time, the family were living nearby in rented accommodation (Victoria Road) which was conveniently located for Mr Core's building business. They did not immediately occupy Green Lane after they bought it, given that they wished to do some extension and refurbishment work on the property. Mr Core carried this work out himself.

The Cores signed a six-month extension to their lease of Victoria Road with the landlord in December 2013. In June 2014, they signed a further six-month extension through to 31 December 2014.

During the course of the refurbishment work on Green Lane, Mr Core fell out with one of the neighbours which perhaps explains why the couple then sold Green Lane to a local buyer on 16 June 2014. They had therefore owned Green Lane for just under 15 months.

Mr and Mrs Core did not include the gain on the sale of Green Lane in their self-assessment tax returns for 2014/15 and subsequently appealed HMRC's closure notices which had brought the gain into charge on the ground that no relief was available under S222 TCGA 1992.

The factual issues in this dispute were:

(i) the date when the buyer of Green Lane offered to buy the property and the date when the Cores accepted this offer; and

(ii) when, for how long and why the Core family moved into Green Lane.

Despite a lack of documentary evidence in relation to the issue (i) above, the First Tier Tribunal found that the offer which was accepted by Mr and Mrs Core had been made in May 2014 (although the buyer had previously put forward lower offers which were rejected).

In relation to the issue in (ii) above, the First Tier Tribunal accepted the Cores' evidence that the family had moved out of Victoria Road and into Green Lane in March/April 2014, at which time the building work at the property was sufficiently advanced to allow the family to relocate. When moving out of Victoria Road, Mr Core did not seek to terminate their lease there in view of the fact that he used it as an office and storage site for building work which his company was doing in the neighbouring property. The family moved out of Green Lane and back to Victoria Road shortly after their acceptance of the buyer's latest offer. This was towards the end of May 2014.

HMRC cited the Court of Appeal's decision in Goodwin v Curtis (1998) as the main reason for refusing Mr and Mrs Core's claim that they 'resided' in Green Lane. In that case, which concerned a taxpayer who put up a property for sale very shortly after acquiring it and who only occupied it for about five weeks, Millett LJ said:

> 'Temporary accommodation at an address does not make a man resident there. The question whether the occupation is sufficient to make him resident is one of fact and degree for the Commissioners to decide.
>
> The substance of the Commissioners' finding taken as a whole, in my judgment, is that the nature, quality, length and circumstances of the taxpayer's occupation of the (property) did not make his occupation qualify as residence.'

Schiemann LJ followed up with:

> 'I accept, as did the Commissioners, the Crown's contention that in order to qualify for relief a taxpayer must provide some evidence that his residence in the property showed some degree of permanence, some degree of continuity or some expectation of continuity.'

Because the taxpayer in Goodwin v Curtis (1998) was unable to establish this position to the satisfaction of the Court, he lost the case.

In this instance, the First Tier Tribunal concluded that, although lower offers had already been made by the buyer of Green Lane by the time when the Core family moved into Green Lane, the fact that they had made the move was strongly indicative of their expectation to live there indefinitely and that this, combined with the Cores' evidence of the unexpected nature of the latest offer from the Green Lane buyer, demonstrated a sufficient expectation that they would remain there indefinitely such that it became their sole residence for that period.

Consequently, the whole of Mr and Mrs Core's gain was within the main residence exemption because the rest of their period of ownership was covered by the so-called 'final period' which stood at 18 months in 2014/15 (see S223(1) TCGA 1992).

Contributed by Robert Jamieson

PPR issues on separation & divorce **(Lecture P1232 – 13.51 minutes)**

Introduction

They say that absence makes the heart grow fonder. They also say that familiarity breeds contempt.

They (whoever "they" are) are certainly being proved right if the latest murmurings about marital breakdowns during lockdown are concerned, as it seems that many relationships are splintering on the rocks of COVID-19. The coronavirus outbreak is leading to big changes in the way we live our everyday lives and some relationships are struggling to survive in the wake of that.

There is a myriad of tax issues to be considered on the breakdown of a relationship with the rules differing depending on whether that relationship is a marriage/civil partnership or one which is not. These notes will look at the effect of a relationship breakdown for the purposes of principal private residence (PPR) relief and will concentrate on spouses rather than unmarried couples.

To reduce my word count, any subsequent references to "spouses" in these notes should also be taken to include civil partners. References to husband and wife should also be taken to include same-sex partners in a civil partnership.

PPR issues for spouses – General principles

A husband and wife are treated as a "single person" for PPR purposes and can accordingly only have one exempt residence between them. This will typically be the matrimonial home which will often therefore escape a CGT charge on disposal.

This state of play operates for as long as the couple are living together as husband and wife. This single "spousal unit" for PPR is therefore broken on separation at which point each party is thereafter entitled to PPR relief on their own main residences.

The date of separation is generally taken to be the date at which the relationship is irretrievably broken, and in most cases has historically been signalled by one partner leaving the matrimonial home.

But these are strange times. Working out the date of separation during the current coronavirus outbreak may not always be straight-forward.

At the moment it may be impossible for some separated couples to physically move into separate households. This is partly due to government lockdown regulations but also because – with economic pressures caused by the pandemic – couples may no longer have the financial capacity to meet the costs of running two separate households.

It is possible to formally separate in the eyes of the law whilst remaining under the same roof. I don't think we need to go into what "living together as husband and wife" means as that takes us into an altogether different genre. But a couple can be living together whilst separated. This will not be uncommon in the current climate, so conversations might need to be had with our clients to find a separation date.

Disposals after separation – property transferred between the parties

Separation (or more likely divorce) will often bring about the sale or transfer or all or part of a property which had at some point been the main residence of the divorcing parties. This will constitute a disposal by the spouse giving up his/her interest.

The first step is therefore to calculate the chargeable gain.

If the transfer takes place in the tax year of separation, the disposal takes place at no-gain-no-loss. This, it must be said, is relatively unusual as the course of the law rarely runs that quickly. However, do remember that a disposal is triggered by a contract, so if the parties are amicably committed to a transfer, there is no reason why contracts can't be put in place quickly to ensure the transfer takes place during the no-gain-no-loss window.

If this can be organised, a swift transfer brings with it the obvious advantage that the donor spouse does not then need to worry about PPR relief as there is no gain to relieve. The donee spouse will inherit his (low?) original base cost, but this is unlikely to prove to be an issue since the likelihood is that the donee spouse will have full PPR relief to shelter whatever gains arise on an eventual disposal.

But the no-gain-no-loss window shuts on 5 April in the tax year of separation. If the transfer takes place between the 6 April following separation and the date of the divorce, the consideration for the disposal is deemed to be the market value of the interest transferred at the date of transfer. This is because the parties (despite being estranged) are still "connected persons" for CGT by virtue of them still being married.

However, it should be borne in mind that the open market value of an interest in the matrimonial home is normally heavily discounted to take account of the rights of occupation of the spouse residing in the home under the Matrimonial Homes Act 1967 (so very often a substantial discount will be in order to reflect these rights). There is no fixed discount rate in these situations, but there are grounds for applying a 15% discount to the half share.

Per the VOA's internal IHT manual (which should also apply for CGT):

> "Where at the valuation date any co-owner remains in occupation of the property as their main residence (other than the co-owner whose share is being valued), the normal approach is to take half the freehold vacant possession value and deduct 15%. This approach is in accordance with the Lands Tribunal decision of Wight and Moss v CIR (264/935/82)…"

If the transfer takes place on or after decree absolute, the parties are no longer connected persons. In the absence of any clear gratuitous intent by one party towards the other, HMRC normally accepts that a subsequent sale/transfer of a property by one party to the other is a "transaction at arm's length". No alternative value is imputed and the disposal consideration is simply the money (or money's worth) changing hands. This "money's worth" will normally be the values agreed between the parties as recorded in the divorce papers.

[One word of caution here is that divorced spouses could still be "connected" for CGT by virtue of being business partners, should this business relationship still continue after the marriage has been dissolved. Complex business relationships can sometimes take a little time to unwind, so this may therefore act to impute a market value where one is not expected.]

Where the transfer of the property is made in pursuance of a Court Order, HMRC practice is to deem the disposal consideration to be equal to the market value of the asset at the date of disposal. This is because an order of the Court is not a "bargain" between the parties as it is the Court which decides the terms of the agreement, not the parties themselves. As such, the transaction cannot be a "bargain at arms' length" and S.17 TCGA therefore applies to impute market value.

The basis of the valuation should be disclosed in the tax return and might thereafter be referred to the HMRC Valuation office.

Disposals after separation – property sold to an unconnected purchaser

The other option of course is for the couple to sell the house and divide the proceeds.

In the event of a third-party disposal of a jointly held property, the capital gain on each owner's share of the property should be computed and reported separately.

Remember that from April 2020, the disposal – assuming that it produces a CGT liability – must be reported on an online "Capital Gains Tax UK property disposals return" within 30 days of completion together with a payment on account of the estimated CGT. An online return is required for each joint seller. No online return is therefore required for gains wholly covered by PPR relief. [The position is different for non-UK residents who must report all gains and losses on property disposals.]

The sale proceeds, costs of sale, costs of acquisition (including enhancement costs) and incidental expenses of acquisition should be divided between the parties in the ratio of their respective beneficial interests. These ratios may or may not be obvious.

In many cases beneficial interests will follow the legal interests, so a husband and wife who are the joint registered owners of a property will normally each have a 50% beneficial interest. This is the default position unless it is shown otherwise.

However, do be aware that if one partner has contributed towards the costs of acquiring the property or towards the mortgage payments without being a registered owner at the Land Registry, he/she will nevertheless have acquired an equitable interest in the home proportional to those contributions and will thereby be entitled to a share of the proceeds on sale. This beneficial share will dictate the CGT treatment.

If the respective beneficial shares cannot be determined by mutual agreement, it will be determined by the Courts. Where such an agreement is reached, both parties will be considered to have held their equitable interests in the home from the outset.

PPR relief

Once the gain is established, the next step is to work out how much PPR relief is due.

PPR relief is based on ownership and occupation. Occupation means actual physical occupation of the property as one's "home" plus deemed occupation being periods when the CGT legislation pretends a taxpayer was living in the home even though he wasn't.

The final 9 months of ownership is treated as occupation provided the taxpayer had some actual occupation at some point. This has reduced from 18 months for disposals after 5 April 2020 thereby increasing potential CGT liabilities. Therefore, assuming that the gap between the cessation of actual occupation and the transfer of the property exceeds 9 months, a chargeable gain will arise.

One side-effect of separating couples living under the same roof is that the taxpayer making the disposal is likely to have a longer period of actual occupation than he/she would have had if they had left the matrimonial home when the marriage failed. "Occupation" in these cases extends beyond the actual date of separation. This will shorten non-qualifying periods for PPR relief and save CGT.

Illustration 1

Mark and Kelly married in June 2012. In July 2012 they bought a house, in joint names, for £200,000. They each had 50% beneficial interests. The house was occupied as their main residence.

In May 2020 Mark and Kelly decided that their marriage had broken down irretrievably and decided to separate. However, Mark was unable to leave the marital home until lockdown restrictions were lifted in July 2020 at which point he left and moved into their holiday flat on the south coast.

Kelly continued to reside in the house after the separation. The couple were divorced in March 2022 at which point the Court directed that Mark transfer his half share in the matrimonial home to Kelly.

The house was valued at £800,000 in March 2022. HMRC Valuation Office accepted that the value of Mark's 50% interest subject to Kelly's rights of occupation would be £340,000 (£400,000 x 85%).

Mark's chargeable gain in March 2022 will be as follows:

		£
Proceeds		340,000
Less: Cost	1/2 x £200,000	(100,000)
Gain		240,000
Less: PPR relief	£240,000 x 105/117	(215,385)
Chargeable gain		24,615

PPR relief:

	Qualifying	Non-Qualifying
July 2012 – July 2020	96	
July 2020 – July 2021		12
July 2021 – March 2022 (last 9 months)	9	
	105	12

Note that in the above example, as the PPR "spousal unit" was broken at the date of separation, Mark's new home (being the holiday flat) will become a qualifying property from the date he occupies it as a residence. No nomination is necessary as this property is, as a question of fact, his main residence.

However, if after the date of separation, Mark has more than one property available for him to use as a residence (and he concurrently resides in both) he is entitled to make a nomination. The 2-year time limit for nominating runs from the date of separation.

S.225B TCGA 1992

The CGT charge can be mitigated in appropriate cases by a claim for relief under S.225B TCGA 1992. Note that (unlike PPR relief in general which is given automatically if the conditions apply), relief under S.225B must be claimed by the taxpayer making the disposal.

S.225B allows the former matrimonial home to be treated as the only or main residence of the transferring spouse (Mark) from the date his occupation ceased (August 2017) until the date of transfer. In this instance, the period from August 2017 to May 2020 would be a period of deemed occupation for Mark, thereby extinguishing his chargeable gain.

However, there are some stings in this particular tail:

1) Relief under S.225B is only available where an interest in a property is transferred to a former spouse or civil partner. Therefore, where the couple is selling to an external third-party buyer, S.225B cannot extend the occupation period (even if proceeds are subsequently transferred to the former spouse). Relief is not available for transfers between unmarried couples.

2) Throughout the period between the individual ceasing to reside in the property and the disposal to the spouse, the property must continue to be the only or main residence of the spouse. If the former spouse moves out before the transfer takes place, S.225B relief will be denied.

3) A S.225B claim can only be made if the departing spouse has not made an election for a different property to be his qualifying residence. This prevents two properties qualifying for PPR relief simultaneously.

Condition 3) is normally the most troublesome hurdle as a S.225B claim may not be beneficial if the departing spouse has acquired a new residence after the date of separation (which is common) and that property is appreciating in value.

If the departing spouse has a new residence and nevertheless wishes to make a claim for relief under S.225B in respect of the old residence, his occupation of his new residence will be treated as period of absence until the disposal of the former marital home.

Note here that it is not possible for a S.225B claim to be varied so as to only apply for part of a period of absence (for example, to leave enough gain in charge to be covered by the annual CGT exemption).

Condition 2) above is also a potential pitfall and must be carefully navigated as shown in the illustration below.

Illustration 2

James and Amy separate. James leaves the family home and moves in with his brother. James and Amy agree that Amy will buy James' share of the property for an agreed discounted value as part of their divorce settlement.

Amy decides that the house is too big for one person and puts the house on the market for sale before the divorce is finalised.

If James wishes to claim relief under S.225B and thereby avoid a CGT liability on the disposal of his share in the property, he must transfer his share to Amy before she moves out. Otherwise, a claim will fail as the property is no longer Amy's main residence.

Finally…

Given the recent reduction in the final period PPR exemption to 9 months, it is now increasingly likely that a partner who leaves the family home as a result of separation will find him/herself with a chargeable gain when and if their interest in the property is sold or transferred on divorce.

Be aware that a S.225B claim can fix this problem, but this is not always a tool which is available.

Also don’t be surprised to be receiving more queries of this nature given the effect that COVID-19 seems to be having on matrimonial health.

Contributed by Steve Sanders

Contingent consideration and repayment of SDLT

Summary – The company was entitled to a refund of SDLT paid to the extent that the consideration was ‘contingent’ and was never actually paid.

In 2008, Project Blue Ltd acquired Chelsea Barracks from the Ministry of Defence for £959m. The company obtained financing for its acquisition in a way that was compliant with Shari'a law. It entered into an agreement with a lender, Qatari Bank Masraf al Rayan (MAR), for £1.25bn under which it sold the freehold of the property to MAR and MAR granted a lease back to Project Blue Ltd. The £1.25bn figure was to finance the property and to cover certain other expenses. It was payable in six tranches provided certain conditions were satisfied.

In a previous case heard in June 2018, the Supreme Court held that Project Blue Ltd was liable to pay SDLT on the full £1.25bn but that the company would have a right to adjust the amount of SDLT due under s80 FA 2003 (adjustment when contingency ceases) to the extent that the full £1.25bn was not paid.

Shortly after the Third Tranche was paid, the deal was refinanced, terminating the agreement. The last three of the tranches were never paid.

In this appeal, Project Blue Ltd argued that the part of the chargeable consideration relating to three of the tranches, was contingent and never became payable. Consequently, the company claimed a repayment of SDLT totalling £11.64m.

HMRC refused Project Blue Ltd’s claim.

Decision

The First Tier Tribunal accepted that, under the refinancing agreement, on 10 February 2010, Project Blue Ltd refinanced its acquisition of the barracks through a conventional loan with interest and reacquired the barracks from MAR. No further tranches fell due.

The First Tier Tribunal found that these tranches were contingent consideration that were never paid. Project Blue Ltd was therefore entitled to be repaid the SDLT of £11.64m which it paid on that part of the consideration.

The First Tier Tribunal also held that, even if it had not concluded that the consideration was contingent, *issue estoppel* would have prevented HMRC from raising the issue. The Tribunal would have been bound by the Supreme Court decision as a matter of precedent.

Project Blue Ltd v HMRC (TC07949)

Multiple dwellings relief **(Lecture P1234 – 20.14 minutes)**

With effect for transactions after 19 July 2011, a new relief became available called multiple dwellings relief (MDR). The rate of SDLT is determined by reference to the total consideration divided by the number of dwellings, with a minimum of 1%. The consideration is then multiplied up again by the number of dwellings. It is on an averaged basis so you do not calculate according to the value of each component (which is a common misunderstanding of these provisions).

It can apply where more than one dwelling is transferred even where non-dwellings are also involved. It cannot include the purchase of a freehold or leasehold interest subject to a long lease of 21 years or more. It cannot apply where a higher threshold interest charge applies nor will that interest count for determining the number of total dwellings for establishing the percentage of charge that applies.

MDR is incredibly useful in terms of reducing SDLT liability and it is important to note that it can be used even where the second dwelling is currently used as part of the main dwelling.

An example of the situation which shows the potential savings. Say someone buys a house for £1.5 million with a basement flat in it. Individually the flat would be worth around £200,000. The SDLT on a single property (no 3% supplement) of £1.5m is £93,750. For £750,000 of consideration (£1,500,000/2) the SDLT is £27,500 so the total with a MDR claim would be £55,000 (£27,500 x 2) giving a saving of £38,750. Ordinarily you would need to apply the 3% supplement when calculating MDR but in this instance the flat was only worth £200,000 so the subsidiary dwelling exemption was in point (see below).

However, it is important to note that we are seeing an increasing number of challenges from HMRC on the question of whether MDR is available. The cases below show this.

It is also important to note that the number of dwellings must remain the same for 3 years or there is a clawback of the relief.

David Merchant and Sarah Gater v HMRC (TC07783)

On 24 March 2016 David Merchant and Sarah Gater bought a property for £1,920,000. The property was a terraced house with an annex, with its own kitchen, shower room, living room and bathroom. The owners confirmed that the annex was accessed "through the main dwelling front door and along a common hallway".

Initially, David Merchant and Sarah Gater filed the relevant form and paid the SDLT due to HMRC on the basis that the property was a single residential property.

However, just over a year later, they were advised to apply for MDR. On 20 April 2017 they wrote to HMRC to request an amendment to their return and claimed a refund of nearly £65,000.

HMRC opened an enquiry into the amended return and ultimately rejected the claim. There was a dispute over the date the return was amended. Although the First Tribunal found that it was not when the taxpayers first wrote to amend the return, but rather on receipt of their second letter that included the contract for sale. A valid amendment must be accompanied by the contract, so the later date was the date of amendment.

Although this made the claim out of time, HMRC accepted the late claim as a valid claim but disputed the MDR to which the claim related.

David Merchant and Sarah Gater appealed, arguing that they were eligible for the relief. Further, they argued that HMRC's closure notice was not valid as rejection of the claim for MDR was not stated in either their closure notice or the letter referred to in the closure notice.

The First Tier Tribunal concluded that, although the annex had a separate kitchen, shower room, living room and bathroom, it was not suitable for use as a single dwelling as it shared a common front door and hallway.

Further, the First Tier Tribunal found that the closure notice was valid even though it did not state that the claim for MDR was rejected. Adopting the reasoning set out in Archer [2018] STC 38, a notice is not ineffective for want of form where it is substantially in conformity with the legislation and its intended effect is reasonably ascertainable.

Keith Fiander and Samantha Brower v HMRC (TC07676)

Keith Fiander and Samantha Brower bought an unoccupied detached property for £575,000 on 27 April 2016. Attached to the main house was a self-contained annex, connected by a corridor with no door, although a door could have been fitted. The properties shared a post box, the utility supplies or there was only one council tax bill. The "Rightmove" website described the property as having three bedrooms with "bedroom 1" being in the annex and two loft rooms. It did not mention the annex. Further there was a restrictive covenant over the land to prevent more than one bungalow being built on it.

The taxpayers argued that the annex was separate from the house and claimed MDR. Under para 7 Sch 6B FA 2003 applies if two properties are each suitable for use as separate dwellings and if so, the SDLT rates can be averaged over the number of properties. The issue here was whether a house and annex were separate dwellings.

HMRC argued that the fact that a door could be installed to separate the annex from the main house was irrelevant. On purchase, this was a singe dwelling.

The First tier Tribunal stated that the test we were dealing with was a test of "suitability" for use, rather than adaptation for use; and it is a test of use as a "single dwelling," rather than of use as separate living accommodation.

The First Tier Tribunal stated that to be suitable for use as a single dwelling, a property must accommodate all of a person's basic domestic living needs and that was the case here.

However, there must also be a degree of privacy and security. The Tribunal could imagine the annex being occupied by an older relative as a "granny flat", or by one of the owners' grown-up children, with this arrangement providing adequate privacy and security to occupants of both parts of the property, given family bonds of trust. However, without such close family ties, the First Tier Tribunal concluded that, with only an open corridor connecting the two, there was insufficient privacy and security for the occupants.

Finally, the decision should be made at the time of completion and on that date, there was nothing that indicated that there had ever been a physical barrier between the annex and the main house. The possibility of erecting a door to separate the properties after purchase was not relevant.

Interestingly, the Tribunal did not put a great deal of weight on the evidence that the annex had no separate utility meters or council tax status. Nor did they consider a single postal address to be a significant factor in this case. Finally, the Tribunal placed no weight on the "restrictive covenant" in the land registry, which they said was unclear in itself and in its implications for the issues in this case.

Interaction between MDR and the 3% supplement

It is important to appreciate the interaction between the MDR provisions and the 3% supplement. The latter applies by default when you are buying more than one dwelling in the course of a single transaction and this would normally automatically bring you into the 3% supplement provisions. There is, however, an exemption where the second property falls within the subsidiary dwelling exemption. This necessitates that second property being below a specified value.

Paragraph 5(5) Schedule 4ZA FA2003 states:

One of the purchased dwellings (dwelling A) is subsidiary to another of the purchased dwellings (dwelling B) if:

Dwelling A is situated within the grounds of, or within the same building as, dwelling B, and

The amount of the chargeable consideration for the transaction which is attributable on a just and reasonable basis to dwelling B is equal to, or greater than, two thirds of the amount of the chargeable consideration for the transaction which is attributable on a just and reasonable basis to the following combined

(I) dwelling A

(ii) dwelling B and

(iii) each of the other purchased dwelling (if any) which are situated within the grounds of, or within the same building as, dwelling B

This is fairly straightforward legislation as long as the values work out. It is quite important to note that the wording of the legislation refers to the value of the dwellings which means you need to be careful if the transaction involves significant land.

Let's go back to our example above of an individual buying a house with a basement flat. The whole property is worth £1.5 million. The flat would need to be worth less than £500,000 in order for the supplement not to apply. As the flat was worth £200,000 the 3% supplement did not apply in the MDR calculations.

The provisions get even more complicated where you have multiple dwellings in linked transactions. Where there are linked transactions, you amalgamate the consideration to work out the rate of SDLT but you could still claim MDR in this situation. However, for the purposes of the 3% supplement, you do not treat this is as a multiple dwelling purchase, so you could have a situation where the 3% supplement is due on one of the purchases but not the other. The easiest way to look at this is to consider an example.

Example 1

Two properties are purchased in separate but linked transactions. So for example, a house is bought by an individual but an associated holiday cottage is bought from the same vendor by the individual's limited company. No 3% surcharge arises on the main house as it is the replacement of a main residence. The house is bought for £600,000 and the cottage for £200,000. We will assume that the normal SDLT rates apply (rather than the ones applicable up to 31 March 2021).

Without the surcharge (but with MDR), the SDLT on the total price is £20,000 (being 2 x £10,000 based on an average consideration of £400,000). With the surcharge, the SDLT on the total price is £44,000 (being 2 x £22,000 based on the same average consideration).

The actual calculation of the SDLT is then as follows:

600,000/800,000 x £20,000 plus 200,000/800,000 x £44,000

This gives a total charge of £26,000.

Interaction between MDR and mixed-use property

Where property purchased is mixed use, including both residential and non-residential property, the rates used to calculate the SDLT liability are the non-residential rates. But if that property also includes multiple dwellings then you can, if beneficial, also claim multiple dwellings relief. Again, the easiest way to look at this is with an example.

Example 2

An individual is purchasing a farm for a total of £1.2 million including a farmhouse (£550,000), a furnished holiday let (£175,000) and agricultural land and buildings (£475,000).

The SDLT on the total of £1.2 million based on mixed use (so non-residential rates) is £49,500.

We then need to calculate the SDLT using residential rates on the two dwellings, but with the benefit of MDR. The SDLT (again using post 31 March 2021 figures) would be £16,250 assuming the 3% supplement is not due based on average consideration of £362,500 (i.e. the average of £550,000 for the farmhouse and £175,000 for the furnished holiday let).

The total SDLT payable using MDR would then be:

475,000/1,200,000 x £49,500 plus £16,250 = £35,844

So it is clearly beneficial to claim the MDR.

If the 3% supplement had been due (and in the case on which this was based, the 3% supplement was due because the FHL was not in the grounds of the original farmhouse), then the SDLT on the residential portion of the land would have been £38,000 and the total would have been:

475,000/1,200,000 x £49,500 plus £38,000 = £57,594

It would not be beneficial to claim MDR.

Contributed by Ros Martin

Administration

Out of date knowledge of residence status

Summary - Despite the taxpayer not checking the correct position, reliance on his out-of-date knowledge on tax residency was careless, rather than deliberate behaviour.

Simon Dolan was a qualified accountant who had not practised since 1997 and so his knowledge of the detailed rules regarding tax residency were out of date.

On 9 July 2013, he ceased to be a UK resident. On 22 January 2015, he submitted his 2013/14 tax return including UK dividend income of £320,000, stating that he was non-UK resident for the year. However, he did not seek up to date tax advice before submitting his return and missed the fact that due to the amount of time that he had spent in the UK in 2013/14, he met the criteria for split year treatment.

On 8 September 2015, HMRC opened an enquiry into his tax return, part of which established that the dividends were received prior to his departure from the UK and were liable to UK income tax.

HMRC concluded that as an accountant, he was aware that he was required to check the correct tax treatment, but he chose not to. In their eyes, the inaccuracy was deliberate, and the disclosure had been prompted by their enquiry. On that basis, HMRC issued a penalty assessment for just over £46,000.

Simon Dolan appealed the penalties on the grounds that his conduct was not deliberate. He said he was 'acting on his tax knowledge "which was enough to arrive at the wrong conclusion, but not enough to arrive at the correct position"'.

Decision

The First Tier Tribunal agreed with Simon Dolan, finding that he did not accurately complete the boxes on his tax return because he did not know the non-resident rules had changed. As he had not knowingly provided an inaccurate return, the inaccuracy was not deliberate.

He did not check the return as he expected his advisors would do that and his return was submitted "last minute". The Tribunal stated that he had acted carelessly by not checking the current position with an adviser and sending in his return at the last minute.

The Tribunal concluded by saying that they did not consider that Simon Dolan had met the "standard of a prudent and reasonable taxpayer in the position of the taxpayer in question" and confirmed that the inaccuracy was careless.

The penalties were reduced to just under £20,000 on the basis of careless rather than deliberate behaviour.

Simon Dolan v HMRC (TC07924)

Adverse family, work and personal circumstances

Summary – Late filing penalties for five years of tax returns were upheld, with the exception of the penalties excused due to the death of one of the taxpayer's accountants.

Kamran Qurban acted as fulltime carer for both of his parents, which put severe strain on his marriage. He stated that he was physically, financially and emotionally drained, and eventually suffered a breakdown.

During this time, he had appointed an accountant to deal with his tax affairs, but this accountant made errors and failed to file his returns up to 2011/2012. He appointed a second accountant to file his outstanding returns, but he died in 2017 causing additional delay. Finally, a third firm of accountants was appointed, and his remaining returns were successfully filed.

As a result of all of this, Kamran Qurban had filed his tax returns late for tax years 2010/2011 through to 2015/2016, resulting in HMRC imposing initial, daily, six-month and 12-month late filing penalties for each year, totalling £9,600.

Kamran Qurban submitted an appeal on 12 April 2019 against the penalties, arguing that he had a reasonable excuse or special circumstances relating to:

- the difficulties endured over a number of years coping with family issues;
- the issues with his accountants;
- his inability to cope with his work due to the stress and pressure that he was under.

Decision

The Tribunal concluded that most of the difficulties that he faced or suffered during the period to which the penalties related were not so severe as to give rise to a reasonable excuse for the delay. However, the Tribunal found that the death of the second accountant in 2017 did give rise to a reasonable excuse for delay over a period of some months, whilst a new accountant was briefed and provided with the details that enabled his tax returns to be completed and filed.

Consequently, the £1,300 of penalties imposed in July 2017 and January 2018 were not payable but the balance of £8,300 was still due.

Kamran Qurban v HMRC (TC07935)

Confusion understandable

Summary – With HMRC cancelling some penalties without explanation and the taxpayer having been advised by the scheme promoter that no tax was due, it was understandable that the taxpayer filed their return late.

Lim Fei Ling was resident in Malaysia and had never been to the UK. On 23 January 2015, she agreed to purchase a car park lot at Glasgow airport for £20,000 from Park First Group. Completion took place in May 2015.

The lot was advertised as returning 8% yield rising to 10% in years 3 and 4, and 12% in years 5 and 6, with the first two years guaranteed by the seller and a buyer's option to sell back to the seller. She was advised by the seller's agents in both the UK and Malaysia that she would not be liable for UK income tax as the rent she would receive was below the personal allowance threshold. She could claim relief from tax being deducted at source by submitting a non-resident landlord (NRL1) form to HMRC.

Like many other investors, following an investigation by the FCA in 2019, she lost her money from the scheme. The scheme was described as a scam.

In 2015/16 and 2016/17 she received £1,600 but nothing after that. Thinking the scheme started in January 2015, she submitted Form NRL1 in 2014/15, following which HMRC issued a Notice to file a return for 2014/15. HMRC also issued a Notice to File for 2015/16 and 2016/2017 which Lim Fei Ling questioned. Following correspondence, HMRC informed her that all of her UK income was taxable, as a person who is not an EU national was not entitled to a Personal Allowance.

HMRC later cancelled the penalties for the late filing of the 2014/15 return as she had not received any income in that year. No penalties arose for the 2016/17 return as, once her position had been clarified with HMRC, this was submitted on time. That left only the penalties relating to 2015/16 which were appealed by the taxpayer. She argued that as a resident of Malaysia who had never been to the UK, she was not familiar with the UK tax system and that she had been told that:

- she was tax exempted from UK tax and had no need to file a tax return;
- the seller's agents would deal with all tax related issues and help her to manage the property.

Decision

The First Tier Tribunal confirmed HMRC's view that Lim Fei Ling had no reasonable excuse for the late submission of the return and so the penalties were correctly charged. When she chose to invest in the UK, she had a legal obligation to make herself aware of the UK tax laws and the filing dates of any Self Assessment tax returns issued to her. She could have checked online or contacted HMRC.

However, the Tribunal concluded that there were special circumstances in this case. It was not surprising that Lim Fei Ling was unclear about her UK filing obligations for two reasons:

1. She had relied on the incorrect advice given to her by the scheme promoter;
2. HMRC had made errors by wrongly imposing penalties for 2014/15, which were cancelled. No explanation for cancellation of those penalties appears to have been given. It was quite possible that the taxpayer believed they had been withdrawn because UK income was not taxable.

The Tribunal stated that this was not a case where the taxpayer was ignoring or not trying to comply with her obligations. As soon as she was aware of the issue, she rectified the position without unreasonable delay.

The Tribunal stated that:

> "Although HMRC are not obliged to give advice to taxpayers, it is reasonable to expect some assistance, when a taxpayer, particularly one from abroad who whilst endeavouring to comply with relevant regulations has so obviously misunderstood their position."

The appeal was allowed.

Lim Fei Ling v HMRC (TC07942)

Sorry, my mistake! (Tax back please?) (Lecture P1233 – 20.49 minutes)

It goes without saying that tax cases before the tribunals and courts are normally decided on the basis of tax law. However, when tax law is against you, an appeal on the grounds of the equitable law of 'mistake' may be successful, as has been demonstrated several times in recent years.

'Mistake' appeals – key points of principle

Mere ignorance, forgetfulness or a misprediction will not be a mistake that the law will recognise as such. For a transaction to be set aside on the basis of mistake, there must be a 'causative mistake' of sufficient gravity that it would be 'unjust or unconscionable' to leave the mistake uncorrected. This will usually only be satisfied when there is a mistake as to the legal character or nature of a transaction, or as to some matter of law or fact that is fundamental to the transaction.

Pitt v Holt

Pitt v Holt [2013] UKSC 26 concerned the scope of 'Hastings-Bass doctrine'. Broadly, this allows those acting in a fiduciary capacity to unwind arrangements into which they have entered, where there are unforeseen consequences. The Court confirmed that the doctrine could not apply where an appellant had (like Mrs. Pitt) taken professional advice beforehand, as they had complied with their statutory duties as a fiduciary.

She had been acting under a power of attorney for her husband, who had been severely injured in an accident and received a large insurance payment. She had settled this on trust for him but had not created a disabled person's trust, resulting in substantial unnecessary inheritance tax (IHT) charges.

The Court, though, also considered the equitable remedy of mistake. The judges unanimously felt that her rather straightforward circumstances warranted this remedy, as there had been a causative mistake so grave that it would have been 'unconscionable' to refuse relief. The same Court, however, reached the opposite conclusion in *Re Futter UKSC 26*, where the mistake concerned how anti-avoidance rules affect UK beneficiaries of offshore trusts.

Pitt v Holt has since been cited in several other tax cases.

Investment bonds

Joost Lobler v HMRC [2015] UKUT 152 concerned the partial encashment of offshore investment bonds, which are issued in segmented form. The appellant ticked the box on the form for a partial encashment of all the segments, rather than opting to encash a certain number of whole segments. This produced a chargeable event gain of over £1 million, despite there having been barely been any increase in value of the bond. Had he ticked a different box, the gain would have been negligible.

The Upper Tribunal referred to Pitt v Holt and allowed the appeal on the grounds of mistake. Note, though, that this remedy may be unnecessary for investment bonds now, due to s.9 F(No.2)A 2017, which inserted s.507A ITTOIA 05. This allows a taxpayer to apply to HMRC for a review of the calculation of a chargeable event gain, on the grounds that it is wholly disproportionate to the economic gain.

Error causing loss of pensions fixed protection.

The appellant In *Gary Hymanson v HMRC (TC06815)* had claimed 'fixed protection' when the pensions lifetime allowance was cut. This allows a claimant to keep the higher allowance, but the protection is withdrawn if the investor has any further pension inputs whatsoever. He had stopped contributions to his main pension scheme but failed to stop some minor direct debits into other pension schemes. The judge confirmed that HMRC had been correct to withdraw fixed protection. However, citing Pitt v Holt, he said that he felt an appeal to the Upper Tribunal on the grounds of mistake would certainly succeed, so allowed the appeal at the First-Tier Tribunal rather than make the appellant go through this process. The loss of fixed protection would have meant extra tax of around £50,000.

Unwinding a trust

In *Suckling v Furness and others [2020] EWHC 987 (Ch),* the 80-year-old appellant, in what her solicitor had advised was a tax neutral transaction, established a life interest trust over business property, with herself as life tenant and remainder to her disabled children.

However, her solicitor, despite being a member of STEP, seemed to be unaware of the major tax changes to trusts of recent years, in particular the FA 2006 changes to the IHT regime. In fact, for tax purposes, this arrangement was far from neutral. For CGT, this was a settlor-interested trust, so the gain arising on creation could not be deferred by holdover relief. Worse still, for IHT there was an immediately chargeable transfer of value on creation of the trust, an IHT charge every 10 years and a gift with reservation of benefit, meaning her share of the property would still be chargeable in her estate on death!

Unsurprisingly, the remedy of mistake was again granted.

It's not cricket!

Legendary 2005 Ashes-winning captain Michael Vaughan had many successes on the cricket field but did not do so well at the High Court earlier this year (*MV Promotions Ltd and another v Telegraph Media Group Ltd and HMRC [2020] EWHC 1357 (Ch)).* The renewal of his contract with Telegraph Media had been mistakenly done in his name, rather than that of his PSC, so that he would be directly taxable on the amounts earned under the contract.

The High Court held that the contracting parties were Telegraph Media Group Ltd and Michael Vaughan and that any reasonable reader of the contract would not conclude otherwise. The necessary preconditions for rectification on the basis of mistake existed but rectification is always at the Court's discretion. Here, the Court said that no rectification was possible if all issues between the parties had been resolved and rectification was sought only to achieve a tax saving.

Conclusion

If a causative mistake has led to 'unconscionable' tax charges and tax law does not provide a remedy, equity may do so, but this will always be at the Court's discretion.

Contributed by Kevin Read

Making a voluntary disclosure to HMRC (Lecture P1235 – 14.59 minutes)

What is a voluntary disclosure?

The term "voluntary disclosure" is not defined in the legislation. Most people will recognise that "voluntary" means doing something because you choose to do it. The position, when considering a disclosure to HMRC (where a person is reporting an underpayment of tax arising from a mistake or error, etc), is that you also need to consider whether it is "unprompted" or "prompted", which are both referred to in the legislation. FA 2007, Sch 24, Para 9(2) (a) states that a disclosure is "unprompted" if "made at a time when the person making it has no reason to believe that HMRC have discovered or are about to discover the inaccuracy, the supply of false information or withholding of information, or the under assessment". Para 9 (2) (b) states that a disclosure not falling within Para (2) (a) is "prompted".

You will need to establish the facts to determine whether your client's disclosure can be regarded as "unprompted".

Why should clients make a voluntary disclosure?

HMRC have access to a substantial volume of information but have limited resources. Consequently, HMRC welcome voluntary disclosures.

HMRC carried out research into the motivators and incentives for voluntary disclosure, and the report can be found at the link, below:

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/457629/Understanding_the_motivators_and_incentives_for_voluntary_disclosure.pdf

There are numerous reasons why clients will want to make a voluntary disclosure to HMRC, and each will have their own. There are numerous benefits to clients, including the potential for a lower penalty than would otherwise be the case, and better management of the resulting enquiry.

How to make the disclosure to HMRC

Historically, there have been various HMRC disclosure campaigns, including the generous Liechtenstein Disclosure Facility. Currently, there is only one such campaign – the Let Property Campaign, which has been running for several years. The process is only open to individuals with a disclosure relating to income arising from residential property.

HMRC direct other potential disclosures to the Digital Disclosure Service, and, for reporting a UK tax liability that relates wholly or in part to an offshore issue, the Worldwide Disclosure Facility. These facilities are not mandatory, and disclosures can be sent to HMRC by outside of those processes.

Advisers need to check what facilities or campaigns are available at the time the client wishes to make the disclosure, and to check their terms and conditions, including eligibility criteria. The adviser then needs to determine the most suitable option for the client.

The disclosure process

There are various stages to the disclosure process. The circumstances of each case will determine the timing and, potentially, order of the stages (for example, in many cases investigation work will be undertaken before the notification is made to HMRC). The following is intended as a guide, which will cover the majority of voluntary disclosure cases (but see below regarding the Contractual Disclosure Facility):

- Notification to HMRC;
- Investigation by adviser;
- Quantification of disclosure;
- Submission to HMRC;
- HMRC review;
- Settlement.

When making a voluntary disclosure, the onus is on the adviser to form a view of the client's behaviour, so that they can determine the relevant period to be covered, and also the level of penalty. Advisers should consider seeking specialist input, to ensure that all relevant disclosure options have been considered, and that an accurate assessment has been made regarding the period to be covered. I have seen numerous examples where the adviser has not been able to take an objective view of the client's position, particularly where there has been a long-standing relationship.

Other considerations

Advisers need to recognise the limitations of HMRC's disclosure facilities, whether it is considerations regarding the period to be disclosed, or the time provided to submit the disclosure, when determining the best option for their client.

Another key consideration for advisers is establishing the client’s behaviour. If HMRC consider that there has been deliberate behaviour, the level of potential penalty increases significantly, as does the disclosure period, and there is the risk of criminal investigation. HMRC’s criminal investigation policy does not have a materiality limit, and advisers need to assess the position.

Advisers will need to consider whether the client should seek inclusion in the Contractual Disclosure Facility, and this is an area where specialist advice should be sought, unless the adviser has significant experience of this process. A key advantage of the Contractual Disclosure Facility is that the client has the benefit of immunity from criminal investigation, providing they make a full disclosure, and meet their obligations under the process. The Contractual Disclosure Facility will be covered in a future session.

Contributed by Phil Berwick- Director, Berwick Tax

Deadlines

1 January 2021

- SME CT due for periods ended 31 March 2020 where not liable to pay by instalments

7 January 2021

- VAT returns and electronic payment for 30 November 2020 quarter

14 January 2021

- Forms CT61 and tax paid for the quarter ended 31 December 2020
- Quarterly CT instalment for large companies depending on accounting year end

19 January 2021

- PAYE, NIC, CIS and student loan due for month to 5 January 2021 if not paying electronically
- File monthly CIS return
- Pay PAYE for quarter ended 5 January 2021 if average monthly liability < £1,500

21 January 2021

- File online monthly EC sales list
- Submit supplementary intrastat declarations for December 2020

22 January 2021

- PAYE, NIC, CIS and student loan liabilities cleared into HMRC bank account

31 January 2021

- Electronic filing date for 2019/20 personal, partnership and trust SA tax returns
- Balance of 2019/200 and first instalment of 2020/21 SA liabilities due
- Deadline for amending 2018/19 SA tax returns
- Companies House should have received accounts of
    - private companies with 30 April 2020 year ends
    - public limited companies with 31 July 2020 year ends
- Corporation tax returns filed for periods ended 31 January 2020

News

Brexit – Trade and Cooperation Agreement

On 24th December 2020, the UK government and European Union announced that they had reached agreement on the legal terms of the future UK-EU relationship. The Agreement is based on international law, with no role for the European Court of Justice and no requirements for the UK to continue following EU law.

Under the Trade and Cooperation Agreement

- there will be no tariffs /quotas on the movement of goods between the UK and EU;
- UK service suppliers will not face barriers to trade when selling into the EU.

It is understood that the deal includes a social security agreement enabling UK citizens to access healthcare when travelling in the EU.

The Agreement confirms the end to the EU State Aid regime, allowing the UK to introduce its own modern subsidy system to support its businesses.

UK and EU leaders are expected to endorse the agreement, but this process will take time and the agreement may be applied on a provisional basis pending ratification in the new year. Clearly more information will follow in the New Year.

https://www.gov.uk/government/publications/agreements-reached-between-the-united-kingdom-of-great-britain-and-northern-ireland-and-the-european-union/summary-explainer

Chancellor's announcements on 17th December 2020

Coronavirus Job Retention Scheme – further extension

The Chancellor announced a further extension to the Coronavirus Job Retention Scheme (CJRS) until the end of April 2021.

For claim periods from 1 November 2020 to 30 April 2021, employers with a PAYE scheme can claim 80% of an employee's usual salary for hours not worked, up to a maximum of £2,500 per month.

March 2021 Budget

On the same day, the Chancellor also announced that he will publish the Budget on Wednesday 3 March 2021. This will set out the next phase of the plan to tackle the virus and protect jobs and will be published alongside the latest forecasts from the Office for Budget Responsibility.

MTD for Income – voluntary pilot

Taxpayers who want to sign up for the scheme on a voluntary basis must be:

- UK resident;
- registered for Self Assessment and their returns and payments must be up to date;
- a sole trader with income from one business only or a landlord who rents out UK property (or both).

Individuals cannot sign up to report income from any other sources.

On 14th December 2020, HMRC updated its guidance to confirm that the following COVID-19 grants prevent an individual from joining the pilot:

- Self-Employment Support Scheme;
- Coronavirus Job Retention Scheme;
- Eat out to Help Out Scheme for businesses in the hospitality sector.

https://www.gov.uk/guidance/follow-the-rules-for-making-tax-digital-for-income-tax

Stop, challenge, protect – Don't get caught out

HMRC has launched 'Tax avoidance: don't get caught out', an awareness campaign warning and educating about how to identify tax avoidance schemes, and the pitfalls of using such schemes.

The campaign is asking the public to:

- stop – not sign anything that they are uncomfortable with or don't understand;
- challenge – check for warning signs and if they are unsure, they should seek independent professional advice;
- protect – report tax avoidance schemes to HMRC or seek help from HMRC if needed.

Further, in an attempt to remove misleading marketing by promoters of tax avoidance schemes, HMRC and the Advertising Standards Authority have joined forces. Their joint enforcement notice requires promoters to be clear about the potential consequences of tax avoidance in any online adverts. They make it clear that Immediate sanctions include having paid advertising removed from search engines and follow-up compliance action, which can include referral to Trading Standards.

https://www.gov.uk/government/news/hmrc-and-asa-launch-new-action-to-disrupt-promoters-of-tax-avoidance-schemes

Business Taxation

Deductions of interest on loan notes

Summary – interest incurred on loan notes that were issued as part of the acquisition of an investment business was deductible. Despite a tax advantage being a main purpose of the loan, the entire expense was commercially driven, and the arrangement did not require a transfer pricing adjustment.

BlackRock Holdco LLC 5 is a US company, tax resident in the UK, forming part of the BlackRock Inc. In 2009, BlackRock Holdco LLC 5 issued several tranches of loan notes to its parent company as part of the acquisition of Barclays Global Investors. It claimed deductions on the interest paid on the loans.

HMRC refused the claims stating that the loan:

- debits were attributable to loan relationships that had an unallowable purpose within the meaning of s441 CTA 2009; or

- relationships that gave rise to the debits were within the scope of s147 TIOPA 2010 and differed from the arm's length provisions that would have been made between independent enterprises.

The company appealed.

Decision

On transfer pricing, the First-tier Tribunal found that, although an independent lender would not have entered into the loan on the same terms as the actual transaction, if it were lending to LLC5, it would — subject to additional covenants — have lent the same amount on the same terms. HMRC's transfer pricing challenge failed.

On the unallowable purpose issue, the tribunal said LLC 5 had a commercial and a tax purpose. Securing a tax advantage was 'an inevitable and inextricable consequence of the loan' and clearly a main purpose. However, the evidence was that LLC5 entered into the loans to further its commercial purpose of making and managing passive investments. This too was a main purpose.

Having reached this conclusion, it was necessary to consider a 'just and reasonable apportionment' as required by s441 CTA. The Tribunal stated that the evidence showed that LLC5 would have entered into the loans even if there had been no tax advantage in doing so. Consequently, given that the tax advantage purpose has not increased the debits, on a just and reasonable basis, all of the relevant debits arising from the loans should be apportioned to the commercial main purpose rather than the tax advantage main purpose.

The company’s appeal was allowed.

Blackrock Holdco 5 LLC v HMRC (TC07920)

Adapted from Taxation (19 November 2020)

Carrying on a trade **(Lecture B1231 – 12.02 minutes)**

It is a well-known fact that the word 'trade', which is important for so many aspects of income tax (and, indeed, other taxes), is not defined in the tax legislation. The closest which we have to a definition can be found in:

- S989 ITA 2007; and
- S1119 CTA 2010.

Both sections tell us that 'trade includes any venture in the nature of trade' – not really a hugely helpful clarification!

It therefore comes as no great surprise that there have been a considerable number of cases on the subject of whether someone is carrying on a trade and, although they all turn on their individual facts, several important principles have emerged.

In Ransom v Higgs (1974), Lord Wilberforce said that, when Parliament introduced the reference to trade in 1799, they wisely abstained from defining it and left it to the Courts to decide what the word means. In the same case, another of the House of Lords judges (Lord Reid) called a trade 'operations of a commercial character by which the trader provides to customers for reward some kind of goods or services'. It should be noted that, on the evidence, the taxpayer was held not to be trading.

There are of course the famous 'badges of trade' set out in the final report of the Royal Commission on the Taxation of Profits and Income which was published in June 1955. These badges of trade were examined in detail in Marson v Morton (1986) and each one has had its own gloss placed upon it by the Courts.

One of the issues which is currently very relevant arises from ATED. This is because ATED is not chargeable where the person entitled to the interest in land is carrying on a property development trade and the land is held exclusively for the purposes of developing and reselling the land in the course of the trade – see S138 FA 2013.

This has been highlighted by the Upper Tribunal hearing in Hopscotch Ltd v HMRC (2020) where the taxpayer company claimed relief from ATED on the basis that it was carrying on a trade. The First Tier Tribunal decided that the company was not carrying on a trade and so, on appeal, the matter fell to be considered by the Upper Tribunal.

This case is interesting because of its novelty. The arguments are nearly always the other way round, with HMRC maintaining that the taxpayer is carrying on a trade so that any profit is chargeable to tax as income. In this instance, HMRC contended that they were not, given that carrying on a trade would entitle the company to relief from the ATED charge.

One particular area of difficulty is where an intention to trade is formed after the purchase of the relevant asset. It will sometimes be the case that an asset is acquired for the purposes of investment (or, in the case of a property, perhaps for private use), but later there is an intention to sell. The question which then arises is whether a trade has commenced so that there would be an appropriation to trading stock (with capital gains consequences under S161 TCGA 1992). There is no doubt that this can occur – see, for example, the Court of Appeal's decision in Taylor v Good (1974).

In Hopscotch Ltd v HMRC (2020), the Upper Tribunal judges laid out very clearly the following fundamental rules in this regard:

(i) An asset can be held as trading stock or it can be held for non-trading purposes as an investment for capital appreciation or income generation or otherwise.

(ii) An asset is either held for the purposes of a trade or it is not. There is no intermediate status.

(iii) The mere fact that an asset was acquired for one purpose does not preclude the asset from being subsequently held for another purpose.

(iv) Steps taken to enhance the value of an asset are capable of being steps taken either for the purposes of a trade or for the purposes of a non-trading activity.

(v) In determining the question of whether an asset is held for the purposes of a trade, it is relevant to consider whether it was brought into use for the purposes of a pre-existing trade.

(vi) In a case where there is no pre-existing trade, there has to be evidence that a trade has been newly set up which entitles the fact-finding body to come to a view that it is more than the taking of steps simply to enhance the value of the asset. This principle was established by the House of Lords in Simmons v CIR (1980).

Hopscotch Ltd owned a residential property (not held as trading stock) which the company decided to sell. However, it would not sell and so, after consulting with their advisers, Hopscotch Ltd resolved that it should be totally redeveloped since the redevelopment would result not only in a sale but in additional profits as well.

Accordingly, the company took detailed advice relating to the development, sought planning permission and borrowed money to finance the cost of the work.

These are exactly the sort of facts which would encourage HMRC to advance the argument that a trade had commenced. However, in the Hopscotch Ltd case, the Upper Tribunal said that this represented nothing more than the company taking steps to enhance the value of the property prior to a sale. HMRC contended that the work involved in redeveloping the property was not enough to constitute a trade. The work, they said, was similar to that routinely undertaken by landowners not carrying on a trade.

As mentioned above, the First Tier Tribunal held that the facts did not support the conclusion that a trade had commenced. The Upper Tribunal upheld this decision.

It will be interesting to see what happens when these same arguments are deployed by a taxpayer in the future. There is of course no assurance that HMRC will accept this reasoning when used against them in another case, but either way this decision looks to have some seriously helpful planning possibilities.

Contributed by Robert Jamieson

COVID-19 and 'reasonable excuse' for companies

As a result of the COVID-19 pandemic, Companies House extended the deadline for filing accounts that were due between 27 June 2020 and 5 April 2021 by three months. Due to this extension, some companies may find that they are unable to file their corporation tax returns on time because a signed set of accounts is not available in time.

COM130070 confirms that a deferred filing date is possible when the Registrar of Companies grants a company further time to deliver its accounts, the company may also be able to deliver its return later than the filing date without incurring a penalty."

Under s118 (2) TMA 1970, HMRC has the power to defer a filing date to:

- allow further time for something to be done;
- accept a reasonable excuse for failure to do something.

So where other COVID-19 related difficulties have caused problems when filing a company's return, the company may request a deferral on the basis that they have a 'reasonable excuse' for late filing. Indeed, the ICAEW's Tax Faculty has confirmed that HMRC has stated that provided a tax return filing date has not yet passed, where a company is having difficulty filing its return on time due to COVID-19, the company can contact HMRC to request a deferral.

https://www.gov.uk/hmrc-internal-manuals/cotax-manual/com130070

Discoverability of mistakes

Summary - The Supreme Court's has unanimously allowed HMRC's appeal in relation to long-running proceedings associated with the franked investment income (FII) group litigation (FII GLO) and remitted the question of when the discovery actually happened to the High Court. The Supreme Court has confirmed that s 32(1)(c) of the Limitation Act 1980 applies to claims for the restitution of money paid under a mistake of law. But, in a departure from settled case law, it has ruled that time begins to run from when the claimant could have recognised that it had a worthwhile claim, not from when the true state of the law was established by a decision of a court of final jurisdiction.

The test claimants contend that differences between the tax treatment of dividends received by UK-resident companies from non-resident subsidiaries when compared with the treatment of dividends received by UK-resident companies from UK-resident subsidiaries breached EU Treaty provisions guaranteeing freedom of establishment and free movement of capital. As a result, they seek repayment of tax that they deem was wrongly paid, including interest, dating back to the UK's entry into the EU in 1973.

This decision deals exclusively with a question of limitation and not the underlying subject matter. Normally, restitutionary claims for the recovery of money are required to be brought within six years of when the money was paid. However, an exception to the rule is outlined in s 32(1)(c) of the Limitation Act 1980, which states that in relation to an 'action for relief from the consequences of a mistake', the limitation period only starts when the claimant discovers the mistake or could have discovered it with reasonable due diligence.

At the Supreme Court, HMRC argued that s 32(1)(c) only applies to mistakes of fact and does not include mistakes of law, or alternatively that the test claimants could reasonably have discovered the mistake over six years before their claims were first issued in 2003. Either way, HMRC contended that a proportion of the claims would be barred due to time limitations.

The majority ruled that 'cause of action estoppel', 'issue estoppel' and an 'abuse of process' did not, in this case, prevent HMRC from withdrawing its earlier concession that s 32(1)(c) applies to mistakes of law, and now to make the contrary case. The majority decision of the Supreme Court ruled that the provision does apply to mistakes of law (upholding Kleinwort Benson Ltd v Lincoln City Council [1999] 2 AC 349). There was a partially dissenting judgment from the minority (three out of seven) that instead would have overruled this case and found that mistakes of law were excluded.

On the question of when time started to run, the Supreme Court overruled the House of Lords decision in Deutsche Morgan Grenfell Group plc v IRC [2006] UKHL 49 and ruled that the correct approach is that time begins to run under s 32(1)(c) 'when the claimant discovers, or could with reasonable diligence discover, his mistake in the sense of recognising that a worthwhile claim arises' with sufficient confidence to justify obtaining legal advice and collecting evidence with a view to commencing a claim. The new test is objective and is based on a standard of 'reasonable diligence' which is formulated as 'how a person carrying on a business of the relevant kind would act, on the assumption that he desired to know whether or not he had made a mistake, if he had adequate but not unlimited staff and resources and was motivated by a reasonable but not excessive sense of urgency'.

Test Claimants in the Franked Investment Income Group Litigation and others v HMRC [2020] UKSC 47

Adapted from the case summary in Tax Journal (4 December 2020)

Write off of corporate debt **(Lecture B1232 – 17.56 minutes)**

When companies are in difficult there is often consideration of debt restructuring but this can be a problematic area due to the loan relationship provisions.

The loan relationship (LR) provisions were always something of an experiment when first introduced in FA1996. The Government wanted to consider moving to a situation where accounts prepared under generally accepted accounting principles would give a profit which would also be the taxable profit, with few adjustments.

The broad policy objective of the LR rules is to ensure that the tax treatment of lending transactions follows the accounting treatment unless this would be inappropriate for tax avoidance reasons or inconsistent with other policy objectives.

It is the extent to which the rules have been tweaked to ensure that they have not been used in a way which the Government feels is inconsistent with policy objectives that have given the rules their complexity.

There are also significant considerations where there are changes in accounting policy which result in differences in accounting treatment of LR type transactions. We are just going to look at the basics of loan relationships and then think about debt restructuring where businesses are in difficulty.

The basics of loan relationships

The basics of the loan relationships provisions can be summarised as follows. The legislation is found in CTA2009 Parts 5 and 6:

- A LR arises where there is a money debt arising from a transaction for the lending of money in respect of which a company stands in the position of either creditor or debtor;
- Certain other arrangements may be treated as LR of a company and these are described in Part 6 CTA 2009;
- Profits and losses on LRs are taxed or allowed for corporation tax purposes as income ie there is no distinction between capital and revenue for these purposes;
- Profits and losses from related transactions and foreign exchange gains and losses are also brought into account under these provisions.

There is a distinction between trading and non-trading loan relationships. Where a company is party to a trading LR, then the debits and credits are dealt with in calculating the company's trading profits. If they are non-trading LRs then credits and debits are brought into account separately and the excess of credits over debits in an accounting period is charged to tax or the excess of debits over credits (called non-trading deficit) in an accounting period can be relieved against specified profits of the company or of fellow group members

Similar rules apply in relation to derivative contracts (DCs)

In most cases, the treatment of lending transactions under the loan relationships rules follows the accounting treatment. The majority of companies will not have complex borrowing or lending arrangements and will not be attempting to exploit the loan relationships rules for tax avoidance purposes, in which case the legislation is generally simple to apply and helpful. However, the rules behind the ostensibly simple principle of taxing and relieving the amounts recognised for accounting purposes can be complex.

There are also modifications of the basic rules for certain types of debt for example where there are connected party debt releases including release of trade debts between connected companies.

Connected parties

The tax treatment of a loan relationship must be determined in accordance with an amortised cost basis of accounting for any accounting period in which the loan relationship is a connected companies loan relationship. This then triggers various changes to the normal rules.

Connected companies' relationship

A connected companies' relationship exists for the whole of an accounting period if there is a connection, at any time in that accounting period, between a debtor and creditor company in relation to the same debt.

For this purpose, a company is treated as a debtor or creditor if it indirectly stands in that position by reference to a series of loan relationships or money debts.

A company has a connection with another company in an accounting period if at any time in that period one company has control of the other or both are under control of the same person. There can also a connection where one company has a major interest in the other. Where such a connection exists at any time in an accounting period, that connection is treated as applying for the entirety of the period.

It is expressly stated in the re-writing of this legislation in CTA 2009 that a 'connected companies' relationship' exists solely between companies, and not between companies and any non-companies.

The definition of control for these purposes is taken from the old s840 ICTA 1988. The definition is, broadly, that control is the power of a person to secure by means of the holding of shares, possession of voting rights or as a result of any powers conferred by the articles of association or other document regulating the affairs of the company (or any other company) that the affairs of a company are conducted in accordance with that person's wishes.

Broadly, a major interest exists where:

1) a company ('A'), together with one other person (regardless of status), controls another company ('B'); and

2) that other person and A each have 40 per cent or more of the controlling stake in B; and

3) for accounting periods beginning before 17 March 2004, both A and the other person (or, subject to status, companies connected with them) are either debtors or creditors of B. This last condition was removed with effect for accounting periods beginning after 16 March 2004, as it was felt it was open to exploitation. For those and subsequent accounting periods, only conditions (1) and (2) are required to be satisfied for a major interest to exist.

In looking at (1) and (2), the rights and powers of a connected company are attributed to A or the other person (but only to that other person if it, too, is a company).

The write off of impaired debt

When a company A loans money to company B and that debt becomes impaired due to the inability of B to repay it, a debit arises for A and a credit arises for B if the loan is written off. This is on the assumption that the parties are not connected.

If this is a connected party loan relationship, then there is still a balanced treatment but there is no debit for tax purposes in A and no credit for tax purposes in B. Whether or not this is a beneficial treatment or not will depend on the circumstances.

There are going to be cases where this is not seem as being helpful; for example, if B has large levels of accumulated losses so that the credit is not going to be taxable then it might be desirable for the debit to be available to A. However, there is no choice in this matter.

Example

Company A lends £150,000 to company B. They are under common ownership. Company A decides that they are not going to get this money back and so formally releases half of it. Although there will be amounts going through the accounts, A will not get any tax relief for the £75,000 written off and B will not be taxed on this amount.

However, even when there is no connection between the parties, there are some cases when there will be no taxable credit arising for the debtor company. This would apply if any of the following conditions are met:

- Release The release of the debt is part of statutory insolvency arrangement;
- The release is in consideration for issue of shares;
- Not a deemed release (see below) and reasonable to assume that in the absence of the release, there would be a material risk that within 12 months the company could not pay its debts;
- The debtor relationship is modified or replaced with another for the reason mentioned in the previous heading.

It is important to note that you are only connected if both parties are companies. If there are loans to or from participators, then there are complications as these do not fall within the connected party provisions.

The write off of a loan from a participator would give rise to a taxable credit for the company with it being unlikely that the participator would get relief on the write off. If you write off a loan to a participator it is taxed on that individual as a dividend but there is legislation which specifically precludes the company from getting a deduction for the write off.

Provisions to avoid abuse

There are various provisions aimed at tackling potential abuse of the connected party provisions:

- Where the position of the debtor is altered;
- An impairment loss is not available even if a connection ends;
- An impairment loss available even though a connection exists;
- Where the position of the creditor is altered;
- Where the credit is brought into account despite connection;
- A loss not available after a connection ends.

If the connection is broken, no debit is available to the creditor for any impairment loss which relates to a period when the companies were connected (CTA 2009, s355). It is not open to the creditor company cease the connection and then write off the debt when they are not connected to secure available of tax relief on the write off.

Example

Company A owns 100% of company B. A Ltd has loaned £100,000 to B Ltd but B Ltd is struggling and it is perceived that it is unlikely to repay the loan. However, two employees of B Ltd believe that they can turn the company around and offer to buy the shares for £1. It is also agreed that the loan will be written off. A Ltd would like to get a deduction for the loan write off and so suggest that they could wait until the company is sold before writing off the debt so that the connection has ceased. However, s355 will mean that the debit is still denied where it is clear that the impairment of the loan has happened whilst they were connected.

Creditor gets an impairment loss even though connection

The creditor can get impairment loss in two situations even though they are connected:

- Where there is a debt for equity swap;
- Where there is an insolvent creditor.

The debt for equity provisions apply where the following conditions are met:

- There is a liability discharged by the creditor;
- In consideration for the issue of shares;
- There was no connection before the shares were acquired;
- This only applies to debt written off at the time of the swap.

Example

RM Ltd has a 31 December accounting year. It makes a loan to unconnected company PH Ltd of £10,000 on 1 January 2018, repayable in 5 years. PH Ltd gets into difficulties and at 30 November 2020, RM Ltd releases £7,000 of the loan, with the balance (£3,000) swapped in return for a controlling shareholding in PH Ltd.

Even though they are connected after the transaction, RM would get tax relief on the write off of the debt.

There would not be a taxable credit for PH as the connected party rules are not superseded.

Example (cont)

RM Ltd has a 31 December accounting year. It makes a loan to unconnected company PH Ltd of £10,000 on 1 January 2018, repayable in 5 years. PH Ltd gets into difficulties and at 30 November 2020, RM Ltd releases £3,000 of the debt, with £2,000 treated as repaid in return for a minority (25%) shareholding in PH Ltd.

This proves insufficient and on 1 March 2021 it releases a further £2,000 of the loan, with £3,000 treated as repaid in return for a further 40% shareholding PH Ltd.

For the first write off, a debit of £3,000 is allowed for RM Ltd as the parties are not connected.

For the second write off, the debt for equity provisions would apply and so relief would be available despite the connection.

In relation to the first write off, the amount written off would be taxable in PH as the parties are not connected. In relation to the second write off, there is no taxable credit for PH as the connected party rules are not superseded.

Example (cont)

RM Ltd has a 31 December accounting year. It makes a loan to unconnected company PH Ltd of £10,000 on 1 January 2018, repayable in 5 years. PH Ltd gets into difficulties and at 30 November 2020, it releases £3,000 of the debt, with £4,000 treated as repaid in return for a majority (55%) shareholding in PH Ltd. This proves insufficient and on 1 March 2021 it releases a further £1,000, with the balance of the loan, £2,000, treated as repaid in return for a further 25% of the shares.

A debit is allowed in RM for the initial write off of the loan because the debt for equity exception applies.

However, no debit is allowed for the write off of the final £1,000 as the companies were connected before this took place.

There is no taxable credit for PH for either transaction as the connected party rules are not superseded.

There are then provisions where the creditor is insolvent.

CTA 2009 s357 provides for an impairment loss to be allowed where condition A, B, C, D or E is met by the creditor:

- The creditor is in insolvent liquidation;
- The creditor is in insolvent administration;
- The creditor is in insolvent administrative receivership;
- An appointment of a provisional liquidator is in force in relation to the creditor under section 135 of the Insolvency Act 1986 (c. 45) or Article 115 of the Insolvency (Northern Ireland) Order 1989 (S.I. 1989/2405 (N.I. 19; or
- Under the law of a country or territory outside the United Kingdom, circumstances exist corresponding to those described in condition A, B, C or D.

This seems the wrong way around in many ways because to many it seems more logical that there should be some variation of the rules where the debtor is insolvent.

There may actually be some capacity to get relief for the creditor if the debtor is insolvent because if the company is in liquidation, then the companies may no longer be connected. If, as a matter of fact, the connection has been broken, then the creditor would get an impairment loss if a debt is written off but there would also be a tax charge for the debtor. For a company in insolvent liquidation this would probably be an irrelevant point as there would be no funds to pay any additional tax.

Taxed credit even where connection

There are problems when, perhaps as part of debt restructuring, parties become connected. This would then mean that you could get the advantage associated with the connected party provisions although, as noted above, this is not always an advantage.

There are provisions which cover the tax treatment of two particular scenarios. These are essentially anti-avoidance provisions designed to prevent companies gaining a tax advantage. These are called 'deemed releases'. The provisions are complex because there are exceptions to both charges.

The first scenario applies when unconnected debtors and creditors become connected. The second scenario applies where a connected company acquires impaired debt to which the debtor is party. This could also apply where someone acquires debt and becomes connected at the same time.

It is assumed that there will be release of part of the impaired debt and if the legislation applies, there is a deemed release of a portion of the debt which would be taxable on the debtor. Effectively the no credit rule in CTA 2009 s358 is disapplied.

Acquisition of debt by connected party

CTA 2009 s361 applies if:

- A company (D) is a party to a loan relationship as debtor;
- Another company (C) becomes a party to it as creditor;
- Immediately after it does so C and D are connected;
- Where the person from whom C acquires its rights under the loan relationship is a company, they were not connected in the period of account in which C acquired the debt;
- The amount or value of any consideration given by C for the acquisition is less than the pre-acquisition carrying value; and
- No relevant exception applies.

Example

W Ltd owes £100,000 to Sutton Bank plc to which it is not connected. Sutton Bank judges W Ltd to be a bad credit risk so writes the loan down to £20,000. CG plc, the parent of W Ltd, offers to purchase the loan for £5,000. SB claims an impairment loss of £15,000. There is a deemed release of value of £95,000 which has to be recognised by W Ltd. SB would have claimed relief for the whole right off of the value of the loan and no further relief is available for CG

Unconnected debtor and creditor become connected

CTA 2009 s362 applies if a company (D) is a party to a loan relationship as debtor and another company (C) which is a party to the loan relationship as creditor and not connected with D becomes connected with D.

Example

C plc holds £1 million of loan notes issued by D plc (part of a retail group). The group of which C plc is part makes a successful takeover of D plc.

Before this, C plc had written down the value of the notes on a fair value basis to £800,000 due to profit warnings issued by D. C has claimed a deduction for that reduction. D was still carrying the liability at its full value.

The difference between those is £200,000 and there would be a deemed release of that amount taxable in D.

Exceptions to the deemed release rules

There are two possible exceptions:

1) Corporate rescue exemption

2) Equity for debt exemption

Corporate rescue exemption

The legislation is at CTA 2009 s361D for the s361 provisions and s362A for the s362 provisions although the basic conditions are the same. The conditions for the corporate rescue exemption are:

- The transaction was at arm's length;

- There has been a change in the ownership of company D at any time in the period beginning one year before and ending 60 days after the date of the acquisition of the debt;

- It is reasonable to assume without the release and any arrangements of which the release forms part, there would be a material risk that at some point within the next 12 months the debtor company would have been unable to pay its debts.

Equity for debt exemption

This is probably the most likely one that we would see and only applies to deemed releases within s361.

The conditions in CTA 2009 s361C must be met, being:

- the acquisition is an arm's length transaction;

- the consideration given by C for the acquisition consists only of shares forming part of the ordinary share capital of C or companies connected with C.

Example

A Ltd owes money to an unconnected party who are now threatening to withdrawn funding due to A's precarious position. B Ltd is within the same group and offer to acquire the loan from the creditor in exchange for shares to B Ltd with the value of shares issued being assessed on an arm's length basis to be the same value as the loan.

Contributed by Ros Martin

Corporate interest restriction – Part I (Lecture B1233 – 20.05 minutes)

This is an introduction to the rules. They are highly complex, amounting to over 50 pages of legislation.

The Corporate Interest Restriction is the UK's legislation implementing the Organisation for Economic Cooperation and Development (OECD) best-practice recommendations for limiting base erosion and profit shifting by means of excessive tax deductions for financing costs.

The aim of the rules is to restrict deductions for a group's net interest and similar financing costs (tax-interest) from 1 April 2017 onwards to an amount which is commensurate with the activities taxed in the UK, taking account how much the group borrows from third parties.

The rules may restrict groups which borrow in the UK from third parties or intra-group to hold or acquire foreign businesses (which do not form part of the UK tax base), and groups which borrow from their shareholders or other related parties, as in typical private equity structures.

The rules apply mechanically. Most of the information needed is already in tax computations, although certain accounting information may also be needed from the group's financial statements. There is no avoidance or purpose condition for the rules to apply.

They apply after most other tax rules, such as transfer pricing and anti-hybrid rules, but before the loss restriction rules.

The company or group can use one of two methods to calculate its interest allowance for the period.

Fixed ratio amount: (smaller of)

1. 30% x Aggregate UK companies' tax-EBITDA

2. Adjusted (worldwide) net-group interest expense ("ANGIE" - accounting measure)

Group ratio amount (smaller of)

31. Group ratio x aggregate UK companies' tax-EBITDA

Group ratio = Qualifying (worldwide) net-group interest expense ("QNGIE") ÷ (worldwide) Group EBITDA (accounting measure)

2. Qualifying (worldwide) net-group interest expense ("QNGIE" – accounting measure)

QNGIE is based on ANGIE but excludes interest expense on borrowings from (non-group) associated companies.

Simple example

A single company which is not part of any group (so the group ratio is irrelevant) has net tax-interest expense of £2,700,000. Its Tax-EBITDA is £9,500,000 and its adjusted net-(group) interest expense is £2,600,000.

How much net tax expense is allowed?

The interest allowance using fixed ratio rule is the smaller of:

- 30% x UK companies' tax-EBITDA i.e. 30% x £9,500,000 = £2,850,000
- Adjusted net-group interest expense £2,600,000

i.e. £2,600,000

Net tax-interest expense is £2,700,000 so £100,000 net-tax interest expense must be disallowed in the period. This is carried forward to try to relieve it in future periods as will be seen later.

Group example (all amounts in £ million)

Aggregate net tax-interest of UK group companies	£50
Aggregate tax-EBITDA of UK group companies	£100
(Worldwide) Group EBITDA	£200
ANGIE	£95
QNGIE	£90

Fixed ratio method - maximum allowable interest is the smaller of:

1. 30% of aggregate UK tax-EBITDA (100m) 30
2. ANGIE 95

   i.e. £30 million.

Under this method, (50 – 30) £20 million of the interest would be disallowed.

Group ratio method - Group ratio % = QNGIE (excludes related party interest) ÷ (Worldwide) Group EBITDA

i.e. 90 ÷ 200 = 45% (note, this ratio is not permitted to exceed 100%)

Maximum allowable interest is the lower of:

1. 45% x aggregate UK tax-EBITDA (100) 45
2. QNGIE 90

   i.e. £45 million

Using group ratio gives a higher allowance. Only (50 – 45) £5 million interest disallowed.

Unused capacity

If the net tax-interest expense is less than the interest capacity (fixed or group ratio calculation), the unused capacity is carried forward and can be added to the capacity of future accounting periods for up to 5 years.

In future years, the capacity for those years is used first, then the brought forward amounts can be used on a FIFO basis to increase capacity, if necessary, to claim more relief for the net tax-interest expense of that future period.

Filing a return – abbreviated and full returns

Filing a return is necessary in order to:

- Carry forward interest allowances;
- Make certain elections under the CIR rules;
- Allocate any interest disallowance to specific companies;
- Allocate interest reactivations (which will not be relevant in the first period).

Where applicable, an abbreviated return gives a simple filing option that keeps flexibility to extend to a full return if beneficial.

The de-minimis provides an important threshold when considering what approach to take.

If the total net tax-interest expense across the UK companies in the group is below the £2 millionannual de- minimis and won't exceed this level in the next five years, there is unlikely to be any benefit in filing a return.

Abbreviated returns

An abbreviated return may only be made if the group is not subject to a restriction of interest. It must contain:

- The name (and UTR if relevant) of the ultimate parent company of the group;
- A list of the names and UTRs of all companies in the group;
- A statement that there is no disallowance;
- A statement that the return is accurate.

Full returns

A full return must contain the same detail as abbreviated return, plus:

- A statement of calculations, including details of tax-interest and tax-EBITDA figures for all companies subject to UK tax, relevant accounts-based figures and the interest allowance and interest capacity;

- A statement as to whether there is a disallowance and if so detail on how it is allocated;

- A statement as to whether there is a reactivation of interest and if so detail on how it is allocated.

Filing requirements

Once a reporting company is appointed (by election or by HMRC), it will have an obligation to file a return:

- within twelve months of the period end, or

- if later three months from its appointment.

An amended return may be made up to three years from the period end (or five years if replacing an abbreviated return with a full return), or if later three months from the reporting company's appointment.

Contributed by Malcolm Greenbaum

VAT

Hospitality, holiday accommodation, attractions – 5% rate extended

In July, the Chancellor announced a temporary VAT reduction from 20% to 5% for businesses involved in:

- hospitality
- hotel and holiday accommodation
- admissions to certain attractions

This reduction was due to end on 12 January 2021 but HMRC has announced that the reduction has now been extended to 31 March 2021.

For a summary of who is eligible to use the scheme, refer back to our August 2020 notes and for more detail, you can use the link below.

https://www.gov.uk/guidance/vat-reduced-rate-for-hospitality-holiday-accommodation-and-attractions?utm_source

Incorrect zero-rating certificate

Summary – A boathouse built by a charitable sea rowing club was not intended for a 'relevant charitable purpose' but the charity did have a reasonable excuse for issuing a zero-rating certificate.

In February 2013, Swanage Sea Rowing Club was granted a 125-year lease on some land on which to build a boathouse for the storage of gigs and equipment to replace the club's 'temporary' polytunnel that had been in use for the previous 10 years. It was intended that the new boathouse would also allow the club to provide changing, shower and toilet facilities and so increase the number of rowing sessions available to members and non-members alike and to expand their youth section.

With the chance to obtain external funding, the club agreed to extend its proposals to provide some use to the wider community, mainly by way of an extension of its rowing activities but also by providing "a base for other groups to use who currently have no premises". In reality the boathouse was also used for wedding receptions, music group rehearsal, and a dance festival

The rowing club appointed a contractor, Greendale Construction Limited, and based on advice received from a telephone call with HMRC, the rowing club issued a zero-rating certificate to its contractors. They believed that this was a supply in the course of construction of a building intended solely for use for relevant charitable purposes. HMRC subsequently disputed this treatment and sought to apply a penalty equal to the VAT, which would have been chargeable on the works (under VATA 1994 s 62).

Both parties agreed that zero-rating would apply if Item 2, Group 5, Schedule 8 VATA 1994 was in point. Key to the case was the application of Note 6 to this Group that states:

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

If the rowing club was able to demonstrate that either of these requirements was satisfied, zero-rating applied.

Even if the club failed both, it would still be entitled to win the appeal if the Tribunal was satisfied that there was a "reasonable excuse for… having given" the zero-rating certificate.

Decision

The First Tier Tribunal concluded that the use of the clubhouse failed.

The rowing club's activities had been operating for some ten years and had every intention of continuing, funded by subscriptions and rowing fees with a view to at least match income to expenses. The Tribunal concluded that the club was run in the course or furtherance of a business. There was a "direct link" between the services supplied by the club and the payments it received. Accordingly, zero-rating was not available to it pursuant to Note 6(a).

The Tribunal moved on to consider Note 6(b). The intended use of the building for the provision of social or recreational facilities for a local community is not enough. The building must be intended for use solely as a village hall or similarly in the provision of such facilities. The First Tier Tribunal held that it was not.

As the conditions in Note 6(a) and 6(b) were not satisfied, zero-rating of the construction work was not available.

Finally, the Tribunal considered whether there was a 'reasonable excuse' for the club incorrectly issuing the zero-rating certificate, as the penalty provisions do not apply where the person issuing the certificate has a reasonable excuse for issuing it.

Swanage Sea Rowing had read HMRC's VAT Notice 708 "Buildings and Construction" and appreciating the importance of interpreting the law correctly, had contacted HMRC's helpline to confirm that zero-rating was appropriate. HMRC had confirmed that zero-rating was appropriate in the circumstances that the club had outlined. HMRC gave no indication that:

- any further information was required from her before he could give the reassurance being sought,
- a detailed written application was required from SSRC,
- the advice being given could only be relied on if it was confirmed in writing by HMRC,

- she should make a specific request if she wanted a written record of the oral advice being given to be kept by HMRC.

The first Tier Tribunal concluded that the rowing club had a reasonable excuse for issuing the zero-rating certificate. The appeal against the penalty was allowed.

Swanage Sea Rowing Club v HMRC (TC07904)

MOSS registration cancelled

Summary – Failing to submit a number of returns as required by the MOSS Implementing Regulations meant that HMRC had no choice but to cancel registration. The company was required to register for VAT in each of the EU member states that it operated in for the two years until the company could re-register.

Krystal Hosting Limited provided web-hosting services throughout the EU.

In July 2017, to avoid the need to register for VAT in all of the EU countries in which supplies were made, the business registered in the UK under the VAT MOSS scheme.

In May 2018, having failed to submit its first three returns on time, HMRC cancelled the company's MOSS registration. This meant that the company would have to account separately for VAT in each of the EU Member States in which it made supplies until it could re-join the scheme, two years later.

Krystal Hosting Limited appealed against the cancellation arguing that the electronic reminder notices issued by HMRC prior to the cancellation of their registration were not clear and did not entitle or require HMRC to cancel the registration. They believed that HMRC should use its discretion to withdraw the cancellation.

Decision

The First Tier Tribunal disagreed stating that a company did not have to register under the MOSS system; it could submit returns in each of the EU member states, if preferred. By registering under the MOSS system, the company must accept the way that the system operated. To remain within the MOSS system, a business must fully comply with the MOSS rules.

The Tribunal confirmed that once the conditions for cancellation of a taxpayer's registration are met, HMRC has no discretion as to whether to deregister a taxpayer as the Implementing Regulations state that HMRC must then cancel registration. This is also consistent with Article 369e Directive 2006/112/EC that states that a Member State "shall" exclude a taxpayer if the relevant conditions are satisfied.

The Tribunal concluded that Krystal Hosting Limited had failed to comply with the MOSS system obligations and so HMRC were right to cancel its registration.

Krystal Hosting Limited v HMRC (TC07923)

Pitch hire and league organisation service

Summary – The supply of pitches combined with a league management service were a composite supply, where the principal element of the supply was exempt pitch hire.

Netbusters (UK) Ltd hires artificial football pitches and netball courts from third parties, such as local authorities and schools, which it then hires on to its customers organising competitive football and netball leagues. No one oversees the use of pitches and, other than toilet and changing room facilities, there are no other facilities provided. No parking facilities are provided at any of the grounds.

Teams register online to play in a particular league and agree with the terms and conditions and pay between £350-£779 per season for around 10 matches. Netbusters (UK) Ltd provides a referee and a ball as part of the league organisation and occasionally bibs (but not kits).

Netbusters (UK) Ltd claimed that 87.5% of its fees related to pitch hire, which was exempt from VAT on the basis that it was the hire of a sporting facility under Group 1, Schedule 9 VATA 1994. The balance of the amount paid was treated as services of organising fixtures and providing referees and bibs for the matches. The company claimed for overpaid output tax up to October 2016.

HMRC disagreed, stating that there was only one supply, the service of 'organisation of football and netball leagues'. HMRC denied the claim for the output tax recovery and raised assessments for the periods since that date when output VAT had not been accounted for.

Netbusters (UK) Ltd argued that the supplies were separate supplies but even if the supplies were not distinct then the principal element of the supply was the exempt supply of the pitch.

Decision

The First Tier Tribunal concluded that there was a single supply being made and that the company was supplying either exempt pitch hire or a standard-rated league organisation service.

The Tribunal decided that the league management services were integral to the pitch hire service and vice versa. Based the evidence presented, the Tribunal concluded that the league management services were of only modest value. These additional services did not change the fundamental nature of the more valuable service of pitch hire.

Netbusters (UK) Ltd was successful in their appeal.

Netbusters (UK) Ltd (TC07915)

Juice cleanse programmes

Summary – Juice Cleanse Programmes should be zero rated as supplies of food rather than standard rated as supplies of beverages.

The Core (Swindon) Limited operates a juice bar which offers Juice Cleanse Programmes consisting of fresh drinkable products made from juicing raw fruits and vegetables.

The company's marketing material clearly shows that the Juice Cleanse Programmes are marketed as meal replacement programmes and not merely as healthy drinks. Customers use the Programmes to replace traditional meals with fruits and vegetables in liquid form and are encouraged to consume water and herbal teas in addition to the Programme.

The company argued that the Juice Cleanse Programmes were zero rated supplies of food under Group 1, Schedule 8 VATA 1994. HMRC disagreed and argued that the Programmes were standard rated supplies of beverages under excepted item 4.

The First Tier Tribunal had found in favour of the company but HMRC appealed on the grounds that the Tribunal had focused too heavily on how the product had been marketed.

Decision

In reaching their decision, the First Tier Tribunal had considered equally the manner in which the products were marketed as well as how they were consumed.

The Upper Tribunal concluded that the First tier Tribunal had considered all material factors in the case and saw no basis on which to interfere with their decision.

HMRC v The Core (Swindon) Limited [2020] UKUT 0301 (TCC)

UK VAT number checker

Businesses can now use the UK's new online system for checking the validity of:

- UK VAT registration numbers;
- the name and address of the business to which the number is registered.

www.gov.uk/check-uk-vat-number

R&C Brief 18(2020): VAT liability of school holiday clubs

This brief clarifies HMRC's policy concerning the VAT treatment of school holiday clubs following the First-tier Tribunal's (FTT) decision of 7 November 2019 in RSR Sports Limited (RSR) (TC07453).

Supplies of welfare services are exempt from VAT under Item 9 of Group 7 of Schedule 9 of VATA 1994. This exemption is subject to the following two conditions.

1. The supply is by:
    - a charity
    - a state-regulated private welfare institution or agency, or
    - a public body
2. The services are welfare services and goods supplied in connection with those welfare services.

Welfare services include those directly connected with the care or protection of children and young persons.

In this case, RSR provided holiday camp services. The First Tier Tribunal found that these services were exempt from VAT as the provision of welfare during the school holidays. The predominant element of the holiday camps was childcare with members of staff merely supervising activities rather than teaching. Staff did not hold any coaching or teaching qualifications and there was no external standard to which the services were being provided.

HMRC has stated that other providers supplying services exhibiting the same key features as this case can exempt their supplies and are included in the welfare exemption.

https://www.gov.uk/government/publications/revenue-and-customs-brief-18-2020-vat-liability-of-school-holiday-clubs-first-tier-tribunal-decision

Northern Ireland Protocol (Lecture B1234 – 12.31 minutes)

Background

The Northern Ireland Protocol means that Northern Ireland maintains alignment with the EU VAT rules for goods, including on goods moving to, from and within Northern Ireland. However, Northern Ireland is, and will remain, part of the UK's VAT system.

UK VAT rules related to transactions in services will apply across the whole of the UK. HMRC will continue to be responsible for the operation of VAT and collection of revenues in Northern Ireland.

Under the obligations in the Protocol, import VAT will be due on goods that enter Northern Ireland from Great Britain (England, Scotland and Wales). The same will also broadly apply to goods entering Great Britain from Northern Ireland.

Under the Protocol, transactions in goods between Northern Ireland and EU businesses and consumers will continue as they do today. The same processes and reporting requirements will apply and Northern Ireland businesses intending to make transactions under the Protocol should ensure they are able to continue to operate in this way.

The only change is related to the use of the 'XI' prefix when trading under the Northern Ireland protocol.

Registering for VAT

There will be no requirement for a new VAT registration for sales of goods in Northern Ireland. Existing VAT registrations will be unaffected and there is no need to get another VAT registration.

Businesses will continue to account for VAT on all sales across the UK through their single UK VAT return, which will contain the same boxes as now.

VAT on goods sold between Great Britain and Northern Ireland

VAT will continue to be accounted as it is currently on goods sold between Great Britain and Northern Ireland. This means that the seller of the goods will continue to charge its customers VAT and should show this on its invoices.

The VAT charged will be accounted for as output VAT on the VAT return in the same box as it is now.

Where the customer receives an invoice from the seller showing that VAT has been charged, it may use this as evidence in order to reclaim the VAT as input VAT, subject to the normal rules.

There are a small number of exceptions to this where goods are:

- declared into a special customs procedure when they enter Northern Ireland or Great Britain;
- currently subject to domestic reverse charge rules including on sales of gold or gas and electricity to a VAT registered business;
- subject to an Onward Supply procedure;
- sold by an overseas seller through an online marketplace.

Where the movement of goods is declared into a special customs procedure, the customer or importer will be liable to account for the VAT.

Where goods are sold between Great Britain and Northern Ireland by an overseas seller to a consumer through an online marketplace, the online marketplace will be liable to account for the VAT on these goods.

VAT on goods sold from Great Britain, transported via Northern Ireland, to EU member state

Similar to accounting for a direct movement from Great Britain to Northern Ireland, the seller will be liable to account for the import VAT into Northern Ireland and zero-rating the goods on export to the EU. The VAT charged will be accounted for as output VAT on the UK VAT return by the seller.

VAT on goods sold to Great Britain from an EU member state via Northern Ireland

Where goods are sold and moved via Northern Ireland to Great Britain from a VAT-registered business in an EU member state (including the Republic of Ireland), the seller will be liable to account for the import VAT to HMRC.

The EU business will have to register with HMRC and account for the VAT on a UK VAT return. The UK customer will be able to reclaim the VAT as input VAT, subject to the normal rules.

Businesses moving their own goods from Great Britain to Northern Ireland

When a VAT registered business moves goods from Great Britain into Northern Ireland, VAT will be due. The business will need to account for VAT on the movement. This should be included as output VAT on the VAT return.

Where the goods are being used for taxable sales, the VAT may also be reclaimed as input VAT on its UK VAT return, subject to the normal rules.

Where a business uses the goods for exempt activities, or where the goods are put to partially exempt use, it may be required to make an adjustment to its partial exemption calculations.

Businesses moving their own goods from Northern Ireland to Great Britain

A business will not be required to account for VAT when it moves its goods from Northern Ireland to Great Britain unless these goods have been subject to a sale or supply.

Sales of goods from Great Britain to Northern Ireland, and within Northern Ireland, by members of a UK VAT group

UK VAT groups will continue to operate largely as they do now. VAT groups will continue to be able to include members that are established in Northern Ireland as well as members that are established in Great Britain.

Usually, supplies of goods between members of a VAT group are disregarded for VAT. This means that the group does not have to account for VAT on the supply.

However, where goods are supplied by members of a VAT group, and those goods move from Great Britain to Northern Ireland, VAT will now be due in the same way as when a business moves its own goods.

Where supplies of goods are made between members of a VAT group, and those goods are located in Northern Ireland at the time that they are supplied, these will only be disregarded if both members are established, or have a fixed establishment, in Northern Ireland.

Where one or both members only have establishments in Great Britain, the disregard will not apply and VAT must be accounted for by the representative member. This VAT may be reclaimed subject to the normal rules.

Where a business moves goods from Great Britain to Northern Ireland, after not having reclaimed the associated input VAT in full, then there is a possibility that there will be irrecoverable input VAT incurred again on the same goods.

To prevent this, businesses will be able to reattribute the previously unrecovered input VAT on the original purchase in Great Britain as if the goods had been used for a taxable purchase. This may be taken into account by businesses when making their annual adjustment.

HMRC will be introducing rules to prevent this from being used for avoidance purposes.

Intra-EU simplifications

Intra-EU rules and simplifications, such as triangulation, will not be available for movements of goods involving Great Britain.

Such simplifications will be available for movements of goods involving EU member states and Northern Ireland or where the intermediary is identified as moving goods in, from, or to, Northern Ireland in the course of its business.

Margin Scheme

In line with EU rules, margin schemes involving goods, such as the second-hand margin schemes, will not usually apply for sales in Northern Ireland where the stock is purchased in Great Britain. The VAT on these sales will be subject to the normal rules and must be accounted for on the full value of the supply.

Margin schemes will remain available for sales of goods that are purchased in Northern Ireland or the EU, whether sold to customers in Northern Ireland, Great Britain or the EU.

Margin schemes will remain available for sellers in Great Britain selling stock originally purchased in Northern Ireland or Great Britain.

Fiscal Warehouses

A fiscal warehouse is a facility where certain goods can be traded VAT-free.

Fiscal warehouses will continue to operate in both Great Britain and Northern Ireland and in most cases, transactions within, or between, UK warehouses will be able to continue to be treated as VAT-free.

Where goods are moved between a fiscal warehouse in Great Britain and a fiscal warehouse in Northern Ireland, this will not be treated as a VAT-free movement. The goods would have to exit the fiscal warehouse in Great Britain and be subject to the appropriate VAT, before entering the fiscal warehouse in Northern Ireland.

Contributed by Malcolm Greenbaum

Know your Incoterms (Lecture B1235 – 14.01 minutes)

What are incoterms?

Published by the International Chamber of Commerce (ICC), Incoterms stands for 'International Commercial Terms'. As the name suggests, these are a set of internationally recognized, abbreviated terms used when trading in goods. Incoterms represent guidelines, rather than law. Governments and legal authorities around the world accept these terms.

Inserted into a contract, incoterms clarify the tasks, costs and risks to be borne by buyers and sellers at each stage of the deal. Further, these terms effectively provide instructions to carriers, forwarders, customs brokers, banks and other financial institutions involved in shipping goods; they specify who is responsible for paying for and managing the shipment, insurance, documentation, customs clearance, and any other activities.

There are 11 incoterms in total, four of which relate specifically to Sea and Inland Waterway Transport.

When including Incoterms in a contract two items need to be included: the abbreviated name of Incoterm being used and the named place, which will be one of the following:

- Place of delivery
- Place of destination
- Port of shipment
- Port of destination

Incoterms for road, rail, air and sea

EXW: Ex Works (Insert place of delivery, usually seller's premises)

FCA: Free Carrier (Insert named place of delivery)

CPT: Carriage Paid to (insert place of destination)

CIP: Carriage and Insurance Paid To (insert place of destination)

DAP: Delivered at Place (insert named place of destination)

DPU: Delivered at Place Unloaded (insert of place of destination)

Formerly: DAT Delivered at Terminal

DDP: Delivered Duty Paid (Insert place of destination).

Incoterms for Sea and Inland Waterway Transport

FAS: Free Alongside Ship (insert name of port of loading)

FOB: Free on Board (insert named port of loading)

CFR: Cost and Freight (insert named port of destination)

CIF: Cost Insurance and Freight (insert named destination port)

Summary of Incoterms with buyer and seller responsibility

There is a useful tabular summary of Incoterms2020, effective from 1 January 2020, showing who is responsible for what that can be found at:

https://incodocs.com/blog/wp-content/uploads/2020/06/IncoDocs-Trade-Guide-2020-J.pdf

Not Covered

It is important to remember that Incoterms do not cover everything. For example, they do not identify the goods being sold, the price or the method and timing of payment. Further the contract will need to detail separately what happens in the event of failure to provide the goods, delayed delivery, and indeed how any dispute will be resolved.

https://iccwbo.org/resources-for-business/incoterms-rules/incoterms-2020/

Practical impact

The implications of incoterms need to be appreciated. If a UK business were to agree DDP terms with an EU customer for post transition trade we will have a problem. The UK supplier is responsible for the UK export documentation and the EU import documentation in the destination state. As a result, the UK supplier will be responsible for the EU import VAT and as such this will normally result in a VAT registration obligation in the destination state. The UK supplier will then be able to recover the import VAT paid and then account for the EU VAT on their onward sale to their EU customer.

Dropshippers

Dropshippers are online retailers who order and ship once they receive a customer order. The goods are normally shipped from outside the EU and go direct to customers within the EU. Sales values per consignment are typically less than £135.

Dropshippers are normally relying on the postal import system and as such it is their customers that are responsible for any import VAT and duty that may be due.

From 1 January 2021 the dropshippers or facilitating online marketplace (OMP) will need to charge supply VAT to UK customers. Where an OMP is not being used the dropshipper will need to register for UK VAT. The consignments are normally valued at less than £135 so no duty is payable.

Dropshippers will continue to rely on the postal import system where the consignment into the UK is valued at more than £135.

Dropshippers will continue to rely on the postal import rules for sales to EU customers up until 30 June 2021.

From 1 July 2021 the dropshipper or facilitating OMP will need to charge supply VAT to EU customers at the destination rate. Where an OMP is not being used the dropshipper will need to register in a single member state under the OSS. Where this applies, the consignments are valued at less than €150 so no duty will be payable.