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Personal tax

Cleaning costs for work clothes

Summary – £60 per tax year was accepted as deductible for cleaning protective clothing or higher if evidence of actual costs could be supplied.

The First Tier Tribunal heard three cases together, each concerned with the availability of relief for employee expenses. In each case, the taxpayers made a claim for cleaning costs of £2,200 relating to the cost of cleaning and sanitising working clothes and the cost of toiletries for personal hygiene. The Tribunal referred to these costs as cleaning costs.

The cleaning costs related to cleaning protective work clothing where the workers were exposed to needles, stagnant water, animal faeces, rodents as well as diseases like Leptospirosis and Hepatitis B.

HMRC did not dispute that expenditure had been incurred but they sought to impose an arbitrary maximum relief of £60 per tax year to cover such cleaning costs.

Decision

The tribunal found that that the cost of cleaning protective and other clothing provided by an employer which an employee is required to wear would be incurred wholly, exclusively and necessarily in the performance of the duties of employment.

In the case of Mr Lyons, the Tribunal was not satisfied that there was any evidence that he was required to wear such clothing. In the case of Mr Higginbottom and Mr Critchley there was such clothing, but they also wore other “ordinary clothing” which was included in the cleaning costs claimed. There would be no relief for the cost of cleaning ordinary work clothes.

In relation to the cost of toiletries the Tribunal was not satisfied that such expenses were incurred wholly and exclusively in the performance of the duties of the employment. Such expenses were incurred partly for purposes of everyday personal hygiene.

The Tribunal accepted HMRC’s figure of £60 per tax year, acknowledging that the figure of £60 per year had not changed since 2008/09 and may therefore be viewed as somewhat out of date. HMRC accepted that the figure of £60 may be increased where there was evidence of the actual costs incurred. However, on the evidence before the Tribunal, they were not satisfied that any higher figure had been incurred on such expenses.

The appeals were dismissed.

Higginbottom, Critchley, Lyons v HMRC (TC06521)

Disguised remuneration – the close company gateway (Lecture P1082 – 21.49 minutes)

S11 and Sch 1 FA 2018 introduce further changes to tackle what the Government refer to as 'disguised remuneration tax avoidance schemes'. These measures build on legislation which has been enacted in FA 2016, FA 2017 and F(No2)A 2017.

The main feature this year is the launch of a new close company gateway which is intended, in HMRC's words, 'to put beyond doubt when Part 7A of ITEPA 2003 applies to the remuneration of owners of close companies'.

Para 2 Sch 1 FA 2018 inserts six new sections (Ss554AA – 554AF ITEPA 2003) near the beginning of Part 7A of ITEPA 2003. If the conditions of either the original gateway in S554A ITEPA 2003 or the new close company gateway in S554AA ITEPA 2003 are met, a charge under Part 7A of ITEPA 2003 can arise.

S554AA ITEPA 2003 provides that there will be a disguised remuneration charge where the conditions of S554AA(1) ITEPA 2003 are met. This subsection requires that:

- there is an arrangement ('the relevant arrangement') to which an individual (A) is a party;
- it is reasonable to suppose that the relevant arrangement is wholly or partly a means of providing payments, benefits or loans which are in some way linked to A;
- a close company (B) enters into a 'relevant transaction';
- it is reasonable to suppose that the relevant transaction was entered into wholly or partly in pursuance of the relevant arrangement;
- at the time when B entered into the relevant transaction, or at any earlier time within three years ended with the date of that transaction, A:
  - was a director or employee of B; and
  - had a material interest (as defined in S68 ITEPA 2003) in B;
- a 'relevant step' is taken by a 'relevant third party' (these terms are defined in S554A ITEPA 2003 and S554AA ITEPA 2003 respectively – under the arrangement, the employer has to make a payment to a third party and the third party has to take a relevant step deriving from that payment); and
- the main purpose of implementing and maintaining the relevant arrangement is the avoidance of income tax, NICs, corporation tax or a charge under S455 CTA 2010.

A relevant transaction is one which falls within S554AB ITEPA 2003 – note that this covers a wide variety of different transactions – and it must not be an 'excluded transaction'. S554AC ITEPA 2003 excludes distributions and certain commercial arrangements that are not connected with tax avoidance from being a relevant transaction. In order for the close company gateway to apply, the payment by the employer must meet all the conditions in S554AB ITEPA 2003.

An important form of relief from possible double taxation is provided by Para 3 Sch 1 FA 2018. A new S554Z2A ITEPA 2003 has been inserted into Part 7A of ITEPA 2003. This sets out the circumstances when the loan to participator rules in CTA 2010 have priority over charges under Part 7A of ITEPA 2003.

Broadly, where a S455 CTA 2010 charge arises by virtue of S459 CTA 2010 at the same time as a charge under Part 7A of ITEPA 2003 by virtue of the close company gateway, the latter charge will be set aside as long as one of two conditions is satisfied:

- the S455 CTA 2010 charge must have been paid in full by the due date; or
- what the legislation calls 'the net S455 CTA 2010 charge' is nil (ie. because the loan has been fully repaid or has been written off before the due date).

It is also possible for an HMRC officer to give his consent that the charge under Part 7A of ITEPA 2003 should be dropped. Finally, S554Z2A ITEPA 2003 relieves charges under Part 7A of ITEPA 2003 from arising at the same time as a charge under Ss415 and 416 ITTOIA 2005 (loan to participator released or written off).

The amendments made by Paras 2 and 3 Sch 1 FA 2018 have effect in relation to relevant steps taken on or after 6 April 2018.

Contributed by Robert Jamieson

The 5 April 2019 loan charge – Part I (Lecture P1083 – 6.58 minutes)

The background

To understand this fully, we first need a short history lesson.

Historically, a very common remuneration planning arrangement for businesses was to reward their employees via a third-party vehicle such as an Employee Benefit Trust ('EBT'). EBT schemes have been around since the 1980s. So rather than paying employees wholly in the form of traditional wages (liable to tax and NIC under PAYE), firms would make contributions to an EBT.

Typically, these trusts were housed offshore to remove them from additional UK tax obligations. Employer Funded Retirement Benefit Schemes ('EFRBS') – essentially unapproved pension schemes - were used for a similar purpose.

In EBT arrangement, the company would receive a CT deduction in the period of the contribution. The EBT would subsequently give the UK employee access to the contributed funds by way of a loan. Such loans were invariably interest-free with no specific repayment terms.

Contractor loan arrangements are a more recent phenomenon but work in the same way.

In a typical arrangement, a contractor carries out his work on behalf of a client via an umbrella company that engages a large number of like-minded contractors. The umbrella company handles the billing and is paid by the end client.

The contractor is then paid a small salary (usually at or around the level of the personal allowance and just above the minimum wage) but his remuneration is topped-up by way of a loan that normally comes from an offshore vehicle established for this purpose. The loans were interest-free with no repayment terms discussed.

Loans – assuming the expectation of eventual repayment – are not earnings. These loans were employment-related so the employee had a taxable benefit-in-kind calculated by reference to the HMRC official interest rate giving an annual UK tax liability on the use of the money at somewhere around 1% or 2% of the amounts advanced. [Some loan schemes charged interest at the ORI to avoid a P11D benefit altogether with the interest rolled-up and added to the capital of the loan.] This was far more palatable than the 40% / 45% / 50% (plus NIC) which would have been due if the money had been paid to the employee as boring-old wages.

It was inevitable that the Government would react. And they did.

Strike 1

The Government's first strike in the ensuing battle came in the case of MacDonald (HMIT) v Dextra Accessories Ltd & Others [2005] ('Dextra'), where the House of Lords unanimously agreed with HMRC that the employer company could not receive a CT deduction until the contributions were used to pay taxable earnings to the employee. Loans didn't count as taxable earnings, so the effect of Dextra was to deny the CT deduction.

Dextra subsequently spawned s.1288 CTA 2009 et seq which now creates a symmetry between the employer deduction and the employee earnings charge. But Dextra and CTA 2009 only dealt with the mismatch between the CT deduction and the income tax charge – it did not address the avoidance of tax and NIC by the employees (and the knock-on avoidance of secondary NICs by the employer). This was addressed in 2010.

Strike 2

The second punch thrown by the Government came in the shape of the "Disguised Remuneration" rules introduced with effect from 9 December 2010, enacted in Finance Act 2011 and now sitting on the statute books as Part 7A ITEPA 2003 under the banner "Employment income provided through third parties". The cornerstone of these rules is to treat certain payments from third parties as being subject to income tax and Class 1 NIC.

The gateway to a Disguised Remuneration charge is:

- An arrangement with the employer to provide rewards to an employee; followed by
- The taking by a third party of a "relevant step" in pursuance of that arrangement.

A "relevant step" includes the making of a loan, the transfer of an asset, the use of an asset, or the earmarking of money or assets (however informally) for an employee with a view to a later relevant step being taken. The main target was third party loans.

The amount charged to income tax is the value of that "relevant step".

So, if an employer contributes to an EBT and on or after 9 December 2010 that EBT then lends £100,000 to an employee, we have all the ingredients for a Disguised Remuneration charge being:

- An arrangement to provide rewards to an employee;
- A relevant third party (in the form of an EBT); and
- A relevant step (being the making by the EBT of the loan).

The £100,000 is accordingly treated as earnings with tax and NIC deductible under PAYE.

Relevant steps taken before the announcement of the new rules in December 2010 were not caught by the Disguised Remuneration provisions in Part 7A. This meant that existing schemes with loans outstanding found themselves in a strange state of inertia. Technically existing loans made to employees remained on their books but there was no expectation on the part of the EBT that the loans would ever be repaid (and indeed many employees had no means of repaying the debts having spent the money). These pre-2010 EBTs duly stopped making loans and hibernated.

In reaction to this set-back, a new generation of more creative arrangements has sprung-up since December 2010. These schemes have attempted to find holes in Part 7A and have manipulated those weak spots to reach the same end-point as before – ie, to provide rewards to employees via debt arrangements with third parties in such a way as to fall outside the Disguised Remuneration provisions.

All of which leads us to….

Strike 3

The latest (and seemingly knockout) blow will be coming shortly in the shape of the April 2019 Loan Charge enacted in Schedule 11 Finance Act (No. 2) 2017 as "Employment income provided through third parties: loans etc outstanding on 5 April 2019". Catchy.

In short, this new charge will revisit both pre-2010 schemes and any new ones which have sprouted up since December 2010 and will hit them with a thumping-great income tax charge.

Schedule 11 does this by creating a new 'relevant step' for the purposes of Part 7A ITEPA 2003 which brings pre-December 2010 loan arrangements and post-2010 debt schemes within the Disguised Remuneration provisions. The 2019 Loan Charge will then be levied on third party loans that remain outstanding at 5 April 2019.

If this smacks of retrospective taxation, then Strike 3 is even more brutal as it backdates the new charge by 20 years to apply to loans made on or after 6 April 1999 (more than 11 years before the original announcement trumpeting disguised remuneration). So old loans that were never originally within Part 7A ITEPA 2003 will now be dragged in.

Loans made before 6 April 1999 will not be caught. Neither will loans made to non-employees, loans not involving a third party or loans that have been fully repaid by 5 April 2019. One option here is therefore for the employee to repay the loan (unpalatable as that is).

Repayments must be “in money” so the employee cannot surrender an asset in satisfaction of the debt (he will instead be required to sell the asset and use the resulting cash proceeds). The loan charge is avoided if the capital of the loan is repaid (any outstanding interest, even if capitalised, can remain outstanding).

The amount charged to income tax and Class 1 NIC is the value of that “relevant step” being the loan outstanding at midnight on 5 April 2019. The taxpayer will therefore be treated as having employment income equal to the amount of their third party loans which have not been repaid by 5 April 2019.

The tax charge is triggered at the point of the relevant step. In most cases this will be 5 April 2019 thereby bringing the tax liability into the tax year 2018/19. There is no provision to trace the payment back to the year(s) to which the loan relates, so dumping the tax charge wholly into one tax year will in many instances create an eye-watering charge of 60.8% of the loan outstanding. Taxpayers who do not pay income tax at the additional 45% rate will obviously have a lower charge but might in turn suffer knock-on charges in the form of a withdrawal of personal allowances in 2018/19 or the imposition of a high-income child benefit charge. The potential windfall for the government here is massive and could generate as much as £2 billion (assuming of course they can collect it all which is another matter).

The April 2019 trigger date can be deferred if the loan outstanding is an ‘approved fixed term loan’ in which cases a charge will only arise on amounts which remain unpaid at the approved repayment date. An ‘approved fixed term loan’ is one which was made on commercial terms and where capital repayments have been made to the lender and at intervals not exceeding 53 weeks. EBT and contractor loans are unlikely to fall into this category.

Where a third party takes a loan charge relevant step and the loan is also an employment-related loan, the new Schedule 11 provisions prevent that loan from being treated as a taxable cheap loan for the purposes of the beneficial loan legislation. This means that if an employee has a loan charge in April 2019, no further benefit charge will arise after 5 April 2019 in relation to the beneficial loan (even if it remains outstanding). However, there are no provisions to credit any amounts previously taxed under the beneficial loan rules against the 2019 loan charge.

Contributed by Steve Sanders

The 5 April 2019 loan charge – Part II (Lecture P1084 – 8.01 minutes)

PAYE

5 April 2019 is the trigger date for PAYE so tax must be accounted for in the April payroll run and paid by 22nd of that month. Well, that’s the theory.

However, bearing in mind that PAYE must be deducted with nothing to deduct it from (these are deemed earnings not real wages), the employer will be left in the unenviable position of coughing-up the PAYE and then trying to recover the tax and NIC from the employee. This is hard enough if the employee is still on the premises (and next to impossible if not).

To apply PAYE correctly, the employer will need details of the amount outstanding. The new loan charge provisions therefore include a requirement that both the person who made the loan (ie, the third party) and the employee who received it must provide information about the loan balance to the employer who is to operate PAYE.

All individuals who have received a loan from a disguised remuneration scheme must provide HMRC with contact details, HMRC references, and details of the outstanding balance of the loan (including any amounts already written-off) no later than 1 October 2019. This will enable HMRC to identify all employers on whom a PAYE obligation falls and will no doubt trigger collection notices under the PAYE Regulations in due course.

If the employer is not compelled to operate PAYE (for example by having no UK tax presence) or if the employer no longer exists, the employee will need to include the value of the relevant step in his 2018/19 Self-Assessment and pay the tax by 31 January 2020. In this case there is no Class 1 NIC liability.

If the employer has a UK presence and still exists but is simply unable to pay, the tax liability can be transferred out to the employee by HMRC applying its existing powers under the PAYE Regulations (Reg 81). As Regulation 81 only applies in relation to tax, there would be no Class 1 NIC liability transferred over to the employee.

This will have the inevitable knock-on effect of many employees not having the means to pay the tax without selling off assets such as their homes. The more hard-nosed amongst us will no doubt argue that these people may not have been able to afford these assets if they (like the rest of us) had paid income tax and NIC on their employment income in the first place, so a clawback is justified and long overdue. What do they say about things which seem too good to be true…?

It is hoped that HMRC will be reasonable in setting up time-to-pay arrangements and agreeing repayment plans with affected employees and indications are that they will. Some of the affected employees will however be forced into IVAs or bankruptcy.

Accelerated Payments Notices (APNs)

HMRC’s victory at the Supreme Court in the protracted and much publicised Rangers case in July 2017 has certainly put a great deal of wind in HMRC’s sails and this momentum will be hard to stop. Buoyed by the Rangers victory, HMRC used their September 2017 (Edition 41) of Spotlight (“Disguised remuneration: A Supreme Court decision”) to reiterate that:

- Employment income paid from an employer to a third party is still taxable as employment income; and

- This principle applies to a wide range of disguised remuneration tax avoidance schemes, no matter what type of third party is used (including but not necessarily limited to EBTs, EFRBS and a range of contractor loan schemes).

The Supreme Court in Rangers upheld HMRC’s long-held opinion that payments from the employer to the EBT were taxable as employment income. So, if this is now the established position, is the 2019 Loan Charge unnecessary?

The wheels for the Loan Charge were already in motion well before July 2017, presumably on the basis that HMRC expected to lose in Rangers (having failed to convince the courts of this point at their previous appeals) and HMRC were therefore putting in place an alternative statutory weapon in their fight against these schemes. Their subsequent continuance with the Loan Charge in the wake of Rangers is "belt and braces" and an extra stick to beat us with. I guess that, as with any decided case, the danger is that taxpayers will argue that the facts in Rangers don't sit 100% square with their own so the decision does not apply. After all, in Rangers the employer sent a letter to the EBT Trustees asking them to resettle the funds on sub-trusts for the employee to call on as he pleased. The Loan Charge is therefore the government's safety net.]

Spotlight 41 promised that HMRC would use the Rangers decision "to take action against many of the disguised remuneration schemes using the full range of our available tools". This in turn has been the catalyst for a raft of Follower Notices and APNs in relation to EBT schemes.

Some taxpayers who are potentially subject to the April 2019 loan charge will therefore already have paid tax in relation to their outstanding loans under an APN (issued either in relation to a loan-scheme notifiable under DOTAS or after the issue of a Follower Notice pursuant to cases like Rangers). Taxpayers who have made a payment under an APN in respect of the 2019 loan charge can apply to postpone the loan charge payment date but only if that payment is equal to or more than the outstanding loan balance. Applications for postponement must be made by 31 December 2018.

If the loan charge exceeds the APN payment, the APN payment (being a payment on account) can be used to offset any liability due at 5 April 2019.

What now?

Firstly, if you have clients with a possible Loan Charge exposure, the sensible advice is to speak to a specialist with experience in this area and with clients in the same boat. This is not an area where one can Google and go from there.

Taxpayers faced with an April 2019 loan charge have a few options.

Ignore it and hope it all goes away. It won't. So don't. HMRC has a habit of finding out about these things and have a population of people employed for this purpose (plus having this particular skeleton in one's closet can't be good for the blood pressure). Ignoring it leaves the way open for increased penalties for non-disclosure (and in cases where the loan is from an offshore scheme, the penalties could fall to be levied under the stricter rules for offshore tax evasion which can lead to Magistrate appearances and jail-time). We will therefore rule this out as an option.

Repaying the loan vs. Paying the tax:

This is an interesting choice.

Let's say your client (X) has outstanding EBT loans of £1 million. If X does nothing, the loan charge will hit in 2018/19 and X will have to pay c. £450,000 in income tax in January 2020. X has until then to raise the money (which should be plenty of time).

Or X could repay £1 million to the Trust before 5 April 2019 (which will cost him more and gives him less time to raise the cash). Prima facie the choice seems obvious. Except….

If X repays the loan, the money will sit in an offshore EBT earmarked for X's benefit thereby giving him (subject to the discretion of the usually cooperative Trustees) access to that money going forward. OK, chances are that if the Trust pays that money to X, the amounts paid will be charged to income tax. However, it might be possible to limit or control the liability either by arranging payments to non-resident beneficiaries outside the UK or by waiting until retirement and dripping out the money to use X's allowances and basic rate bands. We should therefore think of the loan repayment as akin to a contribution to a pension fund whereby money is put aside now to access in the future as the need arises.

Alternatively, the Trustees could be persuaded to invest the fund in a mutually beneficial commercial venture - say X's new business in the UK? - without creating a tax charge.

As an aside, the offshore EBT will be a discretionary trust, so if the money is repaid to the Trustees it will sit outside the individual's estate for IHT. Strictly this will mean that the trust is also a relevant property trust and liable to exit and periodic charges but quite how compliant offshore EBTs have been with those rules is anyone's guess.

Settle the case with HMRC before 5 April 2019:

Settlement means accepting that all funds paid to the third party (EBT) on behalf of the employee are taxable as employment income (which has always been HMRC's stance and which was confirmed in Rangers). This avoids the loan charge as HMRC has generously confirmed that they have no desire to try and tax the same money twice. It also avoids the need to repay the loans as the loans will no longer be loans from a tax perspective. But it will still cost money.

HMRC has historically preferred the settlement route. To facilitate this employers and employees were presented with the opportunity to register their interest in settlement by 31 May 2018 with a view to taxpayers providing all relevant information by 30 September 2018 and settling their liabilities before the loan charge hits in April 2019.

For those who have registered their interest, a negotiated settlement may turn out to be the cheapest way of resolving the issue because the tax liability will be calculated on a year-by-year basis thereby using the rates and bands for the years in which the loans were taken out. The amount taxable will be the employer contribution to the EBT, less any fees incurred for that purpose. Once this calculation is performed, any amounts previously charged to tax under the beneficial loan rules will be deducted and credit given for tax paid on those benefits, but (it seems) only for those years that are still under appeal (although there may be room to claim overpayment relief subject to the relevant time limits).

The settlement will be required to include tax for those years which may be out of time for a discovery assessment, these being included in the deal as "voluntary restitution" on the part of the taxpayer (which is jolly decent of him).

The settlement will include interest for all "in-date" years (but not for tax which is paid "voluntarily").

A CT deduction will then be available for the employer contributions to the EBT – these now being matched with a charge on earnings – but only for CT returns which are still open or still within time to be amended.

For those who did not register an interest by 31 May, strictly speaking the settlement route is now closed. However, HMRC have quietly extended this to 30 September 2018 so registration is still possible for those clients who have only recently come to the decision to settle.

Is the Loan Charge fair?

Many, including our elected representatives, think not.

An Early Day Motion (EDM1239) was tabled in the House of Commons on 8 May 2018 (and has over 50 supporting cross-party MPs) which lists many concerns about the April 2019 loan charge including:

- that it is retrospective applying back to 1999;
- because of the introduction of IR35, umbrella companies were set up and recommended by professional advisers… and that this Charge will affect contractors, freelancers and agency workers, including social workers, supply teachers, locum nurses and doctors;
- it is unfair that HMRC are pursuing people who acted in good faith rather than the client organisations, agencies or umbrella companies all of whom benefited significantly;

HMRC are aggressively pursuing individuals through Advanced Payment Notices with no independent right of appeal:

- the Charge is likely to cause financial distress and bankruptcies, impeding HMRC's ability to recover these tax liabilities and causing a devastating impact on people; and
- that retrospectively taxing something that was technically allowed at the time, is unfair.

The Motion concludes by "calling on the Government to revise the legislation to avoid significant damage to independent contractors and freelancers in the UK". Fine words indeed. But we seem to be way too far down the line with this for there to be any significant back-pedalling so this motion will probably fall on deaf ears. But we will let you know if it doesn't.

Contributed by Steve Sanders

Disguised remuneration settlement terms

So just to be clear, taxpayers wishing to settle liabilities in connection with disguised remuneration schemes on favourable terms before the new loan charge comes into effect on 5 April 2019 should register their interest with HMRC as soon as possible and send all required information by 30 September 2018.

By contacting HMRC to settle their tax affairs now, taxpayers can agree with HMRC what they owe and if required, arrange a payment plan. Settling now will give taxpayers certainty about their disguised remuneration scheme and may also mean they:

- do not have to pay the new loan charge that is being introduced;
- pay a lower rate of tax on their disguised remuneration loans - the loan charge will add all their loans together and tax them in one year;
- do not face extra costs if the scheme moves to litigation.

www.gov.uk/guidance/disguised-remuneration-settling-your-tax-affairs

Capital Taxes

Exercising options – disapplying the market value rule

Summary - S144ZA TCGA 1992 applied to the taxpayer's exercise of option shares granted under the Goldman Sachs SIP, disapplying the market value rule.

Mr Davies had been employed by the Goldman Sachs and in 1999 and 2000, he had been granted unapproved employee share options. Under the option scheme, Goldman Sachs had the right to deliver cash in lieu of all or any portion of the shares otherwise deliverable. In 2006, Mr Davies had become a managing director.

He filed his tax returns on the basis that the exercise of the options had given rise to allowable losses using the losses to set against his other gains in 2005/06, 2006/07, 2007/08 and 2010/11.

The First Trier Tribunal dismissed his appeal and so Mr Davies appealed.

The issue was whether s144ZA TCGA 1992 applied to the exercise of the options. Counsel for Stephen Davies argued that because the employer had a discretion to transfer shares or cash when he exercised his options, it was not bound to a specific form of transaction, as stated in the opening words of s 144ZA(2) which applies when the option binds the grantor to sell.

Decision

The Upper Tribunal said that S144ZA applied when an option was exercised (s 144ZA(1)) so that, by virtue of s 144(2) or (3), the grant of the option and its exercise are treated as a single transaction. The market value would then apply but for s 144ZA. Both conditions were satisfied in this case.

The Tribunal said that Counsel’s view was 'contrary to the natural reading of the subsections, taken in the context of the section as a whole' and there was 'no discernible, rational purpose in limiting the effect of s 144ZA' to options other than those on which the grantor had discretion on how to settle the grantee's entitlement.

Mr Davies’ appeal was dismissed.

Stephen Davies v HMRC [2018] UKUT 130 (TCC)

Guidance on IHT and DOTAS (Lecture P1085 - 29.04 minutes)

The Inheritance Tax Avoidance Schemes (Prescribed Disclosure Of Arrangements) Regulations 2017 (SI 2017/1172) have replaced the previous rules with effect from 1 April 2018. The DOTAS regime relies on ‘hallmarks’ to describe the avoidance arrangements which have to be disclosed. In addition to the latest change, it should be remembered that the confidentiality and premium fee hallmarks were extended to cover IHT with effect from 23 February 2016.

The new IHT hallmark provides that an arrangement is notifiable if it would be reasonable to expect an informed observer (having studied the arrangements and having regard to all relevant circumstances) would conclude that conditions 1 and 2 are met.

Condition 1

This states that the main purpose, or one of the main purposes, of the arrangements is to enable a person to obtain one or more of the following advantages in relation to IHT:

- the avoidance or reduction of a relevant property entry charge;
- the avoidance or reduction of a charge to IHT under Ss64, 65, 72 or 94 IHTA 1984;
- the avoidance or reduction of a charge to IHT arising from the application of Ss102, 102ZA, 102A or 102B FA 1986 in circumstances where there is no charge to income tax under Sch 15 FA 2004;
- a reduction in the value of a person's estate without giving rise to a chargeable transfer or a potentially exempt transfer (PET).

Condition 2

This states that the arrangements involve one or more contrived or abnormal steps without which the tax advantage could not be obtained.

Some time ago, HMRC confirmed that they would be publishing guidance 'in good time' prior to the commencement date of 1 April 2018 to explain:

- how the revised DOTAS hallmark works;
- the condition to be met in order for the arrangements to be notifiable; and
- the circumstances for certain arrangements to be exempted from disclosure.

In the event, this guidance finally materialised on 29 March 2018 which hardly fulfils HMRC's 'in good time' promise!

Let us therefore examine some of the examples provided by HMRC in their guidance note.

The first one involves regular gifts out of income (see S21 IHTA 1984). In the context of condition 1, HMRC say:

> 'If these are gifts to an individual, they may be caught by condition 1(iv) as a main purpose of the gifts is to reduce the value of the person's estate without giving rise to a chargeable transfer or a PET – they give rise to a series of exempt transfers.
>
> If these are gifts into trust, they may also be caught by condition 1(i) in that they avoid or reduce a relevant property entry charge.
>
> Although condition 1 may be met, to be notifiable condition 2 must also be met.'

In the context of condition 2, HMRC continue:

> 'It is not reasonable to expect an informed observer would conclude it is either contrived or abnormal for a person to make regular gifts to those the person wants to benefit from their generosity where they are straightforward gifts to an individual or gifts into trust. This would just be the use of an exemption provided for by the legislation.
>
> In some cases, the person intending to make such gifts may be advised to record their intention or commitment in writing before making the gifts. Such a step might seem contrived or abnormal in the sense that unilateral gifts are commonly made without being preordained so that the preordination appears abnormal. But, in the context of the exemption for regular gifts out of income, which have to be part of the transferor's normal expenditure, recording this commitment in advance is simply a step in demonstrating that the exemption is due. Recording the commitment does not secure the exemption, but it may help to establish that the exemption is due based on the subsequent transfers.'

HMRC's conclusion is that, even though condition 1 is met, condition 2 is not and so such arrangements are not notifiable under the latest hallmark.

The second example involves an individual making a lifetime transfer to a bare trust for a minor beneficiary. HMRC's exposition in this situation is succinct:

> 'The transfer is a gift into a bare trust from which the donor cannot benefit. Although the transfer reduces the value of the transferor's estate, it gives rise to a PET. Condition 1(iv) is therefore not met and the arrangement does not give rise to any of the other tax advantages set out in condition 1. This analysis would apply whether or not the trustees were able to defer actual payments to the beneficiary beyond the age of 18.
>
> As condition 1 is not met, there is no need to consider condition 2.'

Finally, let us look at a more controversial tax planning arrangement, which the speaker has seen on more than one occasion, where a settlor gifts shares which qualify as relevant business property into a trust and where the trustees subsequently sell those shares back to the settlor. In this context, HMRC state:

> 'In isolation, the transfer of shares qualifying for business relief into a trust or the sale of trust assets by the trustees would not meet condition 1. Where arrangements are entered into with the intention that all of these steps take place, the arrangements have the effect of placing cash into a relevant property trust, but without incurring a relevant property entry charge. As one of the main purposes of these arrangements is to reduce or avoid a relevant property entry charge, it would be reasonable to expect an informed observer to conclude that condition 1(i) is met.
>
> This can be contrasted to the situation where, for example, family company shares are transferred into trust for succession planning purposes, at which time there is no intention of the trustees selling those shares.

If the trustees later took an independent decision to sell the shares, it is unlikely that an informed observer would conclude that these separate steps form part of a single overall arrangement or that condition 1(i) was met.

It would not normally be possible to transfer cash into a relevant property trust without incurring a relevant property entry charge, which is what has been achieved. To achieve this outcome and to gain this tax advantage, contrived steps are necessary, that is the transfer of shares qualifying for relief followed by their sale back to the transferor rather than the simple transfer of cash which would be the non-contrived way of achieving the same result. Without these contrived steps, the tax advantage would not arise. It would therefore be reasonable to expect an informed observer to conclude, considering the arrangements as a whole, that condition 2 was met.'

Planning of this sort will therefore fall into the notifiable category.

Contributed by Robert Jamieson

Three case studies on income tax and trusts (Lecture P1081 – 26.16 minutes)

The changes to the tax treatment of dividends in FA 2016 have been widely reported, but relatively little has been written about the impact of these rules on trusts and their trustees.

With regard to the dividend tax allowance, trustees are not entitled to this £5,000 relief, which reduces to £2,000 for 2018/19 onwards, because that benefit is only available to individuals (see S13A ITA 2007). However, given that interest in possession trusts are transparent for income tax purposes (while discretionary trusts are not), this means that the 7.5% dividend tax charge will be credited to the life tenant and he may therefore be entitled to a tax refund if the trust income falls within his dividend nil rate band.

What follows is a collection of three short case studies showing the impact of this new regime on the income of interest in possession and discretionary trusts for 2017/18.

Case study 1

Rupert is entitled to all the income in the Connie Family Settlement until he reaches the age of 25. During the year ended 31 March 2018, the trustees received a dividend of £200,000 from a family company (dividends are not mandated directly to Rupert). The trust had no other taxable income and the expenses properly allocated to the trust income amounted to £1,200.

Given that the trustees are not entitled to a dividend allowance, the trust's taxable income for 2017/18 is:

Dividend income	£200,000
Tax @ 7.5%	£15,000

The trustees will have to pay income tax of £15,000. Following the decision in Aikin v Macdonald's Trustees (1894), they are not allowed to deduct the trust management expenses for tax purposes.

The amount of trust income that is distributed to Rupert is:

		£	£
Dividend income			200,000
Less:	Tax	15,000	
	Trust expenses	1,200	
			16,200
			£183,800

The trustees will therefore pay Rupert £183,800, accompanied by an R185 (Trust Income) tax deduction certificate showing:

Net	Tax	Gross
£	£	£
183,800	14,903	198,703

The dividend income is deemed to have suffered tax at 7.5% and so the gross amount in Rupert's hands is £198,703. On the assumption that Rupert has already used his £5,000 dividend tax allowance, he will be taxed at his marginal dividend rates on £198,703, but with a trust tax credit of £14,903.

If, on the other hand, the trustees had mandated the dividend income directly to Rupert, there would be no relief for the trust management expenses (but, of course, they might not have been incurred). The trustees would not have to complete Form R185 (Trust Income). Rupert would be treated as having received dividend income of £200,000, on which he would be liable to tax in the normal way.

For 2017/18, discretionary trusts are taxed as follows:

- The first £1,000 of taxable income (known as the standard rate band limit) is taxed at the basic rate, ie. 7.5% for dividends and 20% for all other sources of trust income (S491 ITA 2007). The order of priority – where there are different types of trust income – is that non-savings income takes the first slice of the £1,000 band, savings income comes next, with dividends being treated as representing the top part.

- Subject to this, all trust income is taxed at 45% (or 38.1% in the case of dividends). Remember that discretionary trustees – as well as their interest in possession counterparts – are not allowed to use the dividend tax allowance.

- Trust management expenses that are properly chargeable against income can be deducted in computing the additional rate tax payable by the trustees (S484 ITA 2007). This deduction takes effect for the tax year in which the expenditure is incurred, and not the tax year in which the expenditure is paid (if different).

Case study 2

The trustees of the Richard Family Settlement (a discretionary trust) received the following sources of income in 2017/18:

	£
Dividends from listed UK companies	16,000
Rents (net of property expenses)	27,400
Bank interest	10,300

The trust incurred administrative costs of £1,850. The net income was, for the time being, accumulated within the trust.

The trustees' tax position is:

	£	£
Property business income		27,400
Bank interest		10,300
		37,700
Dividends	16,000	
Less: Trust expenses (x 100/92.5)	(2,000)	
		14,000
		£51,700

Note: Trust expenses are set off against dividend income first, then against any other savings income (eg. bank interest) and finally against non-savings income (eg. rents) – see S486 ITA 2007. Because these expenses are not deductible for basic rate purposes, they must be grossed up – in this case, at the dividend basic rate.

The trust's income tax liability for 2017/18 is calculated as follows:

	£	£
Trust tax @ 20%		
On 1,000 (rental income)		200
Trust tax @ 45%		
On 26,400 (rental income)	11,880	
On 10,300 (bank interest)	4,635	
		16,515

Trust tax @ 38.1%	
On 14,000 (dividends)	5,334
Adjustment for non-deductible trust expenses	
7.5% x 2,000	150
	£22,199

Income distributions made by discretionary trustees are always deemed to have suffered tax at 45%. Thus, a payment of, say, £2,200 is treated as a gross receipt of £4,000 from which tax of £1,800 has been taken. This gross £4,000 is classified as income of the beneficiary, with no further tax being due or tax being repaid (as the case may be). The trustees must provide the beneficiary with an R185(Trust Income) certificate, showing the net distribution and the accompanying tax credit.

The underlying income from which the distributions are made loses its original character. Thus, where the trustees distribute dividend income, this ranks simply as an 'annual payment' (ie. non-savings income) in the beneficiary's hands. It does not attract the dividend tax allowance or the lower dividend tax rates.

The legislation provides a special mechanism to enable the trust distributions to carry a 45% tax credit in the beneficiary's hands. This has to be matched by the tax paid by the trustees which is tracked in a 'tax pool'. The tax pool contains the cumulative total of the tax paid by the trustees. When the trustees distribute income, they have to deduct the 45% tax credit attaching to the distribution from the tax pool. This tax pool, therefore, represents the total tax paid by the trustees during the lifetime of the trust less the amount of tax credits used to frank distributions (S497 ITA 2007). However, the tax pool never includes:

- the 10% non-repayable tax on pre-6 April 2016 dividends; and
- any basic rate tax adjustments for non-deductible trust expenses.

If the tax pool exceeds the 45% tax credit for the latest income distribution, no further action is required. On the other hand, if the tax pool balance is insufficient to cover the tax credit, the trustees have to pay HMRC a further amount to deal with the shortfall (S496 ITA 2007).

Notice that, unless the trustees have enough capacity in the tax pool, the full distribution of dividend income which has been taxed on the trustees at 38.1% will invariably lead to an additional 6.9% becoming due under the S496 ITA 2007 charging procedure.

Case study 3

On 31 January 2018, the trustees of the Timothy Discretionary Settlement made an income distribution of £27,500 in cash to the principal beneficiary of the trust. The balance on the trustees' tax pool stood at £21,200 on that date.

The tax credit attaching to this distribution is 45/55 x £27,500 = £22,500, making a gross annual payment of £50,000.

However, since the balance on the tax pool is only £21,200, the trustees must make up the deficit (£22,500 – £21,200 = £1,300) by paying the sum to HMRC under S496 ITA 2007. This is normally done as part of the completion of the trust tax return for the relevant tax year.

On the assumption that the beneficiary's marginal rate of tax for 2017/18 is 40% (so that his liability on the annual payment is 40% x £50,000 = £20,000), he will be entitled to make a tax repayment claim of £22,500 – £20,000 = £2,500.

Contributed by Robert Jamieson

SDLT avoidance arrangements

Summary - Although the combination of FA s 45 and s 71A brought the stamp duty land tax due to nil, the effect of s 75A was that SDLT was payable.

The issue was the SDLT payable on the purchase of the Chelsea Barracks from the Ministry of Defence (MoD) by Project Blue, using an Ijara lease, a form of Sharia compliant financing (as opposed to an interest-bearing loan).

The sale comprised the following steps:

- MoD contracted to sell the land to PBL for £959m;
- Project Blue contracted to sell the land to a Qatari bank (MAR). Under leaseback arrangements, Project Blue was to pay MAR rent (representing instalments of the purchase price); and
- Project Blue and MAR granted each other put and call options over the land.
- The MoD conveyed the land to Project Blue, which conveyed it to MAR. MAR then leased the land to Project Blue.

There were two issues:

1. Whether both sub-sale relief (s45) and the exemption for alternative property finance (s 71A) applied and, if so,
2. How s 75A (the SDLT anti-avoidance provision) should apply to the transaction.

It was accepted that, as a result of s 45, the completion of the contract between the MoD and Project Blue was disregarded, and that s 71A could cover the arrangements between Project Blue and MAR. The central question was the interaction between s 45 and s 71A, and particularly the identification of the 'vendor' under s 71A. The Upper Tribunal had found that Project Blue was the vendor under s 71A whilst the Court of Appeal considered that the vendor could not be Project Blue because the transaction between the MoD and Project Blue fell to be disregarded under s 45.

Decision

The Supreme Court found that the vendor was Project Blue so that MAR's purchase of the barracks from Project Blue was exempt as a result of the combination of s 45 and s 71A.

The court observed that s 71A uses 'real world' language and that whether the 'customer' of the financing arrangement (here PBL) has incurred a liability to SDLT before entering into the Ijara arrangements is not relevant to the applicability of s 71A. This approach is consistent with the aim of s 71A, which is to equate Ijara financing with conventional lending. There is nothing in the wording of s 71A, which suggests that the exemption will not apply where the sale by the customer to the financial institution is a sub-sale. Finally, this approach ensures that, in cases where the financial institution purchases the property from its customer, SDLT is not charged on the amount provided by the financial institution, but rather on the actual purchase price paid by the customer.

As to the application of s 75A, like previous Courts, the Supreme Court found that it was not precluded by the fact that it was not established that Project Blue had entered into the arrangements for tax avoidance purposes. The court observed, inter alia, that there is nothing in the body of the section that expressly or inferentially refers to motivation. It is sufficient, for the operation of s 75A, that a reduced liability results from the series of transactions put in place by the parties. Furthermore, the mischief the section addresses leads to the identification of V and P in each particular case. In the 'real world', Project Blue had acquired the barracks with the benefit of finance from MAR and the loophole which it had used was the combination of s 45 and s 71A; PBL was therefore P for the purpose of s 75A.

Finally, the chargeable transaction on the notional transaction was £1.25bn, as this was the largest amount paid under the arrangements. This was however subject to Project Blue's right to claim a refund under s 80, if the consideration paid by MAR to Project Blue before the Ijara arrangement was brought to an end, was less than the amount paid by Project Blue to the MoD.

Lord Hodge stated:

> 'I recognise the difficulty in interpreting the legislation which has been subjected to incremental amendments and additions since FA 2003, as Parliament has struggled to optimise this new tax.'

Since March 2011, the issue of the interaction of s 45 and s 71A no longer arises as a result of an amendment to s 45.

Project Blue v HMRC [2018] UKSC 30
Adapted from case summary in Tax Journal (15 June 2018)

Advance Clearance Service withdrawn for property investors

In an attempt to side step the new property interest restriction rules applying to individuals, buy to let residential property investors might have thought that incorporation was their best solution. However, while this might solve their interest deduction issue, it could create a capital gains problem that was not anticipated.

To avoid CGT on incorporation, their letting activity must qualify as a letting business rather than being considered passive investment. Historically, many buy to let owners used the HMRC Advance Clearance Service to provide certainty about their tax position before incorporating. However, this clearance facility has been withdrawn by HMRC.

Going forward, property owners will need to make their decision without this safety net. Incorporating without the CGT relief could result in hefty CGT bills that were not anticipated.

Administration

Enquiries into partnership and individuals' returns

Summary – Losses incurred by two taxpayers who took part in a film avoidance scheme were disallowed.

Mark Reid and Simon Emblin took part in a film avoidance scheme that involved gilt-edged securities. It was accepted that both failed.

Mark Reid and Simon Emblin claimed relief for losses arising under the film scheme in 2004/05 in their 2003-04 tax returns.

In September 2006, HMRC opened enquiries into the film scheme for 2004/05 and the taxpayers' returns for the same year and later issued notices amending their returns.

The taxpayers appealed arguing that their loss carry-back claims for 2003/04 were final because HMRC had not enquired into them. They also argued that, because s 12AC was deemed to open an enquiry into the partners' individual returns, the enquiry notices under s 9A were unnecessary. There could be only one enquiry into a tax return.

HMRC said those claims could not be made in the taxpayers' 2003-04 returns because they related to 2004-05. Claims made in the white space in the 2003-04 returns were made 'otherwise than by being included in the relevant return'. Further, the notice of enquiry issued into the partnership's return was enough to deal with the loss claim because, by virtue of the deeming provision in s 12AC(6), it had in effect opened enquiries only into the partnership aspects of the taxpayers' individual self assessments for 2004-05.

Decision

The First-tier Tribunal said a claim for losses arising in 2004/05 had to be made in the self-assessment tax return for that year, even if they were carried back to 2003/04. The judge noted that the claims made in 2004/05 by Mark Reid and Simon Emblin were 'not mere clarifications' but were necessary.

The judge agreed with HMRC that s12AC was a deeming provision that allowed the department to enquire into partnership aspects of an individual's return. It did not cover all aspects of the individual's return for which a s 9A enquiry would be required. A notice under s 28B(4) was served only if HMRC amended the individual's tax return as a result of the closure of a partnership enquiry. It did not close a s 9A enquiry. The Tribunal said the s28B(4) notices were valid and amended the taxpayers' returns to show nil losses under the film scheme. There were no losses to be carried back.

The appeal was dismissed.

Mark Reid & Simon Emblin (TC06469)

Share scheme annual returns

Taxpayers must submit electronically their employment related securities annual return for 2017/18 on or before 6 July 2018, following the end of the tax year.

All new schemes established during 2017/18 must be registered by 6 July 2018.

After the 6 July 2018 the following types of new schemes, established during 2017/18 cannot register or submit an annual return:

- Company Share Option Plan (CSOP)
- Share Incentive Plan (SIP)
- Save As You Earn (SAYE) schemes

www.gov.uk/government/publications/employment-related-securities-bulletin/employment-related-securities-bulletin-28-may-2018

Reasonable excuse that had ended

Summary – Taxpayer's appeal was dismissed due to delay between HMRC notifying her failure to file her return correctly and the taxpayer submitting the form correctly.

Christine Perrin had tried to file her 2010/11 self-assessment tax return before the 31 January deadline, but failed to complete the final step so the form was not submitted. She had experienced a similar problem the previous year and the penalty was cancelled.

When HMRC told her that the 2010/11 form had not been submitted, she tried to file the return again but did so using the 2011/12 form. HMRC notified her of the error and she submitted the form correctly about two months later. The First Tier Tribunal decided that, even if the taxpayer did have reasonable excuse for the late submission, it had come to an end because she did not rectify the problem as soon as HMRC told her about it.

The taxpayer appealed.

Decision

The Upper Tribunal accepted that Christine Perrin had a reasonable excuse but agreed with the First Tier Tribunal that this had ended because of the delay between HMRC notifying her of the error and the taxpayer submitting the form correctly about 2 months later.

The taxpayer's appeal was dismissed.

The judges also added some tips about how a Tribunal should approach reasonable excuse appeals.

1. It should establish the facts asserted by the taxpayer that constitute a reasonable excuse. These may include 'the belief, acts or omissions of the taxpayer or any other person, the taxpayer's own experience or relevant attributes, the situation of the taxpayer at any relevant time and any other relevant external facts'.

2. The Tribunal must assess which of those facts are proven.

3. It must then decide whether, 'viewed objectively', those facts amount to a reasonable excuse for the default. They should take into account 'the experience and other relevant attributes of the taxpayer and the situation in which the taxpayer found himself at the relevant time or times'.

4. The tribunal should consider whether the taxpayer remedied the failure without unreasonable delay.

Ignorance of the law

The judges noted that HMRC often uses this to deny the defence of reasonable excuse. The Upper Tribunal saw 'no basis for this argument', saying some requirements of the law are 'well known, simple and straightforward but others are much less so'. Again, each case had to be viewed objectively to decide whether it was reasonable for the taxpayer to have been ignorant of the relevant law.

Finally, the judges had asked HMRC for clarification of the return submission process because they were concerned that the taxpayer had not realised her return had not been submitted even though she had received a submission receipt number. Having received HMRC's explanation, the judges recommended that it may be prudent in future for the department's system 'to emphasise the point at which, and how, the taxpayer can be sure that his or her return has been submitted and accepted by HMRC'.

Christine Perrin v HMRC [2018] UKUT 0156 (TCC)
Adapted from the case summary in Taxation (7 July 2018)

Credit risk - Requirement to provide security

Summary – Given the taxpayer's history of two previous companies that had failed to pay over tax, national and VAT, HMRC's decision to require security was reasonable.

Mr and Mrs Holt were directors of Tri- Star Protection Limited Ltd, which was placed in creditors voluntary liquidation in October 2014 owing VAT of £80,989 and PAYE tax and National Insurance of £119,807. When the company was dissolved HMRC was among the unsecured creditors.

The couple were also directors of Crays Property Ltd although Mrs Holt resigned on 1 January 2016. On 8 May 2017, Mr Holt emailed HMRC to explain that Crays Property was not in a position to provide security and that he had decided to cease trading. The company was wound up on the petition of HMRC on 17 January 2018 at which date the VAT liability had risen to £102,137.04

In February 2017, Crays Support Services Ltd was incorporated with Mr Holt as sole director. In May, HMRC explained in a notice that the company was a tax risk and required Mr Holt to give security for PAYE tax of £19,584 and for National Insurance of £19,372. The company settled some of its tax and National Insurance, but refused to pay the security because it would damage the cash flow of the company.

Decision

The First Tier Tribunal noted that Mr Holt had been a director of two previous companies that had gone into liquidation owing large sums of PAYE tax and National Insurance as well as VAT. Further, his current company had defaulted on the previous seven months of PAYE.

The director had provided little information to show that Crays Support Services Ltd would avoid the financial problems of its predecessors. Nor had he been able to show how any of these companies had defaulted on their tax payments while continuing to pay his and the workforce's salaries. It seemed that Mr Holt had been deducting the PAYE tax and National Insurance from the salaries but did not pay the sums to HMRC.

The tribunal was satisfied that HMRC's decision to require security was reasonable.

The appeal was dismissed.

Crays Support Services Ltd v HMRC (TC06456),
Adapted from the case summary in Taxation (7 July 2017)

Ignorance of a legislative change

Summary – Ignorance of the fact that the new penalty regime (FA 2009 s 55) does not include a cap was a reasonable excuse for the late filing of returns.

The taxpayers traded together in a farming partnership and had filed both individual and partnership returns, which, for the years 2005/06 to 2009/10 were all delivered late.

The issue was whether the appellants had a reasonable excuse for the late filing.

Decision

The First Tier Tribunal noted that lack of funds was not a reasonable excuse. It also found that the postal problems were not a reasonable excuse as they were aware of the penalties. Furthermore, they did not have a reasonable excuse for the delay in appealing.

However, the First Tier Tribunal accepted the evidence of one of the taxpayers that, when she spoke to HMRC in March and June 2012, she genuinely misunderstood, possibly because the guidance given to her was not clear, that no penalties would be payable insofar as they exceeded the tax liability shown on the returns, and that as no tax was payable, any penalties imposed would be withdrawn.

When she received the £900 daily penalties in August 2012, that same taxpayer contacted HMRC again and it was only at that stage that she correctly understood that much higher penalties under a new penalty regime had been introduced and there was no penalty cap when no tax was payable. She had been diligent in addressing the matter and a reasonable excuse was therefore established for the late filing of returns for the years 2010/11 and 2011/12.

G E Hayhurst and J Hayhurst Partnership and others v HMRC (TC06496)
Adapted from the case summary I Tax Journal (15 June 2018)

Deadlines

1 July 2018

- Pay corporation tax for periods to 30 September 2017 if not liable by instalments;

5 July 2018

- File non-resident landlords' scheme forms NRLY and NRL6;
- Report non-cash benefits not from a registered pension scheme;

6 July 2018

- Forms P9D, P11D, P11D(b) for 2017/18 must be filed;
- Provide employees with 2017/18 benefits information;
- File taxed award scheme returns;
- Details of redundancy packages 2017/18 worth more than £30,000 to HMRC;
- File forms 42;

7 July 2018

- Due date for VAT return and payment for 31 May 2018 (electronic payment);
- Election deadline to aggregate beneficial loans in 2017/18;
- File forms EMI40;

14 July 2018

- File CT61s for quarter ended 30 June 2018;
- File monthly EC sales list if paper return used;

19 July 2018

- Pay PAYE/CIS for month ended 5 July 2018 if by cheque;
- Pay PAYE liability for q/e 5 July 2018 if average monthly liability is less than £1,500;
- Pay 2017/18 class 1A National Insurance contributions by cheque;

21 July 2018

- Submit online monthly EC sales list;
- Intrastat — payment of supplementary declaration for June;

22 July 2018

- Pay PAYE/NIC/student loan payments if being paid online;
- Pay 2017-18 class 1A NICs electronically;

31 July 2018

- Private company accounts with 31 October 2017 year-end to Companies House;
- Second 5% surcharge for unpaid 2016-17 balancing payments;
- 2017/18 second instalment self-assessment liabilities are now due;
- Tax credits claims to be finalised and renewed;
- Companies House should have accounts of plcs with 31 January 2018 year-end;
- CTSA returns for accounting periods ended 31 July 2017 should be filed;
- Annual adjustment for VAT partial exemption claims, April year-end.

News

Tax havens blacklist

On 25 May 2018, the Council removed the Bahamas and Saint Kitts and Nevis from the EU's list of non-cooperative tax jurisdictions.

This leaves seven non-cooperative jurisdictions listed in annex I which are American Samoa, Guam, Namibia, Palau, Samoa, Trinidad and Tobago and the US Virgin Islands.

www.consilium.europa.eu/en/press/press-releases/2018/05/25/taxation-2-jurisdictions-removed-from-eu-list-of-non-cooperative-jurisdictions/

OTS report on savings income taxation

In a recent report, the OTS has stated that although 95% of people have no tax to pay on savings income, the personal savings allowance and dividend allowance are not well understood.

In the report, the OTS makes a number of recommendations including:

- specifying the order of deduction for these allowances, or making them true allowances or exemptions rather than a nil rate;
- ending the differential tax rates for dividend income;
- further flexibility for ISAs;
- improved guidance on pension withdrawals and the use of emergency tax codes for personal pension lump sum withdrawals; and
- a review of rules on partial withdrawals from life insurance bonds.

Personal tax roadmap

The OTS also suggests the government should introduce a personal tax roadmap.

Savings taxation currently works well for most taxpayers but a minority experience real challenges. Many of the issues have arisen because of a series of changes, which has created complexity that is not easily resolved.

The OTS considers that further work on options to consolidate some of the rates and allowances should be undertaken. To approach this area in a strategic way, a personal tax roadmap could set the future direction for income tax, including for savings income, and outline the stages needed to get there.

www.gov.uk/government/publications/simplifying-the-taxation-of-savings-income

Data protection: HMRC privacy notice

On 23rd May, HMRC has issued an updated factsheet that explains how they use and protect the personal information that they collect about taxpayers. The May update includes information about the General Data Protection Regulation and the Data Protection Act 2018.

www.gov.uk/government/publications/data-protection-act-dpa-information-hm-revenue-and-customs-hold-about-you

Making tax digital pilot extended to landlords

In addition to self-employed sole traders, HMRC's making tax digital pilot is now open to landlords receiving income from UK property, but not furnished holiday letting.

Such individuals can sign up to use software to keep digital business records and send income tax updates to HMRC. In certain cases, this will remove the need to file a self-assessment return after 2017/18.

Using software to keep a record of daily income and expenses, every 3 months this is then used to send HMRC a summary of these records. Taxpayers can use this summary information to obtain an estimate of the tax owed at the end of your accounting year.

At the year end, they send a final report to confirm their total income and expenses, claiming allowances and reliefs, within this final report.

Taxpayers can choose to:

- send an update to HMRC more often, to see a more up-to-date estimate of the tax they might owe;
- pay their bill as they go, if it makes it easier for them to manage their budget; and
- ask their accountant to send updates for them.

www.gov.uk/guidance/use-software-to-send-income-tax-updates

Look up residency status for relief at source

The residency status look up service is now available for all pension scheme administrators. To use the look up service, they must have a Government Gateway account with a pension scheme administrator or practitioner ID to sign in.

Administrators can ask questions using the 'Feedback' or 'Get help with this page' links and HMRC will answer these within their normal turnaround times.

www.gov.uk/government/publications/pension-schemes-newsletter-99-may-2018

Manage and register pension schemes service newsletter

As mentioned last month, this newsletter announces the launch of HMRC's new 'Manage and register pension schemes' service that will be developed over the next two years and will replace the pension schemes online service completely after 2020.

From 4 June 2018, when registering as a pension scheme administrator or applying to register a pension scheme, this must be done using the new Manage and Register Pension Schemes service. HMRC has updated their main guidance on GOV.UK to reflect when this new service should be used.

Additional features from9 - 11 June 2018

The Manage and Register Pension Schemes service will temporarily close on 9 and 10 June 2018 to enable changes to be made so that from 11 June, administrators will be able to see a list of the schemes they have applied to register or see the status of these applications.

Existing scheme administrators

Existing administrators are encouraged to log into the service and complete their enrolment information to successfully complete their new online pension scheme administrator record.

Using the service if you're a non-trading company or a public sector organisation

Such entities will only be able to use the service if they have a 10 digit Corporation Tax unique taxpayer reference. HMRC can issue a provisional Corporation Tax UTR. This will not be an active Corporation Tax UTR for HMRC's purposes and there will be no onward Corporation Tax requirements for the company or organisation.

Phase One - second release

In the next main releases due later in 2018 HMRC will include additional features to enable administrators to:

- amend their pension scheme details;
- associate/add additional pension scheme administrators to their scheme;
- remove themselves as a pension scheme administrator in certain circumstances;
- decline an invitation to be associated to a scheme as pension scheme administrator;
- remove themselves as a pension scheme administrator from the new service.

They will also deliver changes to align their registration process with the authorisation process for master trusts.

Work on Phase Two

During Phase Two HMRC are planning to:

- introduce pension scheme reporting on the service;
- add pension scheme practitioners so they can use the new service to support pension scheme administrators with their reporting requirements;
- issue penalties and assessments for pension schemes through the new service;
- migrate existing pension schemes and scheme administrators (who have not already used Manage and Register Pension Schemes) from the current Pension Schemes Online service to the new service;
- start to issue notifications, notices and letters through the service.

www.gov.uk/government/publications/manage-and-register-pension-schemes-service-newsletter-june-2018

Business Taxation

Employed, self employed or a 'worker'?

Summary - Although Mr Smith was self-employed for tax purposes but also a worker. This gave him some protection for the purposes of employment legislation.

Mr Smith was a plumbing and heating engineer. From 2005 to 2011, he had worked for Pimlico, a substantial plumbing business. He claimed that he was an employee under a contract of service within the meaning of the Employment Rights Act 1996 s 230(1) and that he had been dismissed unfairly. He also contended that he had been a worker within the meaning of s 230(3).

Decision

The Supreme Court observed that 'it is conceptually legitimate as well as convenient' to treat the three decisions of the lower courts in this case as 'having been founded upon a conclusion that Mr Smith was a limb (b) worker within the meaning of s 230(3).' The court supported this conclusion and added that Mr Smith had been right to consider himself as self-employed for the purposes of income tax and VAT.

The court added that if Mr Smith was to qualify as a limb (b) worker, it was necessary for him to have undertaken 'to perform personally' his work for Pimlico. It found that this condition was satisfied, even though he could appoint a substitute. This was because this right came with a significant limitation: the substitute had to be a Pimlico representative; i.e. someone bound to Pimlico by an identical suite of heavy obligations. This was the converse of a situation where the other party is not interested in the identity of the substitute.

The court also accepted the tribunal's interpretation of Pimlico's inconsistent contractual terms as meaning that Pimlico's obligation to provide Mr Smith with work was limited to circumstances where work was available. In return, Mr Smith's contractual obligation was to keep himself available to work for up to 40 hours a week.

Finally, the court found that the tribunal had been entitled to conclude that Pimlico was not a client or customer of Mr Smith. Pimlico's tight control over Mr Smith was reflected in its requirements that he should wear the branded Pimlico uniform, drive its branded and tracked van, carry its identity card, and closely follow the administrative instructions of its control room.

Pimlico Plumbers and another v Smith [2018] UKSC 29

Adapted from the case summary in Tax Journal (22 June 2018)

Tax relief for training

Currently, the rules for tax relief on training costs depend on whether the individual is employed or self-employed. In each case there are situations where the individual will not receive any tax relief for any work-related training costs they pay for personally.

For the self-employed, tax relief is generally allowed where the costs are incurred to update the individual's existing skills, but denied if the individual invests in training to develop new skills to use in their business.

For employees, where an individual pays for work-related training costs personally, and is not reimbursed by their employer, then there are only very limited circumstances in which that individual can obtain tax relief for those costs.1

Between an employee and the self-employed there is also an imbalance where both are seeking to develop a new work-related skill. For the self-employed individual there can be no relief as noted above. However if an employee has their course paid for by their employer, there are no tax consequences for the employee on the benefit that they have received and their employer will receive tax relief for the costs incurred.

Jon Stride, Co-chair of ATT's Technical Steering Group, said:

> "We are pleased that HMRC are consulting on extending tax-relief for training costs to help support individuals to undertake, and benefit from, life-long learning.2 We would like to see that, as far as possible, employed and self-employed individuals have a level-playing field for tax relief on work-related training costs. Tax relief for such training costs should be available regardless of whether the individual is employed or self-employed, learning a new skill or updating an existing skill.
>
> "Self-employed individuals are often surprised and disappointed to find that relief is not available for the costs of acquiring new skills to develop their business. It is interesting to note that if the same business was incorporated and run as a limited company - so that the individual became an employee of their own company - they could then direct the company to pay for the course. In that case, provided the course was genuinely for the benefit of the business, the company should receive corporation tax relief on the costs with no tax consequences for the individual.
>
> "We appreciate that extending tax relief is likely to have an initial cost to the Treasury, but anticipate that this would be offset in the longer term as the economy benefits from a more skilled workforce."

www.att.org.uk/technical/news/press-release-att-calls-equal-access-tax-relief-training-costs

IR35 roundup – Part I (Lecture B1083 – 17.54 minutes)

IR35 considers whether, ignoring their personal service or intermediary company, a director would be considered to be an employee of their end client. In making this decision, we use the normal employed versus self employed criteria and can take into account any contracts that have been signed but only to the extent that they represent the commercial reality of what is being done.

Online employment status test

HMRC has an employment status test online. This has been used by the public sector and given that the public sector rules are likely to be extended to the private sector, this tool is going to become increasingly relevant.

At the moment the tool is a little subjective but hopefully it will be improved over time.

HMRC's recent win

Robert Jamieson discussed this case in some detail last month. Interestingly, there are around a 100 similar appeals ongoing.

The case concerned Christa Ackroyd Media Ltd, a company that was facing a £420k PAYE and NIC bill relating to a contract that Christa Ackroyd had with the BBC. Having worked for a competitor, the BBC managed to persuade her to sign a contract with them, resulting in the ratings for their 'Look North' programme far exceeding expectations.

In the court, the factors that indicated that she was employed were:

- She had a seven year contract for 225 days a year;
- Her contract included an exclusivity clause allowing her to work elsewhere but only with the BBC's permission;
- There was no substitution clause in her contract;
- She was economically dependent on the BBC with over 90% of her income coming from the contract;
- BBC editors exercised control over the programme content, directing her as she presented.

The big factors

The key deciding factors are:

- Mutuality;
- Substitution;
- Control.

While Christa Ackroyd fell foul of all three, this might not be the case for others. Let's consider some other cases that have been heard at a similar time.

MDCM Ltd v HMRC

Mr Daniels traded through his personal service company, MDCM Ltd, obtaining work through an agency, STL. Under these arrangements, STL received £370 per day from the end client, £310 of which was passed on to MDCM Ltd. The contract length ran from October 2012 to July 2013 with MDCM supplying Mr Daniels as nightshift manager on two projects. Mr Daniels:

- worked set shifts and reported to a project manager only once a week;
- represented STL as contact point for the contractors;
- did not participate in STL staff meetings or functions;
- provided his own insurance and mobile phone;
- was given protective equipment and access to site computer.

When considering the hypothetical contract between Mr Daniels and STL the First Tier Tribunal concluded there were points for and against employment as follows:

For employment

- No substitution;
- Flat fee with no financial risk;
- Safety equipment provided.

Against employment

- Not integrated into STL business;
- Not controlled;
- Could refuse work at another site;
- No notice periods, severance pay or pay-in-lieu;
- No sick pay or holiday pay.

But on balance, due to the short contract and lack of control, the Tribunal considered that Mr Daniels was not an employee.

Public sector contractor wins again

In Jensal Software Limited v HMRC, Ian Wells had worked as an IT contractor for many years. In 2012/13, he undertook a series of short contracts through his personal service company, JSL, providing his services through a recruitment agency.

HMRC argued that these contracts fell within the IR35 rules and assessed JSL to PAYE and NIC of £27,000 but Ian Wells disagreed. He had won an IR35 case before and believed that he would win again.

Facts to consider in this case were as follows:

- Agency had advertised for an IT contractor to work;
- In agency/JSL contract it stated that no mutuality of obligation was intended;
- For contract duration Mr Wells was free to work for other clients and did so;
- Mr Wells was unsupervised - instructions were limited and checks were minimal;
- His role could only be varied with agreement of agency and himself
- Substitution clauses existed;
- There was an element of financial risk as he would have been expected to rectify any sub-standard work in his own time.

Additionally, he provided some of his own equipment needed to carry out his work

The First Tier Tribunal considered the hypothetical contract between the DWP and Mr Wells which actually involved looking at three actual contracts! There was minimal mutuality of obligation, as the DWP was not committed to offer additional contracts.

The judge stated:

> “There was no continuing obligation on the part of the DWP to provide work; if it chose to abandon the project there was no contractual basis upon which Mr Wells could demand further work”

The Tribunal also concluded that there was a substitution clause and Ian Wells did have more freedom to carry out his work than the DWP employees.

He was in business on his own account and was not in IR35.

This case gives us insight into mutuality, substitution and control.

Overlooked IR35 case

The case of Armitage Technical Design Services Limited v HMRC was reported by Rebecca Cave, in AccountingWeb.

Mr Armitage is a skilled electrical control and instrumentation designer contracting in the nuclear industry. The case concerned his personal service company, Armitage Technical Design Services Ltd and the work that he did for Diamond Light Source Ltd. This case was heard back in November 2016. A summary judgment was released to the parties on 27 January 2017 but neither party applied for a full written judgment within 28 days and so the full judgment had not been published on the courts service website.

The issue was whether the income from Diamond Light Source Ltd for 2009/10 to 2013/14 fell within the IR35 rules. During this period Mr Armitage completed several separate projects for Diamond Light Source Ltd but also worked for other customers. Mr Armitage and his advisers were convinced that the contracts were not within IR35 but offered to settle the tax and NIC due for the two in date years providing that there was no penalty.

They did not want the case dragging on. HMRC refused as it wanted a penalty for negligent conduct, claiming that Mr Armitage had not discussed IR35 in sufficient detail with his accountant. HMRC submitted that in constructing the hypothetical contract, Mr Armitage would be considered to be an employee of Diamond Light Source Ltd.

In reaching their decision, the First tier Tribunal noted a number of relevant points:

- Substitution: Diamond Light Source Ltd would accept a reasonably qualified substitute in the place of Armitage, but this was never tested in practice. The First Tier Tribunal was satisfied that there was not an absolute requirement for Armitage to personally perform the tasks

- Control: Armitage chose to work in Warrington rather than at the Diamond Light Source Ltd headquarters in Didcot ….he only visited the Didcot site once per project. He worked to his own deadlines and was not directly supervised by Diamond Light Source Ltd staff. The judge concluded that Armitage was not subject to the same level of control as the Diamond Light Source Ltd employees.

- In business on his own account: Armitage was paid an hourly rate but he was not subject to the electronic time management system that applied to Diamond Light Source Ltd employees. He provided his own software and some of the computer equipment required for the project and he worked on other projects for other clients concurrently with the projects he was completing for Diamond Light Source Ltd.

- Part and parcel of the organisation: Armitage received none of the benefits provided to the Diamond Light Source Ltd employees such as a locker for personal belongings, sick pay or holiday pay and he did not attend employee social functions or training events and was not included on the team-sheets.

- Mutuality of obligation: The First Tier Tribunal said that the mere offer and acceptance of a piece of work does not amount to mutuality of obligations. The mutuality factor was neutral in this instance.

The First Tier Tribunal concluded that on balance the contracts Armitage performed did not fall under IR35 and all tax determinations and penalties were cancelled.

What can we conclude from recent cases?

When reaching their decision, the First Tier Tribunal consistently consider mutuality, substitution, control and then they consider other relevant factors. It seems that provided you possess one of the key factors, you are highly likely to be outside of IR35. Christa Ackroyd failed on all three and so lost her case.

Employment status consultation

Currently, an employment status consultation is looking at whether the key status tests of mutuality of obligation, personal service, and control should be codified within legislation.

As an alternative they are considering whether we should have a more precise test that sets limits for contract lengths (say one year), percentage of income (say 90%) and location.

Using this approach, Christa Ackroyd's 7 year contract at the BBC would still be caught under IR35 and the other cases that we have looked at would not.

This would make it much easier to assess when our clients are caught by IR35. It will be interesting to see what the outcome is.

IR35 roundup – Part II (Lecture B1084 – 21.55 mintes)

Deemed salary calculation

If caught by IR35, the following calculation is used to calculate the deemed salary as follows.

	£
Income received from relevant engagements in tax year	A
Less: 5% automatic deduction	(B)
	C
Less: Expenses paid by employer allowable as deductions from earnings if paid by an employee	(D)
Less: Employer pension contributions	(E)
Less: Employers NIC on workers actual pay	(F)
Less: Actual salaries and benefits paid	(G)
Gross deemed payment	H
Less: Employers NIC (H × 13.8/113.8)	(I)
Net deemed payment (= Gross pay process through payroll)	J

Compliance

The net deemed payment must be processed though the personal service company's payroll with the tax and NIC paid over to HMRC no later than 22nd April where payment is made electronically.

Remember, the £3,000 employers NIC allowance is never available to deduct from the secondary Class 1 NICs due in respect of a deemed payment.

Corporation tax relief

Under IR35, dividends are effectively reclassified as salary.

The income received from relevant engagements will form part of the intermediary's profits that means that the salary plus employers NIC is tax deductible in the accounting period that includes 5 April. It is not possible to make an accrual in respect of the deemed payment and related national insurance contributions

Dividend repayment

Dividends will only be taxed as dividends to the extent that they exceed the deemed salary payment. If the worker draws a dividend and is also treated as receiving a deemed payment then the same income is being taxed twice! The intermediary company will make a claim for relief to remove this anomaly by setting the deemed employment payment against the dividend.

The relief applies to dividends paid in the same year as the deemed employment payment

Off payroll workers in public sector

From April 2017, any public body engaging a Personal Service Company must decide whether IR35 applies to your client and if so, put the individual on their payroll!.

The system works as follows:

- Personal Service Company invoices £6,000 plus VAT of £1,200;
- Tax and Employees NIC of £1,613 is deducted by public body;
- Public body then pays the Personal Service Company £5,587 (6,000 – 1,613 + 1,200);
- A number of public bodies have started to reduce day rates to account for the fact that they will need to pay the Employers NIC;
- The net pay will be paid to the Personal Service Company and not to the 'employee' worker.
- Output VAT of £1,200 is paid over to HMRC in the normal way:
    - Box 1 £1,200
    - Box 6 £6,000
    - Even if on cash accounting which need to be overriden

In the personal Service Compnay's accounts, the original entries will be:

DR Debtors	£7,200	
CR Turnover		£6,000
CR VAT Liability		£1,200

Turnover will then be reduced by the income tax and Employees NIC of £1,613 deducted at source:

DR Turnover £1,613 (or salary might be more appropriate)

CR Debtors £1,613

The owner then extracts £4,387 as salary); this would be posted to salary as well. Salary would now be showing as £6,000 (1,613 + 4,387).

Do not include the extracted £4,387 on the director's self-assessment return as the director has a payslip from the public authority and a P60 that will show the £6,000 gross amount reported. This is the amount to include on the tax return with the tax deducted.

How has it been going?

Research has confirmed that reform has raised £410m in first ten months of operation. Around 58,000 more public sector contractors are paying tax and NIC. Some contractors did walkout but were replaced with "compliant" contractors. There was no evidence of contractors reverting to self-employed. Public bodies reported experiencing difficulty in filling vacancies due to staff shortages rather than these new IR35 rules.

Public bodies said the rules were easy to administer.

Extending the rues to the private sector

HMRC are very keen on the off payroll rules. With no input from HMRC needed, they get an extra £410m in 10 months. Just how much would they get in the private sector if the same rules were introduced?

There is a consultation on extending the rules to the private sector that runs until 10 August 2018. Under the proposals, the end client would deduct PAYE from the personal service company invoice. This will be a significant change and one that we should assume will happen and it could be in place from April 2019.

What should we be dong now?

Is this a fee opportunity for us? We should certainly be discussing the issues with our Personal Service Companies and explaining recent issues and what is round the corner. Perhaps, we should consider a short, punchy letter to grab their attention.

Could we offer a contract review service for a fixed fee? This could be done using information learnt from the recent First Tier Tribunal decisions. We should look to ensure that good substitution clauses are in place, no mutuality and limited control all feature clearly in the contracts with end users. Consider suggesting shorter contracts to promote no mutuality and while contracts may be renewed ensure that there is no obligation to do so.

Additionally, ensure that the contract's financial terms are clearly stated "excluding all taxes" as who pays the employers NIC has been a problem in the public sector;

By taking these steps, when the private sector use HMRC's online employment indicator tool, the results should be favourable to our clients and they can stay away from payroll.

There is no doubt that Personal Service Company clients will be getting more attention going forward. Contract reviews, making sure your clients know what is happening and what they should be doing will provide a valuable service to clients.

A partnership tax update (Lecture B1081 – 15.48 minutes)

In 2017, HMRC said:

> 'The rules governing the calculation of partnership profits and the return of those profits are clear in the majority of situations, but their application in certain modern commercial arrangements is not always without doubt.'

The changes and clarifications set out in S18 and Sch 6 FA 2018 have emerged from a consultation process that began in August 2016. They seek to address areas of uncertainty and complexity that have been identified in recent years as problematic by advisers and other stakeholders. The new legislation can be broken down into five main parts.

Bare trusts

Part 1 of Sch 6 FA 2018 introduces a new S848A ITTOIA 2005 which deals with the circumstances where a partner acts as bare trustee for a beneficiary who is absolutely entitled to the partner's share of profits. In this case, the beneficiary is to be treated as a partner of the partnership for all tax purposes. One practical effect of S848A ITTOIA 2005 is that the partnership return will have to name the nominee partner and the beneficiary. Nominated partners (ie. the partners appointed to be responsible for making partnership returns to HMRC) will need to ensure that they are aware of all bare trust arrangements.

S848A ITTOIA 2005 applies for tax years from 2018/19 onwards.

Indirect partners in a partnership

Part 2 of Sch 6 FA 2018 inserts a definition of an 'indirect partner' into S847 ITTOIA 2005. For this purpose, an indirect partner is a person who is a partner in a partnership that is itself a partner in another partnership (referred to as an 'underlying partnership'). This relationship can be achieved:

(i) directly; or

(ii) indirectly, via any number of intermediate partnerships.

Hitherto, legislation has prescribed how the basis period rules, for the allocation of profits or losses, apply to individuals who are members of a partnership (see S850 ITTOIA 2005). The new 'notional trade' provisions extend these rules, for 2018/19 onwards, to members of a partnership which is itself a member of a partnership. It is not thought that this amendment will have any great significance.

New reporting requirements

Part 3 of Sch 6 FA 2018 is intended to ensure that partnerships that are partners in other partnerships will always have access to the appropriate profit calculations so that they can complete their own partnership statement accurately. This, say HMRC, 'will reduce the likelihood of errors or mistakes' and should mean that 'the correct tax is calculated for partners in such situations'.

For 2018/19 onwards, additional information in a partnership return and statement must be provided where the reporting partnership is itself a partner in another partnership or includes a partner that is a partnership. The profits and losses of the reporting partnership must be calculated on four different bases, unless the members of the other partnership are individually named (which may be administratively impossible in a large multinational firm).

The amounts shown in the reporting partnership's statement as allocated to the other partnership must be calculated on the assumptions that the other partnership is a:

- UK-resident individual;
- Non-UK resident individual;
- UK-resident company; and
- Non-UK resident company.

The CIOT have commented, that, 'while often there is little or no difference in the calculation of profits under the various bases, in some cases there will be and, even if this measure is not as onerous as we think it will be, it will give rise to more work for some nominated partners'.

Overseas partners in investment partnerships

Part 4 of Sch 6 FA 2018 arises from suggestions that have been made to simplify the return requirements of investment partnerships where there is no UK tax at stake. While the Government expect investment partnerships to continue to submit normal partnership returns as before, FA 2018 does provide that, for returns made after the date of Royal Assent, no unique taxpayer reference needs to be included for non-UK resident partners as long as certain conditions set out in new S12ABZA TMA 1970 (as inserted by Para 8(3) Sch 6 FA 2018) are met.

This is a welcome relaxation.

Returns conclusive as to shares of profits and losses

Various cases over recent years have demonstrated how difficult it can be for an individual who is a partner in a partnership to comply with his personal tax obligations to submit a return that is correct to the best of his knowledge and belief where he disagrees with the information included in the partnership return. Hitherto, tax law has required that a partner should include, in his personal tax return, the amount shown as allocated to him in the partnership return. But how can an individual do this and sign off his return as 'correct' when he disputes the allocation of partnership profits in the partnership return?

It is understandable that HMRC are not overly enthusiastic when individual partners challenge the reporting of profit shares allocated to them by a partnership. In this context, the First-Tier Tribunal decision in King v HMRC (2016) – where the partners were successful in their appeal – is well worth a read. The judge in this case also makes the point that, where tax legislation is unclear, the Courts will seek to establish the ultimate purpose behind the statutory provisions.

The amendments made by Part 5 of Sch 6 FA 2018 will indeed provide more certainty in cases of dispute, for returns relating to 2018/19 and later tax years, but they will also make the challenging of profit allocations harder for individual partners – see new S12ABZB TMA 1970 (as inserted by Para 10(2) Sch 6 FA 2018), which introduces a special Tribunal procedure for the resolution of disagreements, as evidence of this.

For example, if a partner takes issue with the partnership return, it is unclear exactly what he should do until the matter is resolved. S12ABZB(1) TMA 1970 provides that the partnership return is 'conclusive'. So this seems to mean that a partner must include in his personal tax return the amount allocated to him in the partnership return until such time as the dispute over that particular allocation is settled. This will be the position in spite of the fact that, in the individual's view, his personal tax return will not be 'correct'. In addition, a challenge to the allocation of profits (or losses) has to be made through the Tribunal and so there must be a successful outcome here before the partner's personal tax return can be 'corrected'. This suggests that the partner may initially have to pay too much tax before trying to reclaim the overpayment. The CIOT neatly sum up the impact of S12ABZB TMA 1970 with these words:

> 'In our view, this does not seem to reflect the relative "power" of the individuals – everything will be in favour of the partnership and HMRC rather than the hard-done-by partner.'

Another point is that the new legislation does not extend to a dispute about the quantum (before any allocation) of the partnership's profits. This was of course the subject of the dispute in King v HMRC (2016). As the rules stand, it is only the allocation of profits that can be challenged under FA 2018. This means that, if a partner disputes the basic analysis as to whether a particular amount forms part of the firm's taxable profits, he would not have any recourse under this legislation. Would not some sort of appeal procedure make sense in these circumstances?

Finally, a partnership return that has been the subject of a Tribunal referral may not be the subject of another referral (unless it is the first one after the return has been amended). As the CIOT say:

> 'We do not understand why, if one partner has made a referral, no other partner should be able to make a referral, even on an unrelated matter.'

Contributed by Robert Jamieson

Changes to capital allowances (Lecture B1082 – 10.40 minutes)

Enhanced capital allowances (ECAs) for energy-saving and water efficient technologies

Capital expenditure incurred on certain energy-saving and water efficient technologies qualifies for 100% ECAs.

These rules operate in addition to the provisions for annual investment allowances (AIAs) and are particularly beneficial for businesses that have utilised their full AIA entitlement. Relevant details can be found at:

- www.gov.uk/guidance/energy-technology-list (for energy-saving products); and
- www.watertechnologylist.co.uk (for water efficient products).

The availability of ECAs allows profitable businesses to deduct the full cost of investments in energy-saving and water efficient plant or machinery from their taxable profits. Loss-making businesses, however, cannot enjoy this facility. Instead, such businesses are permitted – but only if they are *companies* – to claim first year tax credits when they invest in products that feature on the Energy Technology and Water Technology lists. When first year tax credits were originally introduced for a five-year period in April 2008, companies could surrender losses that were attributable to their ECAs in exchange for a cash payment (this is the first year tax credit). The relevant claim percentage was set at 19% so that a company that incurred qualifying ECA expenditure of £100,000 could receive a tax-free cash rebate of £19,000. At the time, 19% was two-thirds of the then corporation tax rate of 28%. The first year tax credit is subject to an upper limit that is the greater of:

- the company's PAYE and NIC liabilities for the period; or
- £250,000.

The scheme was extended for a further five years in 2013 to ensure that loss-making companies were encouraged to continue purchasing energy-saving and water efficient products. Although first year tax credits were due to expire on 31 March 2018, the Government have decided to amend Sch A1 CAA 2001 in two respects:

- arrangements will be extended for another 5-year period until 31 March 2023);
- claim percentage will be revised to two-thirds of the current corporation tax rate (ie. in line with the original policy intention).

This has been enacted in S29 FA 2018.

Allowances for zero-emission goods vehicles and gas refuelling equipment

The 100% reliefs for capital expenditure on:

- zero-emission goods vehicles (see S45DA CAA 2001); and
- gas refuelling equipment required to refuel vehicles powered by natural gas, biogas or hydrogen (see S45E CAA 2001)

which were due to come to an end this spring are being extended by three years (SI 2017/1304). The rules for zero-emission vehicles will now expire on 31 March 2021 (for persons within the charge to corporation tax) and on 5 April 2021 (for persons within the charge to income tax). The regime for gas refuelling equipment will terminate on 31 March 2021 for both corporation tax and income tax payers.

Contributed by Robert Jamieson

Simplifying tax relief for fixed assets

The Office of Tax Simplification has published its report on whether simplification could be achieved for businesses by replacing capital allowances with accounting depreciation.

Overall, the OTS has concluded that despite the 'long-term benefits of a move to accounts depreciation, these would not be enough to make the disruption of such a radical change worthwhile. It would require lengthy transition periods and involve all businesses, even though only around 30,000 businesses claim capital allowances above the present annual investment allowance of £200,000. Responses to the call for evidence were not enthusiastic about the idea.

The OTS believes there is considerable potential to simplify CAs, taking a combination of the recommendations outlined in the July 2017 review and three further areas outlined in the latest report. If that can be done, the OTS sees 'no conclusive case' in favour of using depreciation.

The report recommends three new structural changes to the capital allowances regime:

1. Widen the scope of the Annual Investment Allowance (AIA): For businesses investing less than the AIA limit, this would extend the AIA to all assets acquired for the business (excluding the usual categories of land and dwellings) without the need for further categorisation. This extension should apply to all business taxpayers, removing the complication of boundaries and thresholds. Businesses spending above the AIA limit may need to distinguish between assets falling within the AIA and those outside. HMRC estimates the cost of an extended AIA would be less than £5bn (compared with the current cost of £2.5bn).

2. Widen the scope of CAs generally (full scope CAs): Widening the CA regime to encompass all assets used in a business would require the creation of an additional CA pool for new business assets (but not land or dwellings) which do not qualify under any of the existing CA provisions, written down at a prescribed rate. HMRC estimates that a 2% flat rate allowance for assets which do not at present qualify for CAs would be cost neutral if the main 18% rate was reduced to 16% and the special 8% rate was reduced to 7%. A greater reduction in other rates may be necessary to achieve neutrality in the longer term.

3. Accounts-based CAs (if the scope of CAs cannot be widened): This would use the categorisation and lives determined for the accounts. There would be CA pools for the accounting categories with writing down allowances given for each pool. Assets such as land and dwellings would remain unrelieved. Benefits of this approach would include simplification of boundary issues and removal of the need to re-classify assets for tax.

Three alternative approaches to accounts-based CAs are suggested applying a writing-down rate:

• to the asset types in the accounts;

• taking account of asset lives as well as asset types; or

• based solely on asset lives.

The report notes that the last of these alternatives for the accounts-based option, based solely on asset lives, may become more appropriate in the future, ‘where asset descriptions are likely to become more difficult to interpret as tangible and intangible assets morph’.

Other recommendations for administrative changes follow those set out in the 2017 corporation tax report, involving:

- •using the capital/revenue distinction in accounts to reduce the burden of having to analyse capital expenditure for tax purposes;
- •introducing a small capital exemption for expenditure under £1,000 per item;
- •producing single list of all assets qualifying for CAs;
- •improving non-statutory clearances; and

www.gov.uk/government/publications/ots-review-on-simplifying-tax-relief-for-fixed-assets

CIS gross payment registration

Summary - The Supreme Court held that statutory requirements for CIS registration are ‘highly prescriptive’ and HMRC’s discretion does not extend to matters beyond these requirements or securing compliance with them.

JP Whitter (Water Well Engineers) Limited is a family-run business. In around 1984 the company registered for gross payment under the CIS. It then underwent regular reviews to determine whether it ought to retain its registration certificate. It first failed a review in July 2009, when its registration was cancelled. The same occurred in June 2010. On both occasions the registration was reinstated by HMRC following an appeal.

Between August 2010 and March 2011 the company was late in making PAYE payments on seven occasions. The delays were generally of a few days, but on one occasion of at least 118 days. It is accepted that the company failed to comply with the requirements of the CIS without reasonable excuse. A further review followed. On 30 May 2011 HMRC, acting under section 66(1) FA 2004, cancelled the company’s registration. In doing so, HMRC took no account of the consequences for the company’s business.

The First-tier Tribunal accepted the company’s evidence that the cancellation, once it took effect, would have had a seriously detrimental impact on the company and allowed the appeal holding that HMRC had been wrong not to take account of the likely impact on the company’s business. The decision was overturned by the Upper Tribunal and upheld by the Court of Appeal. The company appealed to the Supreme Court.

Decision

The statutory requirements for registration for gross payment are highly prescriptive. They include a requirement that the applicant for registration complied, within the previous 12 months, with various tax obligations subject to an exception for non-compliance with reasonable excuse.

The Supreme Court held that any statutory discretion must be exercised consistently with the objects and scope of the statutory scheme. The discretion does not extend to consideration of matters which relate neither to the requirements for registration for gross payment, nor to the objective of securing compliance with those requirements.

The mere fact that the cancellation power is discretionary rather than mandatory is unsurprising. Some element of flexibility allows for cases where the failure is limited, temporary and poses no practical threat to the objectives of the CIS. It is wholly inconsistent with that tightly drawn scheme for there to be implied a general dispensing power.

The company also claimed the right to protection of property under Article 1 of the First Protocol to the European Convention on Human Rights (A1/P1). It argued that cancellation involved an interference with the possessions represented by the subcontractor's entitlement to the full contract price or the bundle of rights inherent in registration. The supreme Court preferred HMRC's argument that, even if the rights conferred by registration amounted to 'possessions', they could not extend beyond the limits set by the legislation by which they are created. It was unnecessary to decide the appeal on that basis because the Court of Appeal was right to hold that any interference with A1/P1 rights was proportionate. Having accepted that the statute did not require the consideration of the impact on the individual taxpayer, nothing in A1/P1 justified the court in reading in such a requirement.

The judge concluded that construction industry scheme registration was 'a privilege conferred by the legislation, which has significant economic advantages, but it is subject to stringent conditions and the risk of cancellation.

The Supreme Court unanimously dismissed the appeal.

JP Whitter (Water Well Engineers) Limited v HMRC [2018] UKSC 31
www.supremecourt.uk/cases/uksc-2017-0016.html

Country-by-country reporting peer reviews

The OECD has released the first peer reviews of the domestic legal and administrative frameworks in place in 95 jurisdictions, as they prepare for the start of country-by-country (CbC) reporting in June 2018. The first annual peer review focuses mainly on the domestic legal and administrative framework, and reflects implementation as of January 2018.

Country-by-Country reporting, with exchanges slated to begin in June 2018, will see tax administrations worldwide collect and share detailed information on all large MNEs doing business in their country. Information collected includes the amount of revenue reported, profit before income tax, and income tax paid and accrued, as well as the stated capital, accumulated earnings, number of employees and tangible assets, broken down by jurisdiction. More than 1400 bilateral relationships are already in place for CbC exchanges, with more to come throughout the year.

CbC reporting is a minimum standard of the OECD/G20 Base Erosion and Profit Shifting initiative, which aims to provide governments with the domestic and international instruments needed to ensure that multi-national enterprise profits are taxed where economic activities generating the profits are performed, and where value is created.

OECD and G20 countries approved a 15-point BEPS package in 2015 to help them curb tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits.

The peer reviews show that practically all countries that serve as headquarters to the large multi-national enterprises covered by the initiative have introduced new reporting obligations compliant with transparency requirements.

60 jurisdictions have already introduced legislation to impose a filing obligation on multi-national enterprises Groups, covering almost all multi-national enterprises Groups expected to be in scope. The remaining jurisdictions are working towards finalising their domestic legal framework with the support of the OECD.

Where legislation is in place, the implementation of CbC Reporting has been found largely consistent with the Action 13 minimum standard. Some jurisdictions have received recommendations for improvement on certain specific aspects of their legislation and work has already begun to bring the provisions concerned in line with the standard.

www.oecd.org/tax/oecd-peer-reviews-on-beps-action-13-country-by-country-reporting-initiative-show-strong-progress-for-global-roll-out-in-june.htm

VAT

Extension of temporary VAT reverse charge

The VAT directive contains provisions allowing member states to apply a temporary reverse charge for supplies listed specifically in the directive as at risk of MTIC fraud. A quick reaction mechanism (QRM) is also available in exceptional cases, offering a faster procedure for enabling member states to apply the reverse charge for supplies not specifically listed, but in sectors where 'sudden and massive' fraud has occurred.

These provisions are due to expire on 31 December 2018.

Feedback received from member states and from stakeholders via the VAT expert group indicates that these provisions remain useful tools against VAT fraud.

The Commission therefore proposes extending these provisions until 30 June 2022, when plans for the 'definitive VAT system' are due to enter into force.

Proposal for a Council Directive - COM(2018) 298 final

Reverse charge for construction services

In the Autumn Budget 2017 the government announced its intention to introduce a VAT reverse charge for supplies of construction services to businesses from 1 October 2019, as a means of tackling fraud in construction industry supply chains.

HMRC is consulting until 20 July on a first draft of the Treasury order specifying the services to which the reverse charge will apply.

Who is likely to be affected?

Businesses involved in buying and selling construction services. It does not apply to zero-rated supplies of construction services.

How it will work

The introduction of a reverse charge does not change the liability of the supply of the specified services. What does change is the way in which the VAT on those supplies is accounted for. For specified services, the customer will be liable to account to HMRC for the VAT in respect of those purchases rather than the supplier (the 'reverse charge'). The reverse charge will apply through the supply chain up to the point where the customer receiving the supply is no longer a business that makes supplies of specified services. Excluded from the reverse charge will be businesses that supply specified services to a connected party within a corporate group structure.

The types of construction services covered by the reverse charge are defined in the draft secondary legislation. These are based on the definition of 'construction operations' used in the Construction Industry Scheme (CIS) under section 74 of the Finance Act 2004.

The draft legislation excludes certain types of supplies of services. This is also based on CIS definitions under section 74 of the Finance Act 2004.

The draft legislation also excludes supplies of specified services that are made to customers who are not construction businesses such as a high street retailer. Also excluded are supplies of specified services where the supplier and customer are connected in a particular way, and for supplies between landlords and tenants. The meaning of connected is defined in the legislation and only applies where the customer is not a construction business and the supplier is part of that customer's corporate group. These exclusions are defined in the draft legislation as excepted supplies. Unlike for CIS, there will be no deemed contractor provisions whereby purchases become subject to reverse charge because the purchaser buys a certain amount of such purchases in a given period.

Where a VAT-registered business receives a supply of specified services (which are not excepted supplies) from another VAT-registered business on or after 1 October 2019, it accounts for that VAT amount through its VAT return instead of paying the VAT amount to its supplier. It will be able to reclaim that VAT amount as input tax, subject to the normal rules. The supplier will need to issue a VAT invoice that indicates the supplies are subject to the reverse charge.

www.gov.uk/government/consultations/draft-legislation-vat-reverse-charge-for-construction-services

VAT treatment of electronic searches

In the First Tier Tribunal decision in Brabners LLP [2017] UKFTT 666 (TC), the Tribunal found that the amount paid by the client in respect of electronic property search fees formed part of the overall consideration they paid for the service provided by the firm. As a result, the Tribunal held that the fees for those searches could not be treated as disbursements for VAT purposes.

The Law Society's position

When a solicitor obtains a report, they should be regarded as acting as agent for their client (Article 79(c) of the Principal VAT Directive), where the relevant conditions are met, and the fee for obtaining the search should therefore be considered a disbursement for VAT purposes. The Law Society's view was that the act of advising on the report is different both in time and conceptually from the act of obtaining the report, and that the report is obtained on behalf of, and belongs to, the client. This argument was accepted by the First-tier Tribunal in the case of Barratt, Goff and Tomlinson [2011] UKFTT 71 (TC) in the context of medical reports, but not accepted by the First-tier Tribunal in Brabners on the facts of that case.

*HMRC's view (*VTAXPER47000)

The VAT treatment will depend on how the information obtained in the search is used. If it is passed on to the client without comment or analysis, the fee may be treated as a disbursement. However, if the firm uses the information to provide advice, or produce a report, the fee for the search will form part of the charges for its services and will be subject to VAT.

The Brabners case

The First Tier Tribunal held that whenever a solicitor obtains a search report on behalf of his or her client, the payment for the search "is part of the overall consideration which the client pays for the service supplied by the solicitor". The Tribunal went further than HMRC's guidance and arrived at the same conclusion whether or not a solicitor produced a separate report. In other words, the Tribunal held that disbursement treatment was not available even where the solicitor passed the search result on without comment or analysis.

The lack of clarity is unsatisfactory for firms and search providers. The result of the judgment in Brabners is that there are now different approaches to VAT treatment depending on the method used to obtain the search. The Tribunal accepted that HMRC had historically made the concession that postal searches were to be treated as a disbursement, but rejected any argument on the resulting inconsistency, in the main because the correct treatment of postal searches was not the subject matter of the case. The Law Society remains of the view that no distinction should be drawn between postal searches and electronic searches.

Discussions with HMRC

The Law Society recently attended a meeting with HMRC to seek clarity on how HMRC intends to approach the VAT treatment of electronic property searches going forward.

HMRC has confirmed that they do not intend to change the approach set out in their published guidance as to whether a property search fee should be treated as a disbursement for VAT purposes; if the search is passed on to the client without comment or analysis, HMRC says the fee may be treated as a disbursement. However, if the firm uses the search itself, for example in providing advice, or a report, HMRC's view is that the fee will form part of the charges for its services and will be subject to VAT.

Although the Law Society's interpretation of Article 79(c) differs from HMRC's in the absence of a binding decision of an Upper Court, firms may wish to follow HMRC's guidance when deciding whether to charge VAT on fees for property related searches going forward.

Historically by concession, HMRC are prepared to allow solicitors to treat postal search fees as disbursements so that VAT will not be payable on the amount of the fee. However, HMRC has acknowledged the need to review the position in respect of the postal search concession. Although it remains available currently, HMRC has ruled out any extension of it to electronic searches.

www.lawsociety.org.uk/news/stories/vat-on-electronic-property-searches--interim-guidance-to-firms/

Planning consent restricting occupation

Summary - Planning consent, restricting the occupation of student accommodation to students of named universities, did not prevent the application of zero-rating.

Summit Electrical Installations Limited, an electrical sub-contractor, made supplies relating to the construction of a block of student studio flats in Leicester, claiming that its supplies were zero-rated as supplies in the course of construction of buildings designed as a number of dwellings. The basis for Summit's argument was that they fell within Items 2 and 4 of

Group 5 of Schedule 8 of VATA 1994 as the building was a “building designed as a ... number of dwellings”.

The First Tier Tribunal had agreed but HMRC appealed. Under the planning consent, occupation was restricted to students attending De Montfort University or the University of Leicester. HMRC believed that Note (2) effectively denied zero rating which reads:

Note (2) reads:

> “A building is designed as a dwelling or a number of dwellings where in relation to each dwelling the following conditions are satisfied—
>
> (a) the dwelling consists of self-contained living accommodation;
>
> (b) there is no provision for direct internal access from the dwelling to any other dwelling or part of a dwelling;
>
> (c) the separate use, or disposal of the dwelling is not prohibited by the term of any covenant, statutory planning consent or similar provision; and
>
> (d) statutory planning consent has been granted in respect of that dwelling and its construction or conversion has been carried out in accordance with that consent.”

The issue was whether (c) above was satisfied.

Decision

The Upper Tribunal referred to Shields [2014] UKUT 453 and Burton [2016] UKUT 20 as authorities for the proposition that a prohibition on separate use for the purposes of VATA 1994 Sch 8 Group 5 note 2 will not exist unless the effect of the relevant term is to prohibit the use of the premises separately from the use of other specific land.

The Upper Tribunal observed that the relevant condition required use in connection with specified universities and not specified locations, as universities commonly expand to new locations. Consequently, there was no prohibition on separate use.

HMRC v Summit Electrical Installations Limited [2018] UKUT 176)

Notice 60: Intrastat general guide

This notice updates the December 2016 version. The main change (section 6.3) is that corrections are only required where the value of an error on a single data line exceeds £10,000 (previously £5,000).

https://www.gov.uk/government/publications/notice-60-intrastat-general-guide

Overpaid VAT not claimed

Summary - The taxpayer's case failed because it had not specified the amount claimed for any prescribed accounting period.

In March 2009, Bratt Autoservices Company Ltd wrote to HMRC enclosing a copy of its accounts of the year ended 31 December 1989, claiming a £1,293,750 overpayment of VAT.

The First Tier Tribunal held that there was no requirement that a claim be made by reference to prescribed accounting periods, and allowed claim.

In February 2016, the Upper Tribunal allowed HMRC's appeal concluding that the company had not made a claim to recover an amount of overpaid VAT.

Bratt Autoservices Company Ltd appealed to the Court of Appeal arguing that repayment ought not to be denied simply on the basis that the claim had not been allocated on a period-by-period basis. While a claim had to relate to output tax accounted for in a prescribed accounting period, the legislation did not prescribe what was to happen where a taxpayer had a claim that extended over several accounting periods. HMRC could allow amendments to claims, once made, of quite an extensive nature. It was incorrect to hold that the substantive requirements for a successful claim had to all be in place at the outset.

Decision

The formal requirements of a claim were those contained in reg 37 of the Value Added Tax Regulations 1995, SI 1995/2518. However, that had to be read with s 80 VATA 1994, so as to give 'claim' and 'amount' a consistent meaning throughout. A claim under s 80 was not any demand for repayment of overpaid tax, but was a demand for repayment of overpaid output tax for a prescribed accounting period which was not output tax due. It was not the case that a claim under the VATA 1994, s 80 could relate to one accounting period or many.

If claims could be made other than by reference to prescribed accounting periods, then it would not be possible, in some cases, to determine without further investigation whether the whole or part of the 'claim' was time-barred.

Running through all the taxpayer's submissions was the suggestion that all that was missing, on HMRC's case, was an estimation of the amount for each of four prescribed periods, and that it could be arrived at by dividing the amount for the calendar year by four. Accounting periods did not necessarily coincide with the beginning and end of calendar years. The ability to make an estimate in some cases would not force a different interpretation of the section

The company’s case had failed because it had not specified the amount claimed for any prescribed accounting period.

The appeal was dismissed.

Bratt Autoservices Company Ltd v Revenue and Customs Commissioners [2018] EWCA Civ 1106

Reduced rate for energy-saving materials

Summary - The supply of a roof system did not fall within the reduced rate provisions of VATA 1994 Sch 7A Group 2.

Wetheralds Construction Ltd supplied a 'Solid Roof System' that was registered with the Local Authority Building Control, (the organisation representing all local authority building control 25 teams in England and Wales). The certificate from the Local Authority Building Control referred to a “solid roof insulation system which replaces existing translucent panes or panels of a domestic conservatory...whilst retaining the existing aluminium profiles, ties and other structural components to the roof.” The Conditions of the certificate stated that “the Registered Detail relates to the reroofing of existing conservatory...roofs.”

The First Tier Tribunal had allowed the company’s appeal against the decision of HMRC that its supplies of the 'Solid Roof System' did not qualify for the reduced rate of VAT.

HMRC argued that the First Tier Tribunal had made two errors of law in reaching its decision:

1. It had erred in its application of Pinevale [2014] UKUT 202; it should have concluded that the supplies were not merely supplies of insulating materials applied to a pre-existing roof;

2. It had erred in its application of the principles in CPP (Case C-349/96) and Levob (Case C-41/04) in concluding that insulation predominated overall to determine the characterisation of the supply.

Decision

The Upper Tribunal noted that the first question was whether the supply was of 'insulation for roofs', as opposed to the supply of roofs. They considered that the supply by Wetheralds Construction Ltd was of all the elements comprised in a roof, save for the original glazing bars. The old roof covering was removed, and a new roof covering (tiling) was added, as well as a new plasterboard ceiling, soffits and rainwater goods. The supply could therefore not be described as 'no more than insulation'. The Tribunal added that Wetheralds' own marketing material referred to the supply of 'your new roof '.

The Tribunal found that a typical consumer of the Solid Roof System would have described the supply as a thermally efficient replacement roof, and not merely as the insulation included within the system.

The appeal was allowed.

HMRC v Wetheralds Construction Ltd [2018] UKUT 173

Challenges of selling a commercial property (Lecture B1085 – 14.04 minutes)

Introduction

VAT and property continues to be a challenge. Let's consider a case study scenario where a firm of solicitors called Legal and Co (a partnership) bought the freehold of a property (office on two floors) for £600,000 plus VAT in 2013 and traded from it for three years. They then relocated to new premises and rented the property out for two years to a firm of accountants. They opted to tax the property when the tenant was found (charging VAT on the rental income) but it is now 2018 and they have decided to sell the freehold. I will consider three different selling situations, all of which have different VAT treatments.

Convert building into residential use

Let us firstly consider the situation where the accountants have ended their rental agreement, so Legal and Co is selling a vacant building.

As an opening question, can you think of two situations when the sale will be made without adding 20% VAT, despite Legal and Co's option to tax election ie the sale will be exempt rather than standard rated?

The first situation is if the buyer intends to convert the building into dwellings or a building that will be used for a 'relevant residential purpose' (RRP). The latter relates to use as eg an elderly persons home, student or nursing accommodation. In other words, a change from commercial to residential use is planned for the building. The buyer will issue form VAT1614D to the seller, which confirms his intention to convert the building into dwellings or for RRP use. The form must be issued before the price of the deal is legally fixed, ie before exchange of contracts (VAT Notice 742A, para 3.4).

Here are the answers to some questions that you might be asking:

If I am the buyer, must I have obtained planning permission to convert the property into dwellings before I can complete form VAT1614D?

The answer is 'no' because it is all about your intention at the time of the deal. The actual statement you will be signing is Condition 2 of the form, which says: "I intend to convert the building or part of the building mentioned above with a view to it being used as a dwelling or dwellings or solely for a relevant residential purpose"

What if my intention as the buyer is to only convert part of the building into dwellings?

The good news is that the seller's option to tax election can be partly overridden to reflect the residential use but VAT will still be charged on the commercial element (Notice 742A, para 3.4.6). There is no specified method of output tax apportionment in the legislation but it must be carried out on a 'fair and reasonable' basis eg a square footage or floor split basis. So if one floor out of two will be used for commercial purposes, a VAT charge on half of the selling price will be reasonable.

If I change my mind after I have bought the building and never convert it to residential use, will I have to repay the VAT I saved?

The answer is 'no' – it is all about the buyer's intention at the time of the supply. If these intentions are genuinely stated, there will be no comeback if the buyer changes his mind in the future about his use of the building.

Charitable use

The second situation when Legal and Co's option to tax election will be overridden is if the buyer is a charity and intends to use the building or part of the building for a 'relevant charitable purpose other than as an office.' In this situation, there is no official HMRC form to complete, so the charity will confirm its intention to the seller in writing.

The phrase 'other than as an office' basically means that the building will not be used by the charity for head office type functions eg dealing with the charity's accounts, administration, IT issues etc. However, if the office use is eg to provide a base for staff operating a telephone helpline service to assist those in need ie a charitable purpose, this is not a problem (VAT Notice 742A, para 3.5).

With regard to the 'part of the building' issue, it is important that the relevant use of the building can be clearly defined for each specific area – see Animal Charity and building use.

Animal charity and building use

Manchester Animals Charity is buying a three floor building and the seller has opted to tax the building so wants to charge 20% VAT on the sale of £300,000. The Charity will use each floor as follows:

- The ground floor will be a shop to sell donated goods to members of the public
- The first floor will be used to treat and look after sick animals
- The second floor will be used as the head office of the charity, dealing with administration issues.

The option to tax election can be overridden by the seller in relation to the first floor ie it will be used for a charitable purpose. So the sale proceeds relevant to this floor will be exempt, with the other two floors being standard rated. The ground floor shop is a 'business' use so does not qualify for exemption and the second floor use is captured by the 'other than as an office' exception for the option to tax override. So it is likely that a floor split basis will apply to the VAT charge ie £300,000 plus VAT of £40,000.

Transfer of a going concern (TOGC)

We have so far considered the potential VAT issues with the building being sold as vacant but what would be the situation if it was sold with a tenant or tenants still in occupation ie the accountants in our case study. The sale will be outside the scope of VAT as a TOGC as long as the deal meets certain conditions:

- The buyer will need to be either VAT registered or liable to be registered at the time of the deal.
- If the seller has opted to tax the property, the buyer must also opt to tax the property before the deal takes place ie form VAT1614A must be completed and submitted to HMRC's Option to Tax Unit in Glasgow.

- The buyer must also confirm to the seller in writing that the option to tax election he has made will not be disapplied. This is an anti-avoidance measure – see VAT Notice 700/9, para 2.4.2.

- The rental arrangement must be carried out on a proper commercial basis ie there is a genuine 'property rental business' in place. I recently dealt with a query where the tenant was only paying a peppercorn rent to the landlord, which did not constitute a business, so there was no scope for a TOGC.

What would be the VAT position if a ten floor building was being sold by a seller who had an option to tax election in place, but only one out of the ten floors had a tenant in place at the time of the sale ie nine floors were sold with vacant possession?

Your initial thought might be that there is scope to treat 1/10 of the selling proceeds as a TOGC but the good news is that all proceeds will qualify as long as the conditions above are met. The HMRC guidance refers to this situation as a 'partially let building' and it makes no difference what the split is between tenanted and vacant. VAT Notice 700/9, para 6.2.

Capital goods scheme and TOGC

There is a twist to the tale for our buyer if a TOGC situation applies, namely that he will take over any remaining capital goods scheme (CGS) adjustments of the seller. Legal and Co bought the property for £600,000 plus VAT five years ago, so this is within the scope of the scheme because the cost is more than £250,000 excluding VAT and the relevant adjustment period for land and property is ten years. So this means that input tax of £120,000 is reviewed by Legal and Co over a ten year period to reflect any change in use between taxable and exempt activities (and non-business activities as well since January 2011). So if Legal and Co bought the property in 2008 or later (which they did ie 2013), then some intervals are still outstanding for the buyer in the event of a TOGC. But as long as the buyer continues to use the building wholly for taxable purposes, the remaining annual adjustments will be 'nil' so no extra VAT is payable.

Option to tax – 20 year rule

This is not relevant to Legal and Co because it only opted to tax the property in 2016 when it sublet the building to the firm of accountants ie to ensure its use of the building was taxable rather than exempt (adding VAT to the rent). However, be aware that if a business made an option to tax election on a property more than 20 years ago, it can reverse the election by submitting form VAT1614J to HMRC. This means that future income from the property will again be exempt from VAT again rather than standard rated. This outcome would be particularly useful to a tenant or buyer who cannot claim input tax eg a bank or a betting shop.

Contributed by Neil Warren

Who was supplying to whom?

Summary - A transaction, involving the aggregation of the barrelage of public houses to secure a greater discount from brewers, involved a supply of services for consideration.

Redwood owns and manages hotels and public houses. It negotiates discounts on the price of beer supplied to it, as well as to public houses owned or tenanted by third parties (the 'publicans'). In relation to the latter, the issue was who was supplying to whom?

In most cases, the discounts due to the publicans were paid to Redwood, which paid a proportion of the discount received to the relevant publicans, retaining a share of the publicans' discounts. The amount retained was not disclosed to the publicans.

Decision

The Upper Tribunal found that Redwood was supplying services to the publicans. These services consisted in negotiating and administering an arrangement with the brewers, whereby the purchases made by publicans were aggregated along with those of Redwood with the effect of achieving greater discounts. This analysis was consistent both with the commercial reality and with the contractual terms both between Redwood and the brewers and between the brewers and the publicans. The consideration for the supplies by Redwood was the amounts retained by Redwood out of the discounts received from the brewers in relation to the publicans. The fact that these retained amounts were not disclosed to publicans was immaterial. It was also irrelevant that Redwood obtained an additional benefit, namely an increased discount on its own supplies, as this was 'extraneous' to the relationship between Redwood and the publicans.

Redwood Birkhill v HMRC [2018] UKUT 189
Adapted from the case summary in Tax Journal (22 June 2018)