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CONTENTS

Personal tax

IR35 case – wrong approach (Lecture P1441 – 19.05 minutes)

Summary –The First Tier Tribunal had erred in law by adopting the wrong approach to the application of the Ready Mixed Concrete stage three test 'in business on own account.'

Between 6 April 2012 to 5 April 2017, Adrian Chiles presented both television and radio shows for the BBC and ITV through a personal service company, Basic Broadcasting Ltd.

HMRC issued assessments for these tax years to collect income tax of £1,249,433 and national insurance contributions totalling £460,739 on the basis that the company was caught by the intermediaries legislation.

On appeal to the First Tier Tribunal, Basic Broadcasting Ltd was successful. When considering whether the hypothetical contract would be a contract of employment or a contract for services, the First Tier Tribunal undertook the three-stage test in the Ready Mixed Concrete case. The tribunal found that while there was sufficient mutuality of obligation and control, Adrian Chiles was in business on his own account.

HMRC appealed to the Upper Tribunal, arguing that the lower tribunal had erred in law when considering its application of this third stage test as to whether Adrian Chiles was in business on his own account. The First Tier Tribunal had failed to put relevant terms of the hypothetical contracts 'at the heart of its analysis'. The First Tier Tribunal had not given sufficient weighting to a number of factors, including whether Adrian Chiles was in business on his own account *in relation to the hypothetical contracts with ITV and the BBC*.

Decision

The Upper Tribunal confirmed that the third stage of the Ready Mixed Concrete case only becomes relevant if the necessary mutuality of obligation and control tests have been established. In this case they were.

Following Atholl House, when considering the third stage test, we should bear in mind that an individual can perform similar services as an employee or as an independent contractor. The key to which applies lie in the terms of the hypothetical contract, rather than the terms and circumstances of other engagements. Further how, when and where work was done in later years should not be used to assess current years.

The Upper Tribunal concluded that the First Tier Tribunal 'took the same sort of flawed approach' as in the Atholl House case. The Upper Tribunal stated that the 'business on own account' third stage test should be looked at on the basis of whether the terms of the hypothetical contracts indicated that Adrian Chiles was in was 'business on own account'. What the tribunal actually looked at was the relationship between the activities under that hypothetical contracts and the individual's other activities. Had the tribunal focussed on whether the hypothetical contracts been entered into as part of an existing business on own account, this would have resulted in the tribunal keeping the terms of the hypothetical contracts at the centre of its consideration.

The Upper Tribunal stated that it could not conclude that the First Tier Tribunal would have reached the same conclusion but for its error. As the error was material, the decision was set aside and remitted back to the First Tier Tribunal.

There was a second ground of appeal by HMRC, should the first fail, which was not the case. However, the Upper Tribunal did go on to give its findings on whether the First Tier Tribunal had erred in law by failing to take into account, and the company failing to prove, whether relevant matters were known or reasonably available to the BBC and/or ITV. This was referred to as the 'knowledge issue'. Basic Broadcasting Ltd objected to this, claiming that the issue was not raised before the First Tier Tribunal; it was a new argument and 'it would be procedurally unfair to permit it to be argued in this appeal'.

The Upper Tribunal stated that in their view the reason this knowledge issue was not previously discussed was that parties were only aware of it being an issue following the Atholl House decision.

Whether it should be admitted or not was not material to the decision to set aside the First Tier Tribunal's decision in this case. However, when remitted back to the First Tier Tribunal, it must now be taken into account by them because that is now the prevailing case law following Atholl House. The Upper Tribunal stated that:

> "It shall be for the FTT to determine whether to make any further findings of fact and whether to allow further evidence to be admitted."

HMRC v Basic Broadcasting Ltd [2024] UKUT 165 (TCC)

Long term incentive plan payment **(Lecture P1441 – 19.05 minutes)**

Summary – Despite the taxpayer being non-UK resident and no longer employed, a sum paid to him was still taxable as employment income.

Between 2 April 2008 and 31 July 2016, Michael Saunders was employed by Hibernia Atlantic UK Ltd. During this time both he and his company were UK resident.

In April 2013, he entered into an agreement under which he was granted Stock Appreciation Rights, all of which vested while he was still employed by the company.

From 31 July 2016 Michael Saunders ceased his employment and from 1 August 2016, he became non-UK resident.

In January 2017, he received a payment of £1,236,956 from his former employer linked to the stock appreciation rights that he been award.

This payment was processed through the Employer's payroll and subjected to deductions of £549,679.26 PAYE and £26,405.08 Class 1 Primary (Employee's) NICs at source.

Michael Saunders claimed split-year residency treatment. Consequently, he prepared his 2016/17 Self Assessment return on the basis that he received the payment while non-UK resident, meaning that the payment was not taxable in the UK. He believed that a repayment of tax was due.

Following an enquiry, HMRC issued a closure notice amending his return on the basis that the payment was taxable income in the UK.

Michael Saunders appealed to the First Tier Tribunal arguing that the Stock Appreciation Rights were ‘valuable contractual or property rights’. The reward for employment was delivered at the time of grant and was taxable at that time to the extent of any value immediately conferred. From that date onwards, the payment bore no ongoing connection to his employment. The payment was made as a result of this ownership, and not as a reward for the performance of his employment duties.

Decision

The Stock Appreciation Rights were part of an incentivisation plan to promote the success of the group, with employees incentivised to remain in employment or leave as good leavers. The value of the Rights was realised by a payment following a Liquidity Event or Sale, with the value increasing as the performance of the company improved.

The Tribunal stated that the Stock Appreciation Agreement detailed the grant and vesting terms. Further, it stated that “Mr Saunders might become entitled to receive a payment after his employment had ceased, in circumstances where he was a good leaver and there was a Closing Date within two years. This was part of the overall reward to which he was entitled as part of his employment”

Consequently, the sum paid was payment of employment income, as a result of the condition of a sale occurring.

Michael Saunders v HMRC (TC09129)

CJRS - variable rate employees (Lecture P1441 – 19.05 minutes)

Summary – Payments under the Coronavirus Job Retention Scheme should have been calculated on the basis that its employees were variable rather than fixed rate employees.

Jama Academy Limited was an after-school tuition centre which had been in existence since 2018.

The company had two employees, the director Mr Jama and his colleague Mr Ali, both of whom provided tuition services to pupils preparing for exams.

During COVID, the company made claims under the Coronavirus Job Retention Scheme, calculating the amounts claimed based on the two employees being “fixed rate” employees.

A fixed employee is one where the employment contract requires employees to be paid an annual salary in equal weekly or monthly instalments, irrespective of the number of hours actually worked in a particular week or month. Where this was the case, the reference salary was the amount of salary payable to the employee in the last weekly or monthly period ending on or before 19 March 2020.

HMRC accepted that the company was eligible to claim under the Coronavirus Job Retention Scheme but that the company had overclaimed as its employees were not fixed-rate employees.

The company appealed.

Decision

The First Tier Tribunal found that the employees were variable rate employees. Their employment contracts did not provide for a fixed salary but rather they were paid an hourly rate. Although the contracts specified fixed hours, the employer could, when required, vary those hours.

The Tribunal confirmed that where the employee was a variable rate employee, the calculation of the reference salary for the Coronavirus Job Retention Scheme payment should be based on the higher of the:

- average monthly (or daily or other appropriate pro-rata) amount paid to the employee for the period comprising the tax year 2019/20 before the period of furlough began; and
- actual amount paid to the employee in the corresponding calendar period in the previous year.

The appeal was dismissed.

Jama Academy Limited v HRC (TC09131)

Pension income (Lecture P1442 – 15.06 minutes)

Authorised member payments are payments that a pension scheme is authorised to make to, or in respect of, the members of the pension scheme.

These include:

- pensions permitted by the pension rules or the death benefit rules;
- lump sums permitted by the lump sum rule or the lump sum death benefit rules;
- payments pursuant to pension sharing order or provision.

Effectively, for money purchase schemes, the following are allowed:

- a drawdown pension for the member, his dependent, nominee or successor;
- an amount to purchase a short-term annuity for the member, his dependent, nominee or successor;
- an amount to purchase a nominee's or successor's annuity;

There are then a series of lump sum payments that can be made:

- a pension commencement lump sum ;
- a pension commencement-excess lump sum ;
- a serious ill health lump sum;

- an uncrystallised funds pension lump sum;
- a short service refund lump sum;
- a refund of excess contributions lump sum;
- a trivial commutation lump sum;
- a winding up lump sum.

Income withdrawals

The regime for pension income changed with effect from 6 April 2015 when 'pension freedom' was introduced. The changes apply only to defined contribution schemes although it is possible to transfer from a defined benefit into a defined contribution scheme. Careful advice would need to be taken if this is proposed as it is likely to be beneficial in very few circumstances.

The new regime allows an individual who has reached the age of 55 to choose between flexi-access drawdown or to take an uncrystallised fund pension lump sum (UFPLS).

Flexi-access drawdown allows for income to be withdrawn in any amount over any period (subject to any restrictions placed on this by the pension fund). Up to 25% of the value can be taken as a tax-free pension commencement lump sum and then further withdrawals will be taxed as income at the marginal rate of tax. The pension fund should withhold tax at source on any income withdrawals.

If you are using an uncrystallised fund pension lump sum, the first 25% of each withdrawal is tax-free with the balance taxed as income. Again, tax will be deducted at source from the income element of each withdrawal. You can take a one-off UFPLS or a series of these.

Are you better off taking an up-front tax-free lump sum or using the UFPLS process to get each income payment with an element of tax-free money? It is an almost impossible judgement to take. Many people would not see the situation in quite such a linear way and probably want the lump sum to have some money to spend on something to celebrate their retirement!

There is still always the option to buy an annuity with their pension fund with many individuals still opting for a 25% tax free sum and then buying an annuity with the balance. These are seen as low risk.

There are various types of annuities available such as single life, joint life, fixed term, investment linked and so on. Decreasing term plans are becoming more popular where you take more now and less when the state pension kicks in.

Of the above options, remember that taking more than the lump sum will potentially bring in the money purchase annual allowance provisions. If you are taking an annuity, only flexible annuities trigger the MPAA.

Whilst an annuity will give security, it dies with the holder whereas surplus funds in drawdown can be passed to nominated beneficiaries tax-free. This is discussed below.

Lump sums

The details above about the available lump sum allowance and available death benefit allowance depends on whether there have been any relevant benefit crystallisation events before. For the avoidance of doubt, these figures tell us what amounts can be paid tax-free from the fund.

To put this in simpler terms, if they have used up any of their lifetime allowance previously, it is only the tax-free amount of the previous benefit crystallisation event which is deducted from the lump sum and death benefit allowances.

Pensions funds are supposed to provide these details to the pension holders at the commencement of this regime but it is not entirely clear whether all funds will do so.

With the lump sum allowance, you would just deduct the relevant proportion of the pension commencement lump sums or uncrystallised funds pension lump sums as shown above. With the death benefit allowance, you would reduce the allowance by the relevant proportion of the above two amounts as well as any serious ill health lump sum or any lump-sum death benefits.

Example

Vera receives a pension commencement lump sum in May 2024 of £25,000. There was a relevant benefit crystallisation event of £100,000 that occurred before 6 April 2024.

Her basic lump sum allowance is £268,275 as she does not have protection. Because of the previous BCE, the available lump sum allowance is:

268,275 – (100,000 x 25%) = £243,275.

The lump sum she is now receiving is well within that amount so can all be paid tax free. The lump sum allowance to be carried forward to the next BCE is £218,275 (being £243,275 less £25,000).

Pension commencement lump sum

This is simply the amount which can be paid by the pension fund which is typically up to 25% of the pension fund (since it is a requirement that three times the lump sum is retained to pay income although that is watered down since pension freedom).

It is tax-free assuming availability of the lump sum allowance/death benefit allowance.

Uncrystallised funds pension lump sum

This is referred to above and is paid out of funds which have not been used to provide any benefits.

Pension commencement excess lump sum

This is a new authorised lump sum that pension schemes can pay members who have used up their lump sum allowance. It used to be that a lump sum could not be paid unless it was tax free. This overrides that. The whole amount is taxable.

Serious ill health lump sum

These can be paid where a member of a registered pension scheme is terminally ill. This allows all of the benefits under the scheme to be paid out in the form of a lump sum. Before payment the administrator must have received evidence from a registered medical practitioner confirming that the member is expected to live less than one year.

The lump sum must either be paid in respect of an uncrystallised arrangement and extinguish the member's benefit entitlements under that arrangement or be paid in respect of uncrystallised rights under an arrangement that is not an uncrystallised arrangement and extinguish those uncrystallised rights.

These are normally exempt from income tax. This would not be the case if the individual is under the age of 75 and the payment exceeds the lump sum and death benefit allowances which are available to the individual. It would also not be the case if the individual is aged 75 or over, in which case it is taxed at the individual's marginal rate of income tax.

Short service refund lump sum

Rights within a pension scheme are preserved once an individual has a minimum level of qualifying service (normally two years) and if the member leaves early, they have the right to refund of own contributions or transfer of accrued rights.

This will never apply once the individual has reached the age of 75 and there is a tax charge to reflect the fact that the contributions have had tax relief. That charge is 20% in respect of first £20,000 and 50% on balance, including interest. Liability arises on the scheme administrator and not on the individual, so no repayment can be made if the marginal rate of tax is less than these percentages.

Refund of excess contributions

Where member has paid pension contributions in excess of that which can obtain tax relief, the excess may be repaid but this must be done before the end of 6 years of the end of the tax year in which the excess contributions were made. Amounts repaid may be reduced by any relief at source given and paid tax-free as no tax relief has been given.

Winding up lump sum

This applies where an occupational pension scheme is wound up and the benefit rights are commuted into a lump sum. The payment cannot exceed the current maximum (£18,000) and the individual is taxed on 75% of the sum if the benefits have not crystallised or 100% if the benefits have.

Winding up lump sums do not use any lump sum allowance or death benefit allowance but members will need to have those available, either in whole or part.

Small pension pots

If an individual has several small pension pots, they may be able to take them as cash lump sums – up to three small pots of £10,000 each from non-occupational pension schemes and an unlimited number from occupational pension schemes, subject to rules.

In reality, it is unlikely that you would advise multiple pension pots due to the costs of running these but if they are there, it is worth considering the options. Small pot crystallisation does not trigger the MPAA.

A small lump sum payment can be made from any arrangement regardless of whether the rights are uncrystallised or represent a pension in payment. The value of the pension is commuted and to allow this the following conditions must be met:

- the member has reached the minimum retirement age or satisfies the condition for ill-health early retirement;
- each payment must not exceed £10,000 at the time it is paid to the member;
- the payment must extinguish all member benefit entitlement under the arrangement.

It must extinguish the benefits under a single arrangement so it could be that there are continuing benefits from the scheme as a whole although this is unusual.

Where the payment represents uncrystallised benefit rights, 25% of the payment is free of income tax and the balance is chargeable to income tax as pension income. If the payment represents crystallised rights, all the payment is chargeable to income tax as pension income. It could be a mixture of both.

Small pots do not use any lump sum allowance or death benefit allowance but members will need to have those available, either in whole or part.

Trivial commutation

Trivial commutation applies where a defined benefit pension member commutes one or more pension arrangements as long as the following conditions are met:

- the member has reached the minimum retirement age or satisfies the condition for ill-health early retirement;
- the lump sum extinguishes the member's entitlement to defined benefits under the registered pension scheme making the payment;
- all commutations take place within a 12-month period from the fate of the first period;
- the value of all member's crystallised rights must not exceed £30,000 including all pensions;
- the member has not been paid a trivial commutation lump sum previously
- the lump sum is paid when the member has available lump sum allowance and death benefit allowance.

If no other benefits have been paid out, then 25% of the payment is tax free with the balance being taxable pension income.

Trivial commutation amounts do not use any lump sum allowance or death benefit allowance but members will need to have those available, either in whole or part.

Legislation sets out the formula as to how you work out whether the total benefits crystallised by the member is under £30,000. You take the total tax-free benefits and multiple by 4, then add in the relevant pension rights that are being crystallised.

The following example comes from the HMRC December pension scheme bulletin:

Member A has:

- £265,775 remaining of their lump sum allowance;
- become entitled to £15,000 uncrystallised pension rights within the scheme;
- not received a serious-ill health lump sum and has no protections in place.

Valuation of crystallised rights (for TCLS) = ((£268,275 - £265,775) × 4) = £10,000

Value of member A's relevant pension rights = £10,000 + £15,000 = £25,000

£25,000 is less than £30,000, so Member A is entitled to receive their full uncrystallised pension rights from the scheme as a TCLS.

Contributed by Ros Martin

Pension lifetime allowance **(Lecture P1443 – 16.06 minutes)**

The lifetime allowance (LTA) was the maximum value that a pension fund can reach without an LTA charge crystallising when benefits are crystallised. However, changes were made to this in the 2023 Budget.

Previously, if the value of total tax-relieved pension rights exceeds the LTA at certain 'benefit crystallisation events' (e.g. when benefits are first taken from the fund, or aged 75), the excess has been subject to an LTA tax charge of:

- 25% if the excess is left in the fund to be drawn as taxable income; or
- 55% if it is drawn out as a lump sum.

The whole regime of benefit crystallisation events was complicated and gave rise to some unexpected outcomes.

However, given the small number of individuals who had pension funds in excess of the lifetime limit, this was not something that many general practitioners ever had to get their head around.

The LTA was introduced in 2006 at £1.5 million, had risen to £1.8m by 2012, but was subsequently reduced 3 times before rising again to £1,073,100. Various types of 'protection' have been available, both on the introduction of the LTA and whenever it has been cut. So some taxpayers can have a higher value of pension rights before incurring an LTA charge.

FA2023 abolishes the lifetime allowance (LTA) charge for pension purposes for 2023/24 and any subsequent tax year.

The lifetime allowance existed in 2023/24 but has now been abolished.

Lump sums paid out in excess of the LTA in 2023/24 were subject to the recipient's marginal rate of income tax.

These provisions effectively mean that rather than attracting the LTA charge in 2023/24 (at a rate of 55% if taken as a lump sum or 25% if taken as a taxable income stream), any value in excess of the LTA will be taxed at the individual's marginal rate of tax. For those who are taking the money out as a lump sum, the immediate impact will be a reduction of 10% (for those who are paying additional rates of tax) but possibly more. The real reduction arises from those who chose to withdraw money as income, since there will be no upfront 25% charge; the income will just be taxed as it is withdrawn.

Although the LTA has been abolished the previous provisions and the protections which clients might have in place will still be relevant as it will determine the tax-free lump sum that can be withdrawn from the pension. The tax-free amount is 25% of the previous LTA figure (25% x £1,073,100 = £268,275), unless the person has 'protection'.

Protections

The LTA was introduced in 2006 and there were two protections introduced at this stage. These had to be registered with HMRC by April 2009 with no late registrations accepted.

Enhanced protection removed funds from the limits entirely but meant that no further contributions to any pension schemes were allowed.

Initially, primary protection gave a lifetime allowance that was enhanced by a factor linked to the amount by which pension rights at 6 April 2006 exceeded £1.5m. Since April 2012, this factor has been a flat rate of 120%. So if the pension fund was valued at £2m in 2006, the lifetime allowance would be £2.4m.

The various subsequent protections are listed below:

- Fixed protection 2012 had to be claimed by 6 April 2012 and gave entitlement to a LTA of the greater of £1.8m or the actual allowance for the tax year in which the benefit crystallisation event occurred. No further contributions could be made.

- Fixed protection 2014 had to be claimed by 6 April 2014 and gave an entitlement to a LTA of the greater of £1.5m and the actual allowance for the tax year in which the benefit crystallisation event occurred. No further contributions could be made.

- Individual protection 2014 where the protected lifetime allowance is the lower of the value of the pension at 5 April 2014 and £1.5m. Additional contributions were allowed and this had to be claimed by 5 April 2017.

- Fixed protection 2016 where the lifetime allowance was fixed at £1.25m and no further contributions could be made. There was no deadline for application for this protection however, applications for protection under this regime will close after 5 April 2025.

- Individual protection 2016 where the protected lifetime allowance was the lower of the value of the pension at 5 April 2016 and £1.25m. Additional contributions were allowed. There was no deadline for application for this protection however applications for this will also close after 5 April 2025.

Late registration for other protections may be made if there is a reasonable excuse for failure to register earlier. There is some case law on this point which has been ambiguous regarding the potential success in doing this.

Those protections continue to be valid in the new regime as they will give entitlement to a higher tax-free lump sum that the standard.

There is one protection above where there is a transitional provision. Enhanced protection (first one above) gave protection for the whole of the fund from any LTA charge, with no additional contributions being able to be made. Under the new regime, the lump sum allowance for those with enhanced protection will be based on the value of the fund on 5 April 2023. Enhanced protection therefore will not protect future growth from tax charges.

There are transitional provisions which need to be considered.

If a protection was validly held at Budget Day 2023 (15 March 2023), then post-cessation events which would have previously invalidated the protection will no longer do that. This only applies to events after 5 April 2023 but it does mean that those who could not make further pension contributions could now do so if they wanted to. This may enable them to build a larger IHT protected fund.

It might still be possible to apply for protections and if this is done after 15 March 2023, they will still be subject to the normal restrictions. It is unlikely that applying for protection now is going to be provide any particular advantages for most clients.

The new regime

It was not seen as being possible for the government to simply abolish the lifetime allowance and so the intention was to reform the system with the following outcomes:

- Keep a 25% tax-free pension commencement lump sum at the same level as before (so linked to the previous lifetime allowance or any enhanced amount available);

- Tax other lifetime benefits at normal income tax rates and

- Prevent tax leakage that might arise if the LTA was abolished completely.

The basic provisions see two new allowances: the lump sum allowance and the death benefit lump sum allowance. The former is set at £268,275 and the latter at £1,073,100.

There is no facility within the legislation for these amounts to be increased. Existing protections and enhancements will adjust those new allowances, as discussed above.

The lump sum allowance caps the amount that can be taken tax-free as a pension commencement lump sum and/or the tax-free element of any uncrystallised funds pension lump sum.

The death benefit lump sum allowance caps the amount taken tax-free in aggregate during the individual's lifetime and on death. This includes amounts counting towards the lump sum allowance, as well as the serious ill-health lump sums and most non-charitable lump sum death benefits for those who die under 75.

For an individual who dies before age 75 holding only uncrystallised funds, this gives broadly the same outcome as under the current rules. The first £1,073,100 of the lump sum would be tax-free and the remainder would be taxed as under the LTA rules. Where the new rules differ from the old regime is where the lump sum is from a drawdown fund and the member dies before their 75th birthday. Under the previous rules, the fund is tested against the lifetime allowance when it is designated for drawdown, but there is no further test on death. The fund could therefore be paid out tax-free, even if it has grown beyond the lifetime allowance. From 6 April 2024, the death benefit is only tax-free to the extent of the remaining lump sum and death benefit allowance, with the remainder being taxed as pension income of the recipient.

The details of this are discussed below in relation to the different lump sums that can be received by an individual.

IHT planning and crystallisation of benefits for beneficiaries

Firstly, it is important to understand the different terminology which applies when we are looking at beneficiaries of pension funds as they can be dependents, nominees or successors.

- Dependents are spouses, civil partners, children under 23 (or older if dependent due to physical or mental impairment) or anyone who is dependent due to physical or mental impairment or who is financially dependent or in a financial relationship which is one of mutual dependence.

- Nominees are people who are not dependents but are nominated by the member. They must be an individual.

- Successor is anyone who is nominated by a dependent, nominee or other successor to receive benefits.

Nomination forms

It is important that members of pension funds understand the nomination process for pension funds.

Each pension fund has own rules and pension members are encouraged to complete nomination or expression of wishes forms. However, it is important to remember that these do not bind the trustees and they can decide who to pay to. In most cases, those wishes will be followed but if another party emerges post-death who appears to have a claim on the money, they can be swayed.

It is important that the forms are completed as clearly as possible so there is no possibility of misunderstanding so better to name specifically rather than putting a class of persons.

The executors will not have any influence over who pension is paid to as this is the remit of the pension trustees, who may have no actual knowledge of the deceased member.

It is, of course, important to make sure that is kept updated.

What happens when the pension member dies

Practical issues

The type of benefits which can be paid out will depend on the type of pension, whether or not benefits have been crystallised and if they have, the type of pension in payment.

Typically, you can see dependent's scheme pensions, beneficiary's annuities and beneficiary's drawdown pensions although the latter two will only arise in defined contribution pension funds.

Tax treatment for beneficiaries

The tax treatment of any pension fund will depend on the age at which the individual dies. The nature of the benefits which might be provided to the beneficiaries is dependent on the pension fund.

For example, some pension funds will not allow income drawdown. So the options below are theoretical options under tax law but may be limited from a practical perspective.

Sometimes, there is a guaranteed minimum period over which a scheme pension or annuity will be paid so that if the member dies before the end of that, their pension would continue to be paid to another person, usually nominated by the member. The terms of this would depend on the actual pension and this income simply remains taxable as pension income on the recipient, regardless of their identity. These types of payments do not follow the normal rules for IHT planning etc. for pensions.

A dependents' scheme pension would also be taxed as income as it is also a continuation of the member's pension entitlement.

In relation to other types of payments, the tax treatment is as follows:

- If the individual dies before age 75, the beneficiaries can take the whole pension fund as a lump sum or draw an income from it tax free, using income drawdown. This assumes the total amount being paid is less than the lump sum allowance or death lump sum allowance. This is discussed below. Dependents (but not other beneficiaries) can also choose to buy an annuity which would also be tax free. This assumes the funds are designated the relevant beneficiary within two years. If they are not, then benefits will become taxable.

- If the individual dies after age 75, beneficiaries will have three options:

1. Take the whole fund as cash in one go. This would be subject to tax at the marginal rate of the beneficiary.

2. Take a regular income through income drawdown or an annuity (if you are a dependent) the income being subject to income tax at the beneficiary's marginal rate

3. Take periodical lump sums through income drawdown with those lump sums being treated as income so subject to income tax at the beneficiary's marginal rate of tax.

No IHT will arise assuming that there is no flaw in the drafting of the pension rules so that the pension fund reverts back to the estate.

Any amounts withdrawn from a pension fund which is not then spent by the recipient will be in the estate for IHT purposes so it might be better to retain those within the pension fund.

Care must be taken when lump sum payments are made to non-qualifying persons as these are subject to a 45% tax charge. A non-qualifying person is someone who is not an individual or someone who is individual receiving the money in their capacity as trustee, person representative, director of a company, partner in a firm or member of an LLP.

This can be an issue if you have an individual who is uncertain about who they want to pay the money from their fund to, as they might think leaving funds into a trust (for example) would then give flexibility for the trustees to decide.

If the trustees subsequently transferred the money to a beneficiary, then they would get a credit for the tax paid on the money received from the pension fund but that may not be as helpful as someone getting the money tax free in the first place.

Lump sum payments made to charities would be tax-free which is an option for those with pension funds who do not have dependents or do not want to benefit those dependents.

The question as to what is withdrawn from a pension fund following the death of the member may depend on the pension fund administrators. Many do not want to have to provide an income stream to the beneficiaries and so will only pay the amount out as a lump sum.

If the member has died under the age of 75, then it is tax-free so it may not matter that the payment is being received in one lump but if the member is over 75 and it is taxable, getting all the money at once may push the recipient into higher rates of tax.

Note: One of the proposals put forward in HMRC's July 2023 policy paper was the removal of the income tax exemption for pension income on funds from members who died before reaching age 75. This proposal has not been taken forward, so it will remain possible for unlimited amounts to pass tax-free if they are taken via dependant/nominee/successor drawdown rather than as a lump sum death benefits.

Where does the lump sum allowance and death benefit allowance come into all this?

If a lump sum death benefit is being paid out, then this is a relevant benefit crystallisation event which means that you have to test the amounts being paid out against the available lump sum allowance and the death benefit allowance. If amounts paid out are in excess of this, then there will be an income tax charge on the excess amounts (rather than it being tax free). If the amount is already being taxed as income (i.e. because the member was over 75 when they died) then there would be no need to consider this point.

Example

Judy dies on 2 October 2024, aged 52. She had neither Enhanced Protection nor Primary Protection and had not asked for a transitional tax-free amount certificate.

On 1 March 2024, she took a serious-ill-health lump sum of £800,000 from one of her two pension schemes. In her other pension scheme, she had uncrystallised rights of £300,000 at her death available to her beneficiaries. Her sole beneficiary is her daughter.

As a result of the tax-free serious-ill-health lump sum, the value of the previous BCE is £800,000.

As she was not entitled to protection, Judy's unadjusted lump-sum and death-benefit allowance immediately before death was £1,073,100. In order to find her available lump-sum and death-benefit allowance, however, we must deduct the 'appropriate percentage' of the previous benefits.

The appropriate percentage is 100%, since Judy became entitled to a serious-ill-health lump sum before 6 April 2024.

Her available lump-sum and death-benefit allowance is hence:

£1,073,100 − £800,000 = £273,100.

Judy's uncrystallised funds of £300,000 therefore exceed her available lump-sum and death-benefit allowance by £26,900. If Judy's daughter takes those funds as a lump-sum death benefit, she will pay income tax at her marginal rate on £26,900 but the remainder will be tax-free.

Planning in relation to pensions

When considering what is best to do, particularly where someone has a short life expectancy, another possibility is to take advantage of the serious ill-health lump sum which enables all of the remaining value of the pension fund to be extracted tax-free but is only available where the individual is expected to live for less than one year. It might be worth considering where money could be left to a spouse IHT-free and then passed on to other beneficiaries.

There is a balance between withdrawing (and spending) money in pension funds and retaining those funds so they can be transferred to beneficiaries.

Particularly when approaching retirement, it may be a good idea to consider if other savings can be used to boost pension savings.

Let us take an example of an individual with a healthy salary and plans to retire early. He has a current pension fund of £250,000 and also £250,000 in ISAs. He currently pays £8,000 net into his pension fund.

This individual has spare capacity within his previous annual allowance and could increase his contributions. If he utilised all of his £250,000 savings, that would give gross contributions of £312,500 and there would be an additional £62,500 of tax relief via Self Assessment as he is a higher rate taxpayer. He could use that money to start putting money back into his ISAs if he wished.

This has the added advantage of taking those funds out of his estate for IHT purposes since the pension fund is excluded but an ISA would be included.

Contributed by Ros Martin

Capital taxes

CGT loss relief for loans (Lecture P1444 – 13.08 minutes)

The First-Tier Tribunal decision in *Bunting v HMRC (2024)* highlights a potential trap in connection with loss relief claims where money lent to a trading company becomes irrecoverable. Sadly, in recent years, this has been a common situation.

The appellant (B) had enjoyed a successful career as a banker. Outside his work, he had a keen interest in sports history and memorabilia.

In the early 2000s, B decided to establish a business dealing in sports history books and memorabilia. This was always intended to be a *bona fide* trading operation. Accordingly, in July 2004, Rectory Sports Ltd was incorporated. B's wife was the sole shareholder and director, given that, at the time, B worked for Goldman Sachs who did not approve of employees holding external directorships. The company was capitalised with a single £1 ordinary share.

The company's activities were funded by B who invested nearly £3.5 million by way of a series of unsecured non-interest-bearing loans. This arrangement represented money lent to Rectory Sports Ltd which was used by the company for the purpose of its trade in books and memorabilia. It was not a debt on a security.

Initially, the company invested heavily in the acquisition of stock. It opened premises in Surrey and hired specialist staff to deal with the trade. For the first few years, the business was successful, but, by 2012, it had become clear to B and his wife that the stock held was going down in value instead of appreciating and that the company's target market was falling away. In other words, the business was becoming unsustainable.

In January 2013, B and the company entered into an agreement for the capitalisation of £2,200,000 of B's loans. Pursuant to that agreement, Rectory Sports Ltd issued 2,200,000 £1 ordinary shares to B in consideration for the appellant agreeing 'fully and irrevocably' to release and discharge the company from any claims or demands which B might have against it.

This capitalisation issue was undertaken for the purpose of enabling B to make an income tax share loss claim under S131 ITA 2007 on the basis that his shares had become of negligible value.

Two months later, the parties entered into a further agreement for the release and discharge of the remaining loans. Liquidation of the company followed and, in January 2014, B made a share loss claim in his 2012/13 self-assessment tax return.

During the enquiry which followed, B eventually accepted that, because the shares were of no value at the time when they were issued, they had not 'become of negligible value' so that he had no entitlement to his share loss claim. In the meantime, he made what the case report described as 'a protective claim to capital losses in respect of the losses arising in connection with the discharge of the capitalised proportion of (his loans)'. This was under s.253 TCGA 1992. HMRC treated the claim for capital losses as one made outside a tax return (the period for amending the 2012/13 tax return having expired).

In February 2017, HMRC started a new enquiry into the validity of B's capital loss claim. That enquiry was closed with a refusal of the claim in September 2022. This was on the basis that the loan was discharged by the issue of the shares so that, at the date of the capital loss claim, there was no 'amount outstanding' as required by s.253(3) TCGA 1992. HMRC accepted that B could of course have made the capital loss claim before his share subscription, but unfortunately he did not do so.

One expert commentator remarked:

> 'HMRC also observed that he had received property (i.e. the shares) in satisfaction of the debt and (the confusingly similar) s.251(3) TCGA 1992 therefore disqualified the loan from relief.'

But how serious was B's tax problem?

Ultimately, the case turned on the correct interpretation of s.253(3) TCGA 1992. This subsection provides that an allowable loss will arise for CGT purposes where 'a person who has made a qualifying loan makes a claim and at that time . . . any outstanding amount of the principal of the loan has become irrecoverable'.

The legislation defines 'a qualifying loan' as a loan where:

'(i) the money lent is used by the borrower wholly for the purposes of a trade carried on by him, not being a trade which consists of or includes the lending of money; and

(ii) if the loan is made before 24 January 2019, the borrower is resident in the UK; and

(iii) the borrower's debt is not a debt on a security.'

In the context of (i) above, money used by the borrower for setting up a trade which is subsequently carried on by him is treated as used for the purposes of that trade.

It seems clear that B's loans met these criteria:

(i) the money lent was used by Rectory Sports Ltd for the purposes of its trade;

(ii) the company was UK-resident; and

(iii) the company's indebtedness did not represent a debt on a security.

The First-Tier Tribunal decided that the words ('any outstanding amount of the principal of the loan has become irrecoverable' – see above) merely means that the debt must be unpaid, regardless of whether or not, as someone has pointed out, 'there was any continuing right of enforcement'. The debt had not been settled and so the test in s.253(3) TCGA 1992 was met.

On HMRC's argument about s.251(3) TCGA 1992, the judges were equally sympathetic to B. The taxing authorities' contention was dismissed on the ground that the shares received in satisfaction of the debt were worthless so that no valuable consideration had been received. This meant that the loans were *not* disqualified from relief.

As a result, B's capital loss claim was successful, but, in the speaker's view, an appeal by HMRC to the Upper Tribunal is quite likely.

Contributed by Robert Jamieson

Jointly owned property **(Lecture P1441 – 19.05 minutes)**

Summary – The taxpayer owned a 50% share in a flat owned jointly with her brother and could deduct costs supported by appropriate evidence. Lettings relief was restricted to the gain that was covered by PPR relief.

Elizabeth Rooke's brother had bought a flat but later, needing funds to buy a family home, her brother was considering selling the property.

In October 1999, Elizabeth Rooke had intended to lend money to her brother, secured by a charge, but later agreed to buy an interest (90/255) in the flat instead for £90,000, when the flat was valued at £255,000.

In 2003, she:

- increased her ownership share so that they owned the flat equally, paying an additional £44,865.50 to acquire a further 14.71% interest, calculated based on the market value of the flat at the time;

- contributed £23,924 towards the cost of a lease extension.

During her ownership period, the flat was either let or available to let to third party tenants until, in October 2013, Elizabeth Rooke moved in, occupying the flat as her main residence.

She moved out in February 2015, four months before the flat was then sold. The net proceeds of sale were £914,685 (after deducting legal fees and estate agent's fees).

The net proceeds of sale were split in equal shares between Elizabeth Rooke and her brother.

Elizabeth Rooke completed a paper tax return for the 2015/16, dated 25 October 2016 claiming the following deductions:

- The initial £90,000 paid in October 1999;

- £24,000 and £192,000 that she claimed she had paid in 2001;

- the additional equity purchase of £44,865;

- lease extension costs of £23,924

- PPR relief of £57,047 (24 + 18 months of occupation, out of 188 months of ownership)

- letting relief: £40,000 (being the lower of PPR relief given, the gain attributable to letting and £40,000)

Twice she amended her return, reducing her allowable costs and so increasing the capital gains tax due.

In March 2020 wrote to HMRC claiming overpayment relief.

She believed that she had overpaid capital gains tax by £18,881 as a result of mistakes made arguing:

- she had originally acquired 76.6% (90/117.5) of the flat, being her share of the "free equity" (£117,500) in the flat in October 1999, so the value after having deducted the mortgage.

- PPR relief claimed continued to be based on 13+18 months, already amended in her earlier return;

Despite asserting that she should be regarded as having acquired over 91% of the value of the flat (76.6% + 14.71%), the sales proceeds attributable to her in the calculation remained at 50%.

Not surprisingly, HMRC opened an enquiry into her return, ultimately denying the overpayment relief.

HMRC rejected her claims that:

- her interest in the flat in 1999 was determined by reference to the available un-mortgaged element of the flat's value at the time, and not by reference to the overall value of the flat;

- she had made another equity purchase in 2001, as she was unable to provide any evidence of this;

Further, her claims for PPR relief and lettings relief were incorrect:

- She was entitled to PPR relief of 21 months, being 17 months of occupation between October 2013 and February 2015 plus the final four months of ownership between February 2015 and the sale in June 2015. This totalled £33,349;

- Her claim for lettings relief was restricted to £33,349.

Elizabeth Rooke appealed.

Decision

The First Tier Tribunal found in HMRC's favour, relying on documentation submitted at appeal rather than on some of Elizabeth Rooke's claims, which were found to be "in many places, inconsistent".

She was taxable on 50% of the proceeds, less the sums she paid in 1999 and 2003, the lease extension costs, as well as the main residence relief based on 21 months of actual and deemed occupation, with lettings relief restricted accordingly.

Elizabeth Rooke's appeal was dismissed.

Elizabeth Rooke v HMRC (TC09170)

Late EIS income tax relief claim (Lecture P1441 – 19.05 minutes)

Summary – An appeal to allow a late claim for EIS income tax relief to effect EIS disposal relief on an £8 million disposal failed as the tribunal had no jurisdiction to allow the late claim.

Following an investment in a company known as "People Apps Ltd", on 1 September 2013, Kaljinder Singh Kalay was issued with shares.

In November 2019, he disposed of his shareholding, submitting his 2019/20 tax return with a claim for EIS disposal relief totalling £8,281,189.

In October 2021, HMRC opened an enquiry into this return.

Realising that a claim had not been made for EIS income tax relief when the shares had been acquired, the taxpayer's agent made a claim for EIS income tax relief by amending his 2019/20 tax return on 28 January 2022.

This claim was rejected by HMRC and on 3 March 2023, HMRC issued a closure notice on the basis that Kaljinder Singh Kalay did not meet the conditions for an EIS income tax relief claim.

Kaljinder Singh Kalay appealed against HMRC's decision to refuse to admit his late claim for EIS income tax relief claim.

HMRC applied to strike out the Appellant's appeal.

Decision

The First Tier Tribunal confirmed that in order for EIS disposal relief to be allowable, an Appellant needs to have made a valid claim for EIS income tax relief. The time-limit for EIS income tax claims is provided for at s.202(1)(b) ITA 2007 and is not later than the fifth anniversary of the normal Self Assessment filing date for the tax year.

The shares were issued on 1 September 2013 so within 2013/14. The filing date for this return was 31 January 2015 and the 5th anniversary of this date was 31 January 2020. By submitting the EIS income tax relief claim in January 2022, the claim was clearly late.

The First Tier Tribunal found that it did not have "jurisdiction to entertain an appeal against the refusal to admit a late claim on public law grounds, nor indeed does it have the jurisdiction to exercise any supervisory jurisdiction over HMRC in relation to this issue."

Given that the EIS income tax claim was late, the Tribunal was satisfied that the appeal against the closure notice had no reasonable prospects of success as no valid claim had been made. Consequently, the appeal against the closure notice was struck out.

Kaljinder Singh Kalay v HMRC (TC09155)

Substantial area of land (Lecture P1441 – 19.05 minutes)

Summary – The property, together with all 41 acres of land, was residential property for Stamp Duty Land Tax purposes.

In August 2018, Simon and Joanne Holding bought Hall Farm. This was a five-bedroom country house with two-bedroom cottage, staff flat and extensive equestrian facilities, covering around 41 acres in total, roughly 24 acres of which was fields.

The couple accepted that all of the land, excluding the fields, was part of the property's grounds as it enabled the better enjoyment of the dwelling. However, they believed that the fields were non-residential property, resulting in the lower, non-residential rate of SDLT applying.

By contrast, HMRC argued that the property, together with all of the land, constituted the property and related grounds, meaning that the residential rates applied.

Decision

The First Tier Tribunal considered the nature of the land at the time of completion, the effective date for SDLT purposes but added that the use of the property since that date may shed some light on the question of whether the fields were part of the grounds at the time of the transaction.

The Tribunal pointed out that if just one of the fields, or indeed part of one of the fields did not form part of the grounds, then the land would fall to be treated as non-residential property and the lower rate of SDLT would be applicable. For example, Field 11 was argued not to be part of the grounds as it was not used for equestrian activities, it could not be viewed from the farmhouse and was used all year round for agricultural activities, namely the growing and cropping of grass for haylage.

The Tribunal stated that the most significant factor in identifying the grounds of a dwelling is the nature of the dwelling and the land, and the relationship between the dwelling and the land. At the time of the transaction, the property had been developed so that it had extensive equestrian facilities including stabling for 8 horses.

The Tribunal acknowledged that there was an informal agreement with an agricultural contractor to look after the fields in return for haylage but found that this did not constitute commercial use of the fields stating that "the fields were not being actively and substantially exploited on a regular basis for any commercial advantage to the vendors."

The fields, including field 11, were available for use by the vendors as winter grazing and for riding their horses. The fields also gave the option to keep other domestic animals, such as their donkey and alpacas.

Further, the fields add to the rural character of the property, providing a degree of privacy from neighbouring land.

The appeal was dismissed.

Simon and Joanne Holding v HMRC (TC09141)

Administration

HMRC third party notices (Lecture P1445 – 12.09 minutes)

This article considers formal information notices issued to a third party by HMRC under the provisions of Schedule 36, Paragraph 2, Finance Act 2008. Please note that there are specific rules for partnerships, groups of undertakings (in certain circumstances), and pensions matters, which are not considered in this article.

What is a third-party notice?

A third-party notice is a notice issued under the provisions of Schedule 36, Paragraph 2, Finance Act 2008. That legislation provides that "an officer of Revenue and Customs may by notice, in writing, require a person

a) to provide information, or

b) to produce a document

if the information or document is reasonably required by the officer for the purpose of checking the tax position of another person whose identity is known to the officer ("the taxpayer")".

The notice must name the taxpayer to whom it relates, unless the tribunal has approved the giving of the notice and disapplied this requirement (see below).

Notice approval

The officer must, generally, obtain approval before a third-party notice can be issued. The officer has, broadly, two options when seeking approval for the issue of the notice. One option is for the officer to seek the approval of the taxpayer for the issue of the third-party notice. In practice, when pursuing this option, the officer will write to the taxpayer setting out the information or documents that will be requested from the third party.

Alternatively, the officer can seek approval from the tribunal. An important distinction between the two approaches is in relation to the appeal rights of the recipient (please see below). The legislation (Schedule 36, Paragraph 3(3), Finance Act 2008) provides that the tribunal may not approve the giving of a third-party notice unless:

a) an application for approval is made by, or with the agreement, of an authorised officer of Revenue and Customs,

b) the tribunal is satisfied that, in the circumstances, the officer giving the notice is justified in doing so,

c) the person to whom the notice is to be addressed has been told that the information or documents referred to in the notice are required and given a reasonable opportunity to make representations to an officer of Revenue and Customs,

d) the tribunal has been given a summary of representations made by that person, and

e) in the case of a third-party notice, the taxpayer has been given a summary of the reasons why an officer of Revenue and Customs requires the information and documents.

The provisions at c) to e) can be disapplied if the tribunal is satisfied that to do otherwise might prejudice the assessment or collection of tax. The tribunal can also disapply the requirement to name the taxpayer in the notice if it is satisfied that the officer has reasonable grounds for believing that naming the taxpayer might seriously prejudice the assessment of collection of tax.

The officer does not need to obtain approval for issuing a third party notice where that document refers only to the person's VAT statutory records relating to the supply of goods or services, the acquisition of goods from an EU member state, or the importation of goods from outside the EU in the course of carrying on a business (there are other circumstances where approval is not needed, but they are outside the scope of this session).

Appeals and penalties

The recipient of a third-party notice approved by the other, named, person has the right to appeal against the notice or any requirement in the notice. However, there is only one ground of appeal - that it would be unduly onerous for the third party to comply with the notice or a requirement in the notice.

There is no right of appeal against:

- a requirement to provide information or produce any document that is part of the named person's statutory records;
- a notice that requires only statutory records, information or documents, of any person relating to the:
  - supply of goods or services;
  - acquisition of goods from an EU member state;
  - importation of goods from outside the EU in the course of carrying on a business;
- a third-party notice that has been issued with the approval of the tribunal.

As with other information notices, there are penalties for non-compliance in relation to a third-party notice. Penalties can be applied for failing to provide information or documents requested, or documents are concealed or destroyed. There is a right of appeal against the penalties, and there will not be a penalty if there is a reasonable excuse for the failure, concealment or destruction. There is also a criminal offence of concealing or destroying documents which are, or HMRC have said may be, required by an information notice which has been approved by the tribunal. This will only be considered in very serious cases.

Miscellaneous points

The officer must issue a copy of the third-party notice to the named person when it is sent to the third party. However, this provision does not apply where HMRC consider that giving a copy to the named person might prejudice the assessment or collection of tax, and the tribunal agrees.

The tribunal needs to be satisfied that there are reasonable grounds for believing that giving a copy of the notice to the taxpayer will prejudice the assessment or collection of tax (Finance Act 2008, Schedule 36, Paragraph 4).

When HMRC want to obtain information about a known taxpayer from a bank, they will, usually, use a Financial Institution Notice, to which specific rules apply, and are not considered here. However, where the information required relates to an account of the taxpayer’s spouse or partner, or is in joint names, officers are instructed to consider the issue of a third-party notice to the spouse, etc, before approaching the financial institution.

In relation to a deceased person, HMRC cannot issue a notice for checking their tax position more than four years after the person’s death.

The general restrictions, and general rules, that apply to information notices apply to third party notices (including restrictions on the items that can be requested, and the time to comply with a notice).

HMRC approach

HMRC’s guidance to its officers is that they should try, wherever it is possible and practical to do so, to get the information or documents they need from the person whose tax position they are checking, before approaching another person for them (see CH23620).

Officers are told that they should normally seek the information or documents from the taxpayer, where it is reasonable to assume that those items are within the taxpayer's power to provide. The officer should, if necessary, issue a taxpayer notice and take penalty action if they do not apply. The guidance continues that only if that approach fails should the officer consider approaching a third party for the items needed. Where the information or documents are not in the power of the taxpayer under enquiry, or HMRC need to verify facts independently, an approach will not be made to the taxpayer.

Practical considerations

Where the adviser is aware that information or documents are needed from a third party, they should, ideally, approach the third party to obtain what is required. This will help to reduce the impact on what might be a sensitive commercial relationship. Where that is not possible, it is, usually, prudent for the taxpayer client to approve the issue of the third-party notice if requested by HMRC (subject to consideration of what is being requested).

However, the adviser, or taxpayer, may not be aware that HMRC are contacting, or intending to contact, the third party. The taxpayer does not have the right to make representations to HMRC, although they may be notified why HMRC requires the information and documents from the third party. Even where the taxpayer is aware that the HMRC are intending to obtain approval from the tribunal for the issue of a third-party notice, the taxpayer, or the third party, are entitled to be present at the hearing.

If a client receives notification, as a third party, that HMRC is going to seek information or documents from them in relation to a taxpayer, it is, usually, prudent to issue those items in response to a formal notice, rather than providing the information or documents voluntarily. In those circumstances, the information has been provided to HMRC in response to a legal notice, which may help minimise the damage to the relevant commercial relationship.

Contributed by Phil Berwick, Director at Berwick Tax

Deadlines

1 July 2024

- Corporation tax for periods to 30 September 2023 if not liable to pay by instalments

5 July 2024

- Application for a PAYE settlement agreement for 2023/24
- Deadline for non-resident landlords' scheme forms NRLY and NRL6

6 July 2024

- Submit 2023/24 forms P9D, P11D, P11D(b) and benefits information to employees
- Taxed award scheme returns
- Report redundancy packages 2023/24 worth more than £30,000

7 July 2024

- Electronic filing and payment of VAT liability for 31 May 2024
- Election to aggregate beneficial loans in 2023/24

19 July 2024

- PAYE for month to 5 July 2024 if by cheque and for quarter to 5 July 2024 if average monthly liability is less than £1,500
- Class 1A NIC 2023/24 by cheque

22 July 2024

- PAYE liabilities if paid online
- Class 1A NIC 2023/24 online

31 July 2024

- Accounts to Companies House
  - private companies with 31 October 2023 year end
  - plcs with 31 January 2024 year end
- Second 5% surcharge for unpaid 2022/23 balancing payments
- 2023/24 second instalment SA liabilities due
- Tax credits claims to be renewed

Business taxes

Basis period reform - tax repercussions (Lecture B1442 – 24.39 minutes)

The new tax year basis

The previous rules for taxing self-employed individuals date back to the mid-1990s and were themselves derived from a *modus operandi* which came into being in the early 1920s. They were straightforward enough for the vast majority of sole traders and most business partnerships drawing up their annual accounts for a period which tied in with the tax year (or to 31 March which, in practice, HMRC normally treated as being equivalent to 5 April). However, choosing an accounting date which was not coterminous with the tax year end was likely to create, HMRC said, 'complexities that lead to businesses making many thousands of tax return errors every year'.

What the Government therefore decided to do in FA 2022 was to reform the concept of basis periods by moving from a current year basis to a tax year basis. In other words, the profits and losses of a tax year are to be those arising in the tax year (often referred to as 'actual'). A sole trader with a 30 April year end date will find that his taxable profits for 2024/25 are based on:

- 1/12th of his profits for the year ended 30 April 2024; and

- 11/12ths of his profits for the year ended 30 April 2025,

whereas, under the previous code, his taxable profits would have comprised his profits for the year ended 30 April 2024.

Strictly speaking, any apportionment for non-tax year trading businesses should be done on a daily basis, but a different time-apportionment mechanism (e.g. by months) can be used as long as it is reasonable and is applied consistently. In all cases, the figures to be apportioned are the tax-adjusted profits or losses, i.e. after dealing with disallowable expenses and capital allowances.

These revised rules take effect for 2024/25 onwards, with 2023/24 being treated as a special transitional year.

Impact of the transitional year

The procedure for calculating taxable profits for a continuing trade for 2023/24 is:

> Start with the profit for the current year basis period. Let us assume that this involves the year ended 30 June 2023.
>
> To this must be added the profit of the 'transition part' defined as:
>
> – beginning immediately after the end of the 'standard' basis period for 2023/24; and
>
> – ending with 5 April 2024.

In other words, we are looking at the results of a nine-month period which runs from 1 July 2023 and ends on 5 April 2024. Where necessary, the usual apportionment rules are applied.

A deduction is then given for the overlap profit which would have been allowed if the trade had actually ceased on 5 April 2024. In practice, this has sometimes proved to be unexpectedly hard to establish.

The resulting figure represents the potentially assessable profits for 2023/24.

However, it should be remembered that FA 2022 contains a special election for the spreading forward of the transition profits (net of any overlap relief) over a five-year period, starting with 2023/24.

The transition profits are defined as the difference between:

- the potentially assessable profits for 2023/24 (see above); and
- the current year basis figure for 2023/24.

Where the former figure is greater than the latter, an election can be made to spread the excess evenly over the five years from 2023/24 onwards. However, there is no requirement that the spreading element has to be an exact one-fifth. It can always be accelerated to any amount of the transition profits not previously charged to tax. Where the former figure is smaller than the latter, there is no spreading.

Example 1

Anthony is an established sole trader whose accounting date is 30 April. His profits for the year ended 30 April 2023 were £55,000. For the year ended 30 April 2024, they are £66,000. Anthony has overlap profits brought forward amounting to £20,000.

Anthony's potentially assessable profits for 2023/24 are calculated as follows:

	£
Current year basis (year ended 30 April 2023)	55,000
Add: Transition part (1 May 2023 – 5 April 2024)	
11/12 x 66,000	60,500
	115,500
Less: Overlap relief	20,000
	95,500

These profits exceed the profits determined under the current year basis by £40,500 (£95,500 – £55,000) and so Anthony can spread the excess over five years. The amount to be added to his 2023/24 assessment is:

£40,500 ÷ 5	£8,100

Anthony's profits for 2023/24 are therefore £55,000 + £8,100 = £63,100. This adjustment of £8,100 must also be made for each of the next four tax years, unless he opts for a larger adjustment.

Example 2

Boris is an established sole trader whose accounting date is 30 June. His profits for the year ended 30 June 2023 were £35,000. For the year ended 30 June 2024, they are £20,000. Boris has overlap profits brought forward amounting to £30,000.

Boris' potentially assessable profits for 2023/24 are calculated as follows:

	£
Current year basis (year ended 30 June 2023)	35,000
Add: Transition part (1 July 2023 – 5 April 2024)	
9/12 x 20,000	15,000
	50,000
Less: Overlap relief	30,000
	20,000

These profits do not exceed the profits of £35,000 determined under the current year basis. There is no spreading and Boris' assessable profits for 2023/24 are £20,000.

Calculation of income tax liability on the transition profits

Special rules found in Para 75 Sch 2 FA 2022 apply to calculate the trader's liability to income tax on the transition profits. These modify the normal calculation routine in S23 ITA 2007 such that the transition profits are treated as a separate component of total income. As a result:

(i) any relief which is deductible under S24 ITA 2007 at Step 2 of S23 ITA 2007 (e.g. trading loss relief against general income under S64 ITA 2007) is set, if necessary, against the transition profits at this stage;

(ii) any remaining profits are removed from the calculation of 'net income' (Step 2);

(iii) a standalone amount of income tax is calculated on the left-out profits; and

(iv) this tax is added back at Step 4.

The standalone tax added back at Step 4 is the difference between:

(i) the tax which would have been payable had the transition profits remained in net income; and

(ii) the tax which would have been payable had the transition profits been removed from net income.

Calculating the tax in this way allows the trader's personal allowance to be deducted from the transition profits in Step 3. It also allows the tax reducers in S26 ITA 2007 (e.g. the EIS, SEIS and VCT reliefs) to be set against the tax arising on the transition profits.

Effect of this regime on various tax provisions

The following technical details should be noted:

1. The HICBC threshold is based on 'adjusted net income' (as defined by S58 ITA 2007). Because transition profits are excluded from net income, the existence of transition profits should not, on their own, cause this threshold to be breached.

2. The pension annual allowance taper for high-income individuals in S228ZA FA 2004 uses one half of the excess of the taxpayer's 'adjusted income' over £260,000 (subject to a £10,000 minimum). The starting point for this calculation is the individual's net income and so the level of transition profits should not adversely affect annual allowance tapering.

3. Transition profits will, however, count towards 'relevant UK earnings' for the purposes of tax relief on pension contributions. This phrase is defined in S189(2) FA 2004 and, although doubts have been expressed about the correctness of this understanding, HMRC have recently confirmed the veracity of the statement.

4. Tapering of the personal allowance occurs where the taxpayer's adjusted net income exceeds £100,000. As mentioned in above, transition profits are excluded from net income and so it might be thought that such profits should be ignored in this context. Unfortunately, this is not the case. The calculation requires a comparison between the tax payable if the amount of the transition profits were left in net income versus the tax payable if they were excluded. Thus the personal allowance taper may still be felt if the amount of transition profits takes the adjusted net income figure over £100,000. For example, if, in 2023/24, a trader has current year basis profits of £100,000 and transition profits (after spreading) of £9,000, he will lose ½ x £9,000 = £4,500 of his personal allowance when calculating the tax on the transition profits.

5. Another difficult area is whether transition profits can affect CGT rates. By virtue of S1I TCGA 1992, higher rates of CGT are in point where an individual's income 'is chargeable to income tax at a higher income tax rate'. The speaker's view is that CGT rates are not affected by the existence of transition profits. Such profits are not charged to any particular rate of income tax – they suffer a standalone tax charge. In addition, removing transition profits from net income means that they do not use up any part of the taxpayer's basic rate band. It is believed that HMRC agree with this analysis.

Contributed by Robert Jamieson

Flawed post-cessation trade relief (Lecture B1441 – 23.51 minutes)

Summary – With HMRC's enquiry being out of time, the taxpayer's claim for post-cessation trade relief was allowed, even though the payments did not fall within s.97 ITA 2007.

Anthony Dennison was a partner in Rowe Cohen, a firm of solicitors and also held a 33% interest in Legal Report Services Limited.

The partnership entered into a contract with this company whereby the company would arrange for medical examinations of clients of Rowe Cohen in return for a fee. Anthony Dennison acted as a representative of Rowe Cohen in negotiating those agreements but did not declare his interest in the company to the partnership.

In February 2004, Anthony Dennison sold his shares in the company to Expedia for £1.5 million.

Three years later, in February 2007, the partnership ceased trading and around June 2007, the former partners discovered that Anthony Dennison had sold shares back in 2004. They claimed breach of contract and breach of equitable and common law duties.

In September 2009, a settlement was reached and Anthony Dennison was required to make settlement payments totalling £300,000 to his former partners, split into two payments of £150,000. He also agreed to release his interest in a loan note issued by Expedia, as a result of which Expedia agreed to pay £100,000 to the former partners.

In a letter dated 28 April 2011, he claimed that he amended his 2009/10 tax return, claiming post cessation trade relief of £250,000, being the forfeiture of the loan note of £100,000 and the first settlement payment of £150,000.

In April 2012, Anthony Dennison was struck off the roll of solicitors.

In July 2012, HMRC opened an enquiry in to his 2009/10 return but did not send a copy to his agents, Smith & Williamson. There was also a dispute between the parties as to when this letter was posted and received.

On 28 February 2014, HMRC issued a closure notice disallowing the claim for post-cessation trade relief as the settlement payments related to fiduciary breaches and other duties as a partner, which did not qualify for relief.

On 21 August 2017, following review, Anthony Dennison notified his appeal to the Tribunal arguing that his claim was valid and that HMRC's notice of enquiry contained in the letter dated 27 July 2012 was out of time.

Decision

The First Tier Tribunal reminded us that s.9A TMA 1970 provides that HMRC may enquire into a return by giving notice to the taxpayer within the time allowed. Where a tax return is amended, this is the date up to and including the quarter day following the first anniversary of the date on which the amendment was made. For this purpose, the quarter days are 31st January, 30th April, 31st July and 31st October.

The First Tier Tribunal found that the taxpayer's 2009/10 tax return had been amended on 28 April 2011, meaning the quarter day was 30 April, giving a deadline of 30 April 2012. The

First Tier Tribunal stated that even if HMRC had been correct and the amendment was not received until 1 May 2011, extending the deadline by 3 months, HMRC's enquiry letter dated 27 July 2012, would not have been received before 31 July 2012. In reaching this decision, the Tribunal referred to HMRC's guidance stating that letters sent by second class post should be sent at least four working days before any relevant time limit and where possible at least seven working days before any relevant time limit. The enquiry letter was out of time, the notice was invalid and the appeal allowed.

The Tribunal went on to consider whether, had HMRC issued the notice to enquire within time, whether the post-cessation trade relief claim would have been invalid.

The settlement payments related to claims made against the taxpayer for breach of contract and breach of equitable and common law duties that the taxpayer owed to his former partners.

To qualify as valid post-cessation payments, s.97(2)(b) ITA 2007 requires that the settlement payments must have been made "in respect of defective work done, goods supplied, or services provided in the course of the [relevant trade or profession]". Anthony Dennison claimed that this included payments for defective work by him in negotiating the settlement with the firm's suppliers, Legal Report Services Limited.

The First Tier Tribunal disagreed, stating that it had not been provided with any authority on the extent of the provision and stated that the legislation should be given its natural meaning. The payments were not "qualifying payments" within s.97 ITA 2007. Had the enquiry been within time, the appeal would have been disallowed.

Anthony Dennison v HMRC (TC09153)

Construction Industry Scheme (CIS) – interpreting Regulations

Summary – *There was nothing preventing HMRC reducing any determination of a CIS underpayment – for example, on an 'equitable' basis to reflect the fact that there was no real loss of tax – and that HMRC should interpret the rules more broadly.*

This case highlights a potential mismatch between different parts of the Income Tax (Construction Industry Scheme) Regulations, SI 2005/2045.

Regulation 9 allows HMRC to forgo collection of any CIS duties, where it is fair and reasonable to do so, and reg 13 governs HMRC collection and enforcement of actual duties due. Unfortunately, the case showed the two separate sets of rules do not work smoothly in tandem with each other.

Under reg 9, HMRC is able to forgo collection of CIS deductions in a number of given circumstances. These include where HMRC is satisfied the recipient has already included the income in their own tax returns, as this would otherwise result in 'double taxation'.

For disputed duties remaining unpaid, HMRC may issue a determination under reg 13(2), of its best estimate of the outstanding liability.

This is where the problems arose in this case. Payments had been made from one group company to another without CIS being applied; each company should have registered for CIS purposes but didn't.

HMRC seem to have accepted each business had included the income within its own accounts, i.e. so there was no true loss of tax. Nonetheless, they maintained there was a technical failure to follow CIS regulations which created a liability for the payer.

In HMRC's view, the appeal grounds against any reg 13 determination should be confined to whether any CIS liability does apply, strictly. This is because reg 13(3) also says the determination 'must not include amounts in respect of which a direction under reg 9(5) has been made'. To date, HMRC has therefore taken the unfortunate view that, once a determination has been issued under reg 13, it is not possible to later consider any appeal under reg 9, for example on the basis that it would be simply 'unfair' to pursue collection.

The wording of regs 9 and 13 taken together, would also appear to deny the contractor access to any valid appeal forum, such that its only recourse was to apply for judicial review. However, the Court of Appeal disagreed with HMRC's interpretation: a decision could indeed be made under reg 9 *after* a reg 13 determination had been issued, and the contractor was entitled to apply for judicial review insofar as the normal tribunal appeals process was denied.

Beech Developments (Manchester) Ltd and other companies v HMRC [2024] EWCA Civ 486

Adapted from the case summary in Tax Journal (17 May 2024)

DLA repayments – nature and timing (Lecture B1443 – 12.57 minutes)

Background

There are various potential tax consequences where a director’s loan account becomes overdrawn. For example, there is a possible tax charge on a close company under the ‘loans to participators’ provisions (in CTA 2010, s 455); if the participator is a director or employee, there is a possible benefit-in-kind charge under the beneficial loan rules (in ITEPA 2003, s 175); and if the loan account is released or written off, there’s generally an income tax charge on the participator (under CTA 2010, s 415), and a repayment of any corresponding tax charge for the company on the loan (under CTA 2010, s 458).

It's all in the timing

The timing of overdrawn directors’ loan account credits, repayments, or any release or writing-off of the loan account is equally significant for several tax reasons. For example, the timing will determine the date of payment or repayment of any loans to participator charge for the close company; also, the tax year in which a beneficial loan income tax charge for the director is reduced or ceases altogether; and the tax year in which the repayment, release or writing-off of the loan account is taxable on the participator.

(a) Earnings

There are tax rules to determine when cash earnings are treated as having been received for employment income purposes (in ITEPA 2003, s 18(1)), and different but broadly similar rules to determine when a payment of income is treated as made for PAYE purposes (in ITEPA 2003, s 686(1)). HMRC accepts (following *Garforth v Newsmith Stainless Ltd*, ChD 1978, 52 TC 522) that crediting an account in the employer’s books represents ‘payment’ for these tax purposes (see HMRC’s Employment Income Manual at EIM42270).

In many owner-managed and family companies, directors often draw money from the company during the year, which is debited to their loan account and repaid at the end of the year by crediting earnings voted or declared post-year end. Until then, in the absence of specific evidence to the contrary, the amounts drawn do not actually belong to the director.

Those in-year drawings aren't payments on account of earnings for the purpose of the tax rules which determine when earnings are treated as having been received for employment income and PAYE purposes (see EIM42280).

(b) Dividends

Commonly, an overdrawn loan account of a director shareholder is cleared or reduced by crediting a dividend from the company to the loan account. However, care is needed to ensure that company law requirements are satisfied. For example, the dividend should be properly voted, paid, and formally documented by minutes, dividend vouchers, etc. It's also important to appreciate when a dividend is treated as paid.

A company's articles often distinguish between final and interim dividends, by providing that final dividends may be declared by the company in general meeting, and interim dividends may be paid by the directors from time to time. A final dividend which has been properly declared and which doesn't specify a date for payment creates an immediately enforceable debt. On the other hand, an interim dividend can be varied or rescinded at any time before payment and may therefore only be regarded as due and payable when it's actually paid (*Potel v CIR* (1971) 46 TC 958).

HMRC's view is that payment of an interim dividend isn't made until a right to draw on the dividend exists, which is generally when the appropriate entries are made in the company's books. If the interim dividend entries aren't made until the annual accounts are prepared, and this takes place after the end of the accounting period in which the directors resolved that an interim dividend be paid, the due and payable date will be in the later accounting period rather than the earlier one. This could mean, for example, that an overdrawn director's loan account isn't repaid as early as the company expected.

(c) General repayments

HMRC will not necessarily object to director's loan account repayments via book entries, if those entries reflect the underlying reality of a transaction and are properly recorded in the company's books. But a repayment by book entry will normally be treated as taking place at the date the book entry is made; and in HMRC's view it is only on that date that the relief on loans to participators (in CTA 2010, s 458) is due (see CTM61600).

Which debt?

Many director shareholders will have a single directors' loan account with the company, into which any loans from the company will normally be paid. HMRC's guidance on loans to participators (in the Company Taxation Manual at CTM61600) states that where there are multiple loans or advances on a single loan account, the parties involved (i.e., the participator and/or the company) can specify against which debt they want to set the repayment. Where the debt is not specified, HMRC will generally set the repayment against the earliest debt first, following the rule in *Clayton's Case* [1816] 1 Mer 572. The rule in that case generally applies when a debtor has a 'running account' with a creditor (e.g., a bank account). In such situations, a payment will be allocated against the earliest debt first.

On the other hand, where a debtor makes a payment to a creditor in respect of a specific debt, the debtor may appropriate the money how they please. However, if the debtor does not make any appropriation, the right of appropriation devolves on the creditor. This treatment is in accordance with *The Mecca* [1897] AC 286.

DLA written off: or was it?

In *Plumpton v Revenue and Customs* [2024] UKFTT 367 (TC), the taxpayer was a director and shareholder of a company ('BGH'). The taxpayer had a director's loan account with BGH. In BGH's financial statements for the year ended 31 January 2014, the sum of £783,289 showing as owing to BGH by the taxpayer was recorded as having been written-off in the tax year 2013/14. On the form to reclaim tax paid by close companies on loans to participators', BGH reclaimed from HMRC the tax previously paid on an amount recorded as having been written off by BGH on 29 January 2014 in respect of the director's loan account. However, in the taxpayer's self-assessment return for 2013/14, no mention was made of income received by way of the written-off director's loan account (NB. this was an amended tax return; the taxpayer's original return had recorded as 'other income' a written-off director's loan account sum of £783,289). Following an enquiry into the taxpayer's amended return for 2013/14, HMRC amended the return on the basis that the director's loan account had been written off, resulting in an income tax liability. The taxpayer contended that the director's loan account had not been written off in 2013/14, and so there was no income tax liability thereon.

The First-tier Tribunal concluded from the evidence that the taxpayer had shown it was more likely than not there was no writing-off of his director's loan account on 29th January 2014. Among the reasons for its decision, the tribunal noted there were no relevant documents whatsoever from that tax year showing the directors' loan account being written off. HMRC presented evidence of what it considered to be directors' board meeting minutes (dated 29 January 2015), reflecting a writing-off of the director's loan account on 29 January 2014. However, the tribunal held the document didn't reflect a meeting of the board, and there was compelling evidence that the meeting hadn't occurred. In addition, BGH's tax repayment claim to HMRC (under CTA 2010, s 458) was dated prior to when the minutes were created. The taxpayer's appeal was allowed.

Record keeping

HMRC's Directors' Loan Account Toolkit indicates that there's a possible risk if transactions relevant to director's loan accounts haven't been posted contemporaneously. It states that where a contemporaneous record hasn't been kept, consideration should be given to whether the loan account should be rewritten to identify if it was overdrawn at any point during the year. Keeping the director's loan account up-to-date could therefore save further work in the long run.

Contributed by Mark McLaughlin

Loan relationships unallowable purpose

Summary – Kwik-Fit Group Ltd and others had an unallowable purpose in being party to loan relationships.

Kwik-Fit Group Ltd and others were party to an intra-group debt reorganisation under which:

- loan receivables owed by the appellants were assigned to an intermediate holding company, Speedy 1 Ltd (Speedy 1) (the 'assigned loans');
- new loan receivables were created in Speedy 1's favour (the 'new loans'); and
- the interest rates on the assigned loans, as well as a loan that one of the appellants already owed to Speedy 1 (the 'pre-existing loan'), were increased to reflect the arm's length interest rate at the time.

Speedy 1 had around £48million of non-trading loan relationship deficits (NTLRDs) carried forward from earlier periods.

Under the loss relief rules at the time, the NTLRDs were effectively 'trapped' in Speedy 1 and could not be utilised by other members of the group.

The effect of the reorganisation was to accelerate the use of Speedy 1's NTLRDs through the interest income it received, whilst generating tax relief for the appellants on the interest expenses incurred.

HMRC disallowed the claims for relief, on the basis that the reorganisation engaged the unallowable purpose rule (s.441 – 442 CTA 2009). It capped the disallowance at the amount of Speedy 1's NTLRDs.

The First Tier Tribunal found that, although the appellants initially had a commercial purpose for being party to the assigned loans and the pre-existing loan, they acquired a new (tax avoidance) main purpose for being party to them as a result of the reorganisation. Accordingly, it disallowed the debits on these loans in respect of the increased interest rate. In relation to the new loans, it found that there was only a tax avoidance main purpose for being party to those loans. It therefore attributed all of the debits on the new loans to the unallowable purpose and disallowed all of the interest expense. In relation to all three categories of loans, the First Tier Tribunal agreed with HMRC that the disallowance should be capped at the amount of Speedy 1's NTLRDs.

With the Upper Tribunal dismissing the appeal, the case moved to the Court of Appeal, with the appellants appealing on two principal grounds:

1. The First Tier and Upper Tribunals had erred in concluding that the purpose of the reorganisation was to obtain a tax advantage for themselves. Their purpose, they contended, was confined to accelerating the utilisation of Speedy 1's valid and unrelated NTLRDs. This purpose did not constitute a tax advantage because Speedy 1 was not better off as against HMRC as a result. This purpose also had to be distinguished from the appellants' knowledge that they would obtain deductible debits.

2. The First Tier and Upper Tribunals had erred in their application of the just and reasonable principle.

Decision

The Court of Appeal accepted that there was 'significant force' in the argument that the use of Speedy 1's existing losses did not constitute a tax advantage.

However, it concluded that the 'real benefit' – the one that made the group better off as against HMRC – was the generation of tax deductions for the appellants in circumstances in which the corresponding income was sheltered by reliefs that would otherwise have been trapped in Speedy 1. The arrangements had the economic effect of releasing the NTLRDs trapped in Speedy 1 for use by the group as a whole.

The NTLRDs could not be accessed directly under the rules at the time, so they were indirectly utilised by creating deductions in the appellants and using Speedy 1's losses to absorb the resulting income.

The Court of Appeal also rejected as 'unreal' the appellants claim that there was a distinction to be drawn between their (acknowledged) purpose of accelerating the use of Speedy 1's losses and their subjective knowledge that a tax deduction would be unavailable as a result. The First Tier Tribunal had been right to find a single unallowable purpose in the combined 'group purpose' of the arrangements.

One aspect of the appellants' arguments, not raised at the First Tier Tribunal, was that HMRC had not identified any actual tax saving resulting from the arrangements as the appellants were loss-making. However, the Court of Appeal dismissed this as irrelevant. The unallowable purpose rule required a consideration of subjective intentions, i.e. what is sought to be achieved, not what is actually achieved.

The Court of Appeal also rejected the second ground of appeal. It held that, given the First Tier Tribunal's findings of fact that (i) the main purpose of increasing the interest rates on the assigned loan and the pre-existing loan was a tax avoidance purpose, it was entitled to disallow all the debits in respect of the increased interest rate, and (ii) the only main purpose of entering into the new loans was a tax avoidance purpose, it was entitled to disallow the debits on the new loans.

Kwik-Fit Group Ltd and others v HMRC [2024] EWCA Civ 434

Adapted from the case summary on Tax Journal (17 May 2024)

Interest on recurring loans

Summary - Interest on recurring loans was yearly interest (even if the duration of individual loans was less than a year) and the UK tax resident company, which was the recipient of the interest, was not beneficially entitled to the interest so that the UK to UK withholding tax exemption did not apply. Consequently, UK income tax should have been deducted from the interest payments.

The borrower, a UK resident taxpayer and the parent of a group engaged in UK property investment, financed its activities with loans from multiple lenders.

In 2004, the loan terms were changed with the aim of the interest not being taxable in the UK, so:

- each lender assigned its right to interest (and also its right to the principal) to a Guernsey resident entity for consideration shortly before the interest was due: from 2012, after being assigned to the Guernsey entity, the interest was assigned again to Houmet, a UK incorporated and tax resident company;

- a day or two after the assignment, interest was paid and the principal repaid; and
- then the relevant lender advanced a new loan equalling or exceeding the amount of its previous loan to the borrower: the new loan being funded by the proceeds of the loan assignment.

The cycle of assignment, repayment and new advance normally occurred on an annual basis or sometimes at a longer interval.

Decision

The Court of Appeal dismissed the borrower's argument that the Upper Tribunal had erred in deciding that the interest was yearly interest when the individual loans endured for less than a year but were 'routinely replaced by further loans [of the same or a larger amount] from the same lenders'.

The First Tier and Upper Tribunals had not made a legal error because they had applied the correct legal approach and because 'the loans were in the nature of long-term funding, were regarded by the lenders as an investment and formed part of the capital of the business, with a permanency that belied their apparent short-term nature … It makes no difference to this whether an individual loan happened to last for less than a year.'

Applying the case law principles on the meaning of 'beneficially entitled' and construing the term purposively in accordance with the *Ramsay* principle, the Court of Appeal decided that the First Tier Tribunal and the Upper Tribunal had 'correctly concluded that [the UK to UK withholding tax exemption did not apply because] Houmet was not beneficially entitled to the interest assigned to it'.

The Court of Appeal also noted that:

- even if Houmet may have been required to bring the interest received into account for corporation tax purposes, this was not sufficient to avoid the need to determine whether it obtained any benefit from its entitlement to the interest;
- the Court of Appeal did not endorse the suggestion (made in para 28 of the Upper Tribunal's decision) that 'mere payment on by the recipient company to an entity outside the UK may be enough to disapply (s.933 ITA 2007)'; but
- there was something else about the interest paid to Houmet that made a difference (see below).

This decision highlights that yearly interest includes interest paid on loans that endure for less than a year where those loans are 'routinely replaced by further loans [of the same or a larger amount] from the same lenders'.

On upholding the decisions of the First Tier Tribunal and the Upper Tribunal that Houmet (the UK tax resident recipient of the interest) was not beneficially entitled to the interest and therefore the UK-to-UK exemption from withholding tax could not apply, the Court of Appeal provided the following detailed reasoning:

> 'Hargreaves was unable to establish that, viewed realistically, the transactions conferred any benefit of an entitlement to the interest. There was no evidence to suggest that Houmet could have used the funds received for any other purpose,

> or that it could benefit from them in any other manner. There was no indication that it derived any meaningful margin or other profit from its participation in the arrangements. Further, Houmet's involvement was entirely ephemeral, being confined to successive assignments of interest very shortly before the loans in question were repaid. There is no suggestion that Houmet was either at risk as to the amount that might be paid, such that it might not be put in funds to pay for the assignment to it, or that it might be able to benefit from the receipt being higher than anticipated'.

It is also worth noting that the decisions of the Upper Tribunal (which upheld the decisions of the First Tier Tribunal) that the interest had a UK source and that the Guernsey/UK double tax treaty did not disapply the withholding tax obligation were not before the Court of Appeal and therefore not considered by it.

Hargreaves Property Holdings Ltd v HMRC [2024] EWCA Civ 365

Adapted from the case summary in Tax Journal (23 April 2024)

'Total relevant expenditure' for R&D (Lecture B1441 – 23.51 minutes)

Finance Act 2024 contained an amendment to the definition of 'R&D intensive' for the purpose of entitlement to 86% enhancement and 14.5% payable credit. It is 40% (30% for accounting periods beginning from 1 April 2024) of 'total relevant expenditure' aggregated with connected companies' relevant expenditure.

Total relevant expenditure is now defined as (inserted as s.1045ZA into CTA 2009) expenditure:

- Brought into account under GAAP in calculating the profits of any trade carried on by the company, or
- In respect of which the company is entitled to relief under s.1045 (pre-trading expenditure), or
- Any amounts deductible in the tax computation under s.1308 (capitalised qualifying development costs)

To avoid double counting expenditure incurred with connected companies is ignored as is amortisation of capitalised development costs if they were included in total relevant expenditure when incurred.

Previously, it either said or it was proposed that a company had to exclude costs which were not deductible for tax purposes.

Pillar 2 taxes: Covered tax balance – Part 2 (Lecture B1444 – 23.23 minutes)

Introduction

The 'total deferred tax adjustment amount' is included in the calculation of the covered tax balance.

The 'total deferred tax adjustment amount'

1. Covered taxes paid/ refunded in the current period relating to an uncertain tax position excluded in an earlier period (see above);

2. Credit/refund relating to a tax credit that is not a qualifying refundable tax credit and has not been reflected in qualifying current tax expense of the current or a prior period;

3. Covered taxes refunded/credited other than a qualifying refundable tax credit;

4. 'Special loss' deferred tax assets used in the current period (see below);

5. Covered taxes recorded in OCI relating to amounts included in the adjusted profits which are subject to covered taxes;

6. Covered taxes relating to changes in accounting policy/prior period errors included in this period's adjusted profits;

7. Amounts allocated to the member from another MNG member.

Total deferred tax adjustment amounts (s.182)

The starting point is the deferred tax expense relating to covered taxes reflected in the member's underlying profit.

This is then adjusted to exclude:

- DT expense related to items not reflected in the member's adjusted profits;

- DT expense related to disallowed accruals or unclaimed accruals;

- Impact of a valuation adjustment or accounting recognition adjustment with respect to a deferred tax asset (e.g. if a DT asset is not recognised because it is assessed that it is not probable that the asset will be recovered in the foreseeable future, it is still assumed to be recognised when calculating the adjusted deferred tax in this section);

- DT expense arising from a re-measurement due to a change in the rate of tax;

- DT expense that reflects the generation or use of tax credits.

Unclaimed accruals (s.182)

If a DT liability is reversed in an accounting period (hence reducing deferred tax expense), and the liability was originally treated as an 'unclaimed accrual' in a previous period, the DT is increased to ignore the reversal.

The unclaimed accrual is the increase in a DT liability reflected in the member's underlying profits for an accounting period that is not expected to be reversed before the end of the 5th accounting period after that period, and in respect of which the filing member has elected not to include in the total DT adjustment amount for that period.

A disallowed accrual is any movement in DT expense included in the member's underlying profits which relates to either:

1. An uncertain tax position, or
2. Distributions from another member of that group

Other DT adjustments (s.183)

Where a DT asset is not reflected in the DT expense only as a result of the recognition criteria not being met, that DT asset is reflected in the total DT adjustment amount.

Where a recaptured DT liability (relating to a timing difference that does not reverse within 5 years) for a previous accounting period is reversed during the accounting period, it is included in the total DT adjustment amount.

The recaptured DT liability excludes accelerated capital allowances, R&D expenses, FV gains and losses, FX gains and losses and gains rolled over.

Where the DT expense related to covered taxes where the rate is greater than 15%, the amount of that expense (after adjustment as above) is adjusted so that it reflects the amount it would have been had the rate been 15%.

Example

An entity in a foreign territory with a 31 December year-end purchases an intangible asset for £1.2 million on 30 June 2024. The tax law in the territory gives 100% tax relief when purchased.

The company will amortise the intangible asset over its estimated useful life of 8 years on a straight-line basis.

The relevant tax rate in the territory is 15%.

Analysis

The entity would recognise a DT liability on 30 June 2024 of (15% x £1.2 million) £180,000 with a corresponding deferred tax expense in P&L.

The DT liability would be amortised to the DT expense (as a credit) in the profit and loss account as the asset is depreciated.

By 31 December 2024, the asset will have been depreciated by 6 months (out of 8 years), i.e. by 6.25%.

As a result, the net DT expense recognised in respect of the asset at 31 December 2024 will be (180,000 - 6.25%, or £11,250), i.e. £168,750.

£22,500 of the remaining deferred tax balance will reverse out each year for the following 5 accounting periods (£112,500 in total).

This leaves (168,750 – 112,500) £56,250 which will reverse out more than 5 accounting periods after the initial period.

The recaptured deferred tax liability is therefore £56,250.

The recaptured DT liability is excluded from the covered DT adjustment amount for the initial period and the effective tax rate and the top-up amounts must be recalculated for the initial period, i.e. the DT expense for the year ended 31 December 2024 would need to be reduced by £56,250 if this was the DT liability still outstanding at 31 December 2029 in respect of the asset purchased.

Existing DT balances on entering Pillar 2 (s.185)

Each DT asset and liability as at the start of the first accounting period to which Pillar 2 applies is taken into account in determining the DT expense.

If the nominal rate related to the asset is less than 15% and the member can demonstrate that a DT asset relates to a loss which would have been taken into account in determining adjusted profits if those profits were subject to Pillar 2, the asset is taken into account in calculating the DT expense as if the rate of tax to which the asset related was 15%.

If not, each asset and liability is calculated as the smaller of the actual nominal rate or 15%.

To the extent that a DT asset is not recognised because it is not considered probable that it will be recovered in the foreseeable future, it is recognised for this purpose and is included in the net DT expense as if it was recognised.

Where a DT asset relates to a tax credit, on its reversal, if the nominal tax rate exceeds 15%, the amount of reversal (and therefore DT expense amount) is treated as the amount of DT expense in the underlying profit x 15% and divided by the nominal tax rate applying on the reversal.

DT assets are ignored where they arose to a member on a transaction after 30 November 2021 and before the first period subject to Pillar 2 where the item is included in the taxable income but would not have been included in the adjusted profits had Pillar 2 applied then, or vice-versa.

DT assets recorded at less than 15% (s.186)

Where a member of an MNG has an adjusted loss and the value of a DT asset was computed using a tax rate of less than 15%, the member can elect for the DT asset to be computed using a tax rate of 15%.

If the loss on which the DT asset is based exceeds the adjusted loss, the ‘relevant part’ of the asset (i.e. the adjusted loss) is treated as having been computed using a tax rate of 15%.

Special loss DT assets election (s.187)

The filing member can make an election that covers standard members in a particular territory. It must be made to have effect for the first accounting period to which Pillar 2 applies and, if revoked later, cannot be made again. An election cannot be made for a territory that has an ‘eligible distribution tax system’ (ss188 – 192).

The result of the election is that none of the members in that territory has a total deferred tax adjustment amount for the period and if those members have, between them, made a loss, the amount of the loss multiplied by 15% is a special loss deferred tax asset of those members.

If the members of that territory have, between them made a profit, and the members have one or more special loss deferred tax assets, they must use those assets in that period to increase their covered tax balances as follows:

1. The amount of the special loss deferred tax assets that is to be used is the smaller of the amount of the assets, and the amount which would cause the effective tax rate of the standard members of the group in that territory to be 15%

2. Any remainder continues to be a special loss deferred tax asset of the relevant members (and is carried forward to later accounting periods)

Each of the members that made a profit in that period must use the proportion of the total amount in proportion to its adjusted profits compared to the total adjusted profits of all the members that made a profit.

Eligible tax distribution systems (ss.189 – 192)

The filing member can elect that a deemed distribution tax arises (s.190) to the standard members in a territory, if it has an eligible tax distribution system, i.e. where tax at a rate of at least 15% is generally only payable by a company when profits are distributed (or deemed to be distributed) to its members, or when it incurs certain non-business expenses, and the system was in force on or before 1 July 2021.

The legislation details the deemed distribution tax amount, certain 'recapture' amounts and recalculations when a member leaves the group.

Contributed by Malcolm Greenbaum

VAT and other indirect taxes

Skin treatments (Lecture B1441 – 23.51 minutes)

Summary – Skin treatments were not exempt medical care, but HMRC's assessment was not issued in time.

Gillian Graham qualified as a registered general nurse in 1994, initially working as an NHS intensive care nurse and then later, for large skin care clinics. From October 2001, she ran her own clinic in London under the name "Skin Science".

In 2011, she qualified as a nurse prescriber. Having assessed and diagnosed a client's issue, she was then able to prescribe the medication that she would be issuing as a skin care provider.

Typically, patients attended her clinic by choice and were not referred to her by a GP, specialist doctor or psychologist. Gillian Graham stated that the vast majority of her patients came to her as they are suffering from medical conditions caused by "UV damage" and were sometimes referred to her by beauticians who were unable to carry out the treatment required.

On 25 April 2017 HMRC wrote to Gillian Graham explaining that, from information provided in her Self Assessment returns, she had been trading in excess of the VAT registration threshold.

She replied, stating that she did not need to be registered for VAT as she was a registered general nurse and her work consisted of providing exempt medical care for patients.

Subsequently, HMRC wrote, stating that there was insufficient evidence to conclude that her supplies were VAT exempt. HMRC argued that the treatments were "overwhelmingly cosmetic and so do not satisfy the requirements of the medical care exemption." HMRC stated that she would be compulsorily registered for VAT from 1 May 2007. This was formally noted in January 2018.

HMRC issued a best judgement VAT assessment on 7 September 2018 for the period 1 May 2007 to 28 February 2018.

Believing that all her treatments qualified for exemption, Gillian Graham submitted a "nil return" on 27 October 2020, albeit with the period starting from 1 November 2007, rather than 1 May 2007, which resulted in the previous assessment being "cancelled" or "superseded". HMRC issued a new assessment on 18 March 2021.

Gillian Graham appealed against both the compulsory registration notified in January 2018 and the VAT assessment issued in March 2021.

Decision

To fall within the medical exemption for VAT, Gillian Graham needed to satisfy the First Tier Tribunal that the principal purpose of the treatments was for the protection, including the maintenance or restoration of health.

The Tribunal found that she had failed to do so. None of her patients had been referred to her by medical specialists. Which could be seen as an indication of her patients seeing their treatments as cosmetic rather than therapeutic. Indeed, patient reviews obtained by HMRC from the internet were focused generally on the cosmetic aspects of their treatment. Further, her advertising was indicative of the treatments being intended for cosmetic rather than therapeutic purposes, their focus being on improving appearance. The First Tier Tribunal concluded that the treatments offered included: fillers, hyalauronic acid, botox/toxin and retinol. These were 'overwhelmingly cosmetic' and did not fall within the medical exemption.

Both parties agreed that the relevant time limit was 'one year after evidence of facts, sufficient in the opinion of the Commissioners to justify the making of the assessment, comes to their knowledge' (S.73(6)(b) VATA 1994).

HMRC argued that the new assessment was issued within time. However, the only new information supplied, which caused HMRC to issue the March 2021 Assessment, was the taxpayer’s nil return.

Gillian Graham argued that submitting a nil return was not new information for this purpose. The First Tier Tribunal stated 'that if an existing in-time assessment was cancelled mandatorily by reason of submission of a nil return, submission of that nil return and its contents and the extinguishment of the taxpayer's liability <u>could</u> be evidence of facts justifying the issue by HMRC of a new assessment.'

However, in this case, the nil return did not contain any new information. Although it contained a slightly different period and a slightly different amount, those differences were determined by facts known to HMRC more than a year prior to the assessment. The nil return itself “was not evidence of facts for the purpose of s 73(6)(b)”.

The Tribunal stated that the issue to determine was whether the 2018 Assessment was automatically cancelled or extinguished by submission of the nil return. The First Tier Tribunal was not provided with any statutory reason why the submission of a nil VAT return must cancel a previous in-time assessment. It was 'simply a consequence of the administrative system put in place by HMRC.' The submission of the nil VAT return was not a fact that justified the later assessment. With the later assessment issued based on facts known to HMRC more than one year before it was issued, it was not made within time and this appeal was allowed.

Gillian Graham T/A Skin Science v HMRC (TC09152)

VAT assessment within one-year time limit (Lecture B1441 – 23.51 minutes)

Summary – HMRC's VAT assessment had been made within the time limit set out in s.73(6)(b) VATA 1994.

On 29 April 2019, HMRC assessed Nottingham Forest Football Club Limited for VAT of approximately £350,000 for the period 08/15. The assessment arose as a result of errors that had innocently arisen following a change in the company's accounting systems. The VAT assessed was not under dispute, but rather the company claimed that the assessment had been issued out of time.

Section 73(6)(b) VATA 1994 states that an assessment shall not be made later than:

- two years after the end of the prescribed accounting period; or
- one year after evidence of facts, sufficient in the opinion of HMRC to justify making the assessment, comes to its knowledge

Nottingham Forest Football Club Ltd argued that HMRC had the required facts on 20 April 2018. Having visited the club on 16 April to understand the business and its accounting systems, the HMRC officer returned on 20 April 2018 to examine invoices and download general ledger data from current/new accounting system. Raising an assessment on 29 April 2019, meant that the 12-month deadline had expired.

HMRC argued their knowledge of the facts was only complete from 9 May 2018, when a back-up memory stick containing data from the club's previous accounting system was collected by the HMRC officer. On this basis, the assessment raised on 29 April 2019 was within time.

The First Tier Tribunal found in HMRC's favour and the case moved to the Upper Tribunal.

Decision

The Upper Tribunal's decision was neatly summarised in Tax Journal (31 May 2024) as follows.

The first ground of the taxpayer's appeal was that the First Tier Tribunal failed to apply the correct test for the one-year rule as set out in *Pegasus Birds Ltd v C&E Commrs* [1999] STC 95. In particular, the club suggested that email correspondence in May 2018 showed that the HMRC officer had everything he needed to make the assessment from the Navision data provided on 20 April 2018. However, the First Tier Tribunal had found that submissions made about the Sage data (provided on 9 May) were unsupported and therefore had to be disregarded. The Upper Tribunal considered that this ground must fail due to the absence of evidence provided to the First Tier Tribunal.

The second ground pertained to the burden of proof. The club disputed that the burden of proof fell on the taxpayer. Despite the volume of case law on the one-year time limit it appeared that there had never been a challenge to the proposition that the taxpayer bears the burden of proof. The Upper Tribunal concluded that it made sense for the appellant to have the burden of showing the assessment was made out of time. It was true that once the taxpayer had made a prima facie case then the evidential burden shifted to HMRC to rebut this with evidence of its own. However, it could not be said that the club had established a prima facie case. This ground was therefore rejected.

A final ground of appeal was made to set aside a finding of fact that had been made 'without any evidence or upon a view of the facts which could not reasonably be entertained' (*Edwards v Bairstow* [1956] AC 14 challenge). However, this ground was also held to be without merit.

Nottingham Forest Football Club Ltd v HMRC *[2024] UKUT 145 (TCC)*

Share sale costs: decision overturned (Lecture B1441 – 23.51 minutes)

Summary – Input VAT incurred as a result of selling shares in a company could not be recovered as there was a direct and immediate link with an exempt supply.

Hotel La Tour Ltd owned a 100% subsidiary, a company that owned and operated a luxury hotel in Birmingham. Both companies were part of the same VAT group.

The holding company decided to sell the shares in its Birmingham company and use the proceeds from sale to develop a new hotel in Milton Keynes.

To facilitate the sale, Hotel La Tour Ltd incurred marketing, legal, tax and accountancy fees totalling £382,899.51 plus VAT of £76,822.95. The company filed its 09/17 VAT Return seeking repayment of the input tax incurred.

HMRC commenced enquiries, later concluding that this input VAT was not recoverable.

Hotel La Tour Ltd argued that the professional services were directly and immediately linked to its 'downstream taxable activities' to fund and so develop its Milton Keynes hotel.

On appeal, both the First Tier and Upper Tribunal found in Hotel La Tour Ltd's favour, concluding that the exempt share sale did not break the direct and immediate link with the taxable hotel activity. The purpose of the sale was fundraising, to later use those funds to make taxable supplies.

HMRC appealed to the Court of Appeal.

Decision

The Court of Appeal overturned the decision.

In applying the 'direct and immediate link' test, the First Tier and Upper Tribunals should have first considered if there was a direct and immediate link between the professional services and the exempt share sale. If no such link existed, then and only then should a link have been considered between the company's 'general (downstream) taxable activity'

In this case, the First Tier Tribunal had found that the professional fees were incurred as part of the process of selling the shares and so were directly and immediately linked with the exempt share sale. With such a link existing, the input VAT was not recoverable.

The Court of Appeal found that this position was not changed as a result of the two companies being part of the same VAT group. Hotel La Tour Ltd claimed that its intra-group management services should be disregarded, meaning that it was not engaged in any economic activity. With the share sale being outside the scope of VAT, the related professional fees should be treated as general overheads and the input VAT was therefore deductible as the group as a whole was making wholly taxable supplies. The Court of Appeal disagreed, stating that Hotel La Tour Ltd supplied management services to its Birmingham company, meaning it was engaged in economic activity in the form of managing its subsidiary. “That brings the share sale within economic activity, as an exempt supply.”

HMRC v Hotel La Tour Ltd [2024] EWCA Civ 564

Card fee and reservation service

Summary – A credit card fee charged on to clients did not fall within the financial services exemption but rather, was ancillary to the reservation service, making it standard rated.

SilverDoor Limited provided services to its “property partners” who provided short-term rentals, predominantly to businesses seeking short-term accommodation for employees on temporary assignments.

The company charges commission to its “property partners” for the provision of its services, which include advertising the accommodation, making reservations, collecting client payments. The amount paid to SilverDoor Limited is then paid on to its “Property Partner”, net of its commission.

Where a client pays by corporate credit card, SilverDoor Limited charge a fee for making reservations calculated as 2.95% of the accommodation charge. It is the VAT treatment of these fees that is being questioned in this case.

It was common ground that, where SilverDoor Limited charges this fee, the company is making a supply of services to the client and the fee is consideration received from the client for that supply.

The First Tier Tribunal had found that SilverDoor Limited was providing a reservation service to clients and characterised the fee as an amount charged to clients for this reservation service. Consequently, the card fee was standard rated.

There were two issues to decide:

1. The Characterisation Issue: The company argued that the corporate credit card fee was consideration for a separate supply from the accommodation;

2. The Exemption Issue: The supply was exempt under Item 5 Group 5 Sch 9 VATA 1994. Whereby the company brought together clients who wished to pay by credit card with the merchant acquirers, with a view to securing payment by this means. This was a distinct act of mediation.

SilverDoor Limited appealed to the Upper Tribunal.

Decision

The Upper Tribunal found that:

- SilverDoor Limited was providing a reservation service to clients and also providing services to the "Property Partners";
- the card payment service was tied up with the "wider reservation services provided by SilverDoor and had no separate validity";
- the service should be considered as a service that was "ancillary to the principal service provided by SilverDoor for Clients".

If made for consideration, the reservation service would have been standard-rated; as an ancillary service, the card fee should also be standard-rated. It did not matter that there was no consideration for the principal reservation service.

Although there was no need to address the second issue, the Upper Tribunal chose to consider whether the card payment facility would in isolation qualify for exemption as financial intermediation.

SilverDoor Limited argued it was acting as an intermediary between the client and the merchant acquirer.

However, the Upper Tribunal disagreed. The company did not negotiate contract terms between client and merchant acquirer. Indeed, there was no contract between the merchant acquirer and the clients. SilverDoor Limited did not even obtain the client's card information to pass on to the merchant acquirer. The company was not providing intermediary services within the meaning of the financial services exemption

The appeal failed.

SilverDoor Limited v HMRC [2024] UKUT 00147 (TCC)

VAT recovery on cars and other assets (Lecture B1445 – 15.27 minutes)

Input tax recovery is normally very simple. If the input tax properly incurred relates wholly to taxable activity it is recoverable unless it relates to:

- cars for private use;
- customer entertaining;
- building materials not ordinarily incorporated.

If you have exempt income then it gets trickier in that you must ascertain whether the input tax incurred is directly taxable, directly exempt or residual.

Charities have the added complication of non-business activity and they will be very aware that they have no input tax deduction for their non-business activity.

Attribution of input tax is key for partially exempt businesses and charities.

Cars available for private use

Cars that are available for private use when purchased are blocked from input tax recovery. Some garages are telling customers that electric cars do not fall within the blocking order – this is incorrect as input tax will be blocked if electric cars are available for private use.

Pool cars would be outside of the blocking provisions providing you have evidence that the pool cars are not available for private use.

Other assets available for private use

<u>Sole trader/Partnerships</u>

When sole traders or partnerships incur VAT on a business cost they will recover the VAT incurred if they are a fully taxable business. Where that cost has an element of private use they have two choices:

1. Deduct the business proportion only;

2. Deduct input VAT on the full cost and account for output tax on private use in each quarter (Lennartz).

If for example a sole trader bought a £3,000 plus VAT laptop through his business it looks like it is fully deductible. On closer examination the laptop has significant gaming attributes and will be used 40% for private purposes. The sole trader could recover £360 (£600 x 60%) in the quarter of purchase and have no further input tax restrictions. Alternatively, he could recover £600 and account for private use each quarter. If the 40% is a reasonable estimate of the private use this could equate to £12 per quarter over the next five years. In reality the output tax calculation is more involved as you need to look at the actual private use in each quarter – probably easier just to recover £360 in quarter of purchase and be done.

It should also be noted that if he were to sell the laptop at any stage he will only have to account for VAT on 60% of the net proceeds (assuming he recovered 60% VAT when purchasing the laptop).

It should be noted that Lennartz cannot be used for property, ships and aircraft so option 1 would be the only option for those assets.

<u>Corporates</u>

Corporates have the same options as above but option 2 tends to be used more.

For example, a new car dealer would recover VAT in full on cars purchased new and for resale. Some of these new cars would be used as demonstrators (demo cars) for test drives etc. These demo cars are normally available for staff to take home in the evenings and at the weekend.

HMRC and the Retail Motor Industry Federation have agreed a simplified method by which the motor dealers may calculate the VAT due on the private use of demo cars.

If these demo cars are still held as demos after 12 months there will be a self supply charge on the business i.e. output VAT due. Input tax would not be deductible as the cars would no longer be regarded as new and for resale after 12 months.

As a result, new car dealers are very keen to sell their demo stock before the 12 month point so as to avoid the self supply charge.

Commercial vehicles v cars

The normal rules on when to claim VAT back apply to the purchase of any road vehicle other than a car e.g. vans. So the business proportion is deductible on purchase or the taxpayer can adopt Lennartz. Generally HMRC views any incidental private use of most types of commercial vehicle as de minimis and input tax would not be restricted in that case.

The intended use of commercial vehicles that are suitable for private use are more likely to involve private use implications. Commercial vehicles suitable for private use include motor caravans, motorcycles and double cab pick ups. .

It should also be noted that where a business converts a commercial vehicle into a car it will become liable to an output tax charge on a self-supply of the vehicle to itself. And if it is converted into a car available for private use the self supply output VAT will not be deductible. The purpose of the self supply is to put the taxpayer in the same position as if they had bought a car.

Vehicles are not treated as cars for VAT purposes if they have a payload of one tonne or more. Payload is the difference between a vehicle's maximum gross weight and its kerbside weight. Given the different treatment of cars and commercial vehicles it is important for manufacturers, distributors, dealers and business customers to know the payload of any double cab vehicle they sell or buy. It is especially important to be aware that by adding accessories to the ex-works model they may, by lowering the payload of the vehicle, convert it into a car. This would make the vehicle liable to the self-supply charge. Such conversions are most likely to occur with double cabs that have an ex-works payload of 1000 to 1050 kg.