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Personal tax

Statutory residence test (Lecture P1321 – 17.50 minutes)

Summary – Returning to the UK to care for an alcoholic sister and her minor children were exceptional circumstances under the statutory residence test. As a result, the appellant remained non-UK resident despite spending more than 45 days in the UK.

In this case, the First Tier Tribunal prohibited the publication of the name or address of the Appellant or any member of her family referred to in the proceedings.

The Appellant was resident in the UK, living with her husband and their two children. On 4 April 2015, she had moved with her younger daughter to Dublin and for 2015/16, declared on her Self Assessment tax return that she was non-UK resident under the Statutory Residence test. Her husband had remained in the UK in the former family home, with the intention being that in two years he would retire and move to Dublin.

On 16 September 2014 her husband transferred a shareholding to her and in the period ended 31 March 2016, she received dividends of approximately £8 million. Arguing that under the Statutory Residence Test she was still UK resident in 2015/16, HMRC sought to levy UK tax on this dividend, resulting in additional tax payable of £3.1 million.

The appellant appealed arguing that she was non-UK resident throughout 2015/16, as days spent in the UK in December 2015 and February 2016 should be disregarded under the exemption contained in Schedule 45 Finance Act 2013. She acknowledged that there was "a lot riding on the day count".

It was common ground that in 2015/16 tax year, under the Statutory Residence Test the appellant would be non-resident in the UK if she spent 45 days or less in the UK. The Appellant accepted that by 21 November 2015, she had used up 44 days of the 45-day allowance. However, she then made two further visits, in December 2015 and February 2016, to the UK. She believed that these visits could be ignored as her presence in the UK was due to exceptional circumstances beyond her control. She claimed that in December 2015 and February 2016 she had come to the UK as her twin sister was suicidal and she needed to care for both her twin as well as her twin's minor children.

HMRC did not accept that the appellant had shown that these exceptional circumstances had prevented her from leaving the UK on each day, since she had access to a private jet and could have returned to Dublin each evening.

Decision

There were a number of pieces of evidence that did not ring true with the First Tier Tribunal:

- If her twin was a genuine suicidal risk, it was 'strange and implausible' that she did not seek medical psychiatric assistance during her two visits to help her; and
- restaurant and supermarket receipts showed that she was not 100% committed to helping her sister during these two 'exceptional' visits;
- the Appellant had made no record, even in outline, of the reason for her visits and why they prevented her from leaving the UK.

The Appellant did not satisfy the Tribunal that she came to and remained in the UK in December 2015 and February 2016 because her twin sister had threatened to commit suicide.

Further, although medical records supported the claim that her twin had suffered with both alcoholism and depression for many years, neither were considered to be exceptional circumstances on their own.

However, the fact that the twin sister had minor children, for whom the Appellant also cared for, changed the position. The Tribunal stated:

> "In our view, the combination of the need for the Appellant to care for her twin sister and, particularly, for her minor children at a time of crisis caused by the twin sister's alcoholism does constitute exceptional circumstances for the purposes of paragraph 22(4)."

The First Tier Tribunal found in the Appellant's favour and allowed the appeal.

A Taxpayer v HMRC (TC08464)

Jersey company distributions

Summary – Distributions from a share premium account by a listed company incorporated in Jersey were subject to UK income tax as dividends.

Alexander Beard was a shareholder and employee in Glencore International PLC, a publicly listed company incorporated in Jersey and domiciled in Switzerland. The company was not resident in the UK for UK tax purposes.

A corporate restructuring, whereby certificates in a Swiss subsidiary of Glencore were exchanged for Glencore shares, had created around $9 billion of 'qualifying reserves' which, under Swiss law, could be repaid to shareholders without Swiss withholding tax. As a result, between 2011/12 and 2015/16, Alexander Beard received distributions each year out of these qualifying reserves, with the company deducting the distributions from their share premium account rather than retained earnings. Alexander Beard included these distributions in his tax returns as capital distributions.

HMRC argued that the distributions should be subject to income tax rather than capital gains tax.

Alexander Beard appealed, contending that under s.402(4) ITTOIA 2005 the distributions were of a capital nature and therefore not chargeable to income tax in the UK.

Decision

The First Tier Tribunal stated that the correct approach to adopt in determining the tax treatment of a payment made by a non-UK company, was to:

1. Establish the character of the payment under Jersey law, where the paying company was incorporated; and

2. Apply UK tax legislation to that payment.

Having considered case law, Jersey and UK law, the First Tier Tribunal concluded that:

- Jersey law used the term distribution rather than dividend but the term dividend was not defined in Jersey law. There was nothing in Jersey legislation to say that the distributions could not be dividends for English law purposes. Further, the terms dividend and distribution were used interchangeably in general use.

- Under Jersey legislation everything, including the share premium is distributable, unless specifically 'assimilated to capital'. As Jersey law did not define share premium as assimilated to capital, it must therefore be distributable profit, available to be paid by a company by way of dividend.

Consequently, the distributions represented dividends paid out of distributable income profits, which were not capital and so were taxable as income.

The appeal was dismissed.

Alexander Beard v HMRC (TC08460)

Redemption of preference shares (Lecture P1321 – 17.50 minutes)

Summary - The redemption of preference shares not disclosed to HMRC made the advance statutory clearance void. The buybacks fell within the transactions in securities legislation and income tax applied.

Ivan Wroe, Stephen Rimmer and Colin Timms each owned 200 ordinary shares in Proline Engineering Limited, holding approximately 30% of the issued share capital of Proline. A fourth individual, Mr Jones, owned the balance.

In August 2013, a new holding company, Jenbest Limited, was inserted above Proline Engineering Limited. Each taxpayer exchanged their Proline shares for 25% of the ordinary share capital and £600,000 £1 preference shares in Jenbest Limited. Mr Jones was issued with 25% of the ordinary shares in Jenbest Limited.

It was argued that the reorganisation equalised the shareholdings of the four individuals while also compensating the original shareholders for the reduction in their shareholdings and facilitated their eventual retirement.

Describing the preference shares as irredeemable, the company obtained statutory clearance from HMRC that the transactions in securities legislation would not apply.

During the 2014/15 and 2015/16, Jenbest Limited repurchased the preference shares at nominal value, with the taxpayers reporting their disposal as capital gains eligible for Entrepreneurs’ Relief.

Later, HMRC issued assessments to each of the taxpayers, arguing that the transactions in securities legislation applied. The statutory clearance had been given without mention that the preference shares could and would be repurchased, making it void. HMRC believed that a main purpose to the transaction was to obtain an income tax advantage for each of the three taxpayers.

The three taxpayers appealed.

Decision

The First Tier Tribunal was referred to a letter from the company's advisers that effectively made HMRC's case for them. The letter made it clear that mentioning the plan to redeem the preference shares 'would simply flag the matter to HMRC'. If the shareholders were to reduce their combined shareholding from 90% to 75% followed by the preference share repurchase, advance clearance would be unlikely to be given. They would have successfully withdrawn £1.8 million from the company while still retaining control. The letter confirmed that in this case, the cash consideration would then be charged to income tax as a deemed dividend.

The First Tier Tribunal found that this letter made it abundantly clear that the preference shares would be repurchased but the repurchase was not needed to equalise the shareholdings. Although part of a planned retirement plan, the deal was structured to produce a capital gain, avoiding a much larger income tax charge on a deemed distribution. One of the main purposes of the buyback was to obtain a tax advantage. This was not incidental or 'merely the icing on the cake'. Key facts had been hidden from HMRC.

The First Tier Tribunal found that the advance statutory clearance was void, as the application deliberately failed to mention the repurchase of the preference shares.

The taxpayers' appeal was dismissed.

Ivan Wroe, Stephen Rimmer, Colin Timms v HMRC (TC08474)

Disguised remuneration rules apply to payments

Summary – Company contributions to a remuneration trust were disallowable for corporation tax and the loans from the trust to employees taxable as disguised remuneration.

CIA Insurance Services Ltd was an insurance broker and subsidiary of another company which was wholly owned by three individuals, each of whom was an employee of the company; two were also directors.

The company made contributions to a remuneration trust which were used to make loans exceeding £9.5 million to the three individuals. Each loan was made under a finance agreement for a period of ten years and a one day. The company claimed corporation tax deductions for the contributions to the trust and that no income tax or National Insurance charge arose on the loans.

Decision

The First Tier Tribunal found that the company had entered into a marketed scheme which involved a series of pre-ordained steps. A purpose of setting up the trust and making contributions was to secure a tax advantage. The judge did not accept the company's alternative reasons. These included to provide a fighting fund to benefit customers and the business and because it had lost confidence in banks. Therefore, irrespective of whether the company's purposes could be 'best described as tax avoidance or tax mitigation', or whether that was a valid distinction to be making in this context, the making of the contributions could not be expenses incurred wholly and exclusively for the purposes of its trade.

On whether the individuals were taxable in respect of the loans, the tribunal disagreed with HMRC's argument that the loans represented earnings of the individuals which had been redirected to the trust. The loans were made under finance agreements under which they had an obligation to repay. The main issue was whether the loans were provided 'in connection with' the individuals' employment. The First Tier Tribunal noted that the individuals took significant salary reductions with no evidence of a reduction in duties. The First tier Tribunal concluded that the loans were provided to the individuals in connection with their employment and so the disguised remuneration rules in Part 7A ITEPA 2003 applied. The loans were chargeable to income tax and National Insurance.

The appeal was dismissed.

CIA Insurance Services Ltd v HMRC (TC08475)

Adapted from the case summary in Taxation (26 May 2022)

PAYE credits, judicial review and transfer of assets abroad

Summary - The Court of Appeal rejected the taxpayer's appeal that concerned a disguised remuneration loan scheme, ruling that HMRC retained a discretion under s.684(7A)(b) ITEPA 2003 that can operate retrospectively which had the effect that the taxpayer's income tax liability had to be paid by him without setting off notional PAYE deductions that would otherwise have been treated as made by the end users.

Stephen Hoey was a UK based IT contractor providing services to UK end users. His employers made contributions to employee benefit trusts, which in turn made loans to him.

It was accepted that the contributions to the trust were Stephen Hoey’s taxable employment income. As his employers were based outside the UK, the law provided that the UK end users of his services were liable for PAYE on the employment income (s.710(2)(b) ITEPA 2003.

However, an HMRC officer chose not to pursue the end users for that PAYE tax as they knew nothing of the avoidance arrangements that existed. Instead, the officer chose to collect the tax directly from Stephen Hoey, with no credit for PAYE.

The assessments were upheld by the First Tier Tribunal who found that s.684(7A) ITEPA gives a very wide discretion to HMRC to collect tax other than via PAYE but that it did not have jurisdiction to decide whether or not that discretion had been properly exercised here. He was not entitled to a PAYE credit.

The Upper Tribunal agreed with the First Tier Tribunal on the jurisdiction issue but did find that s 684(7A) only applies prospectively. Consequently, Stephen Hoey would have been entitled to the PAYE credit were it not for the jurisdiction point.

Stephen Hoey appealed to the Court of Appeal.

Decision

The Court of Appeal rejected Stephen Hoey's appeal, finding that HMRC's discretion was lawfully exercised. It agreed that the tribunals have no jurisdiction to review the exercise by HMRC of this discretion, and that the only possibility of challenge is by judicial review; and it disagreed with the Upper Tribunal that s 684(7A) only applies prospectively, finding that HMRC can also use the power retrospectively to remove an obligation after it has already been triggered. The plain language of the s 684(7A) power simply requires the officer to ask whether it is appropriate to expect the end user to comply with the PAYE regulations by accounting for the employee's income tax. To limit the exercise of the power to a situation in which HMRC are aware of all the facts in advance and can only operate it with prospective effect would seriously curtail the scope of the power, and there is nothing to warrant such a conclusion.

On another issue, it was part of HMRC's case before the Upper Tribunal that any charge to tax under the transfer of assets abroad legislation would take priority over any liability under the employment income provisions of ITEPA and the Upper Tribunal had accepted this submission. During the Court of Appeal hearing, HMRC conceded that the transfer of assets abroad provisions do not have priority, although they do have a role to play as a fallback head of charge. The Court of Appeal welcomed this, describing the earlier submission as extraordinary.

Stephen Hoey & Others v HMRC [2022] EWCA Civ 656

Adapted from the case summary in Tax Journal (27 May 2022)

Capital taxes

No trading, no entrepreneurs' relief (Lecture P1321 – 17.50 minutes)

Summary –The taxpayer's claim for entrepreneurs' relief was denied as the LLP had not started trading at the time of disposal.

John Wardle owned 14.65% of a Limited Liability Partnership (LLP) that was established in 2015 to acquire, construct, and operate a power plant in Hull using wood waste biomass.

In August 2015 the LLP entered into a number of contracts relating to the construction, operation, and financing of a plant in Hull, including a contract to purchase feedstock from a supplier.

On 14 September 2016, the LLP applied to the Environment Agency for a permit to operate the power plant, which was granted some 8 months later, in May 2017.

In November 2016, prior to the permit being granting, John Wardle disposed of just under half of his interest in the LLP. He reported the related gain in his 2016/17 tax return, claiming that he was eligible for entrepreneurs' relief.

In May 2018, HMRC opened an enquiry and in March 2020, HMRC closed their enquiry rejecting the entrepreneurs' relief claim. HMRC saw the business as a manufacturing trade and unless electricity was generated there would be no income.

John Wardle appealed arguing that the LLP's business was not simply to generate electricity. It also included the construction and operation of the plant as a waste-to-energy business, procuring waste wood and then converting it into electricity with the LLP's principal revenue stream being the sale of electricity as a by-product of processing waste wood. On that basis, the trade started in August 2015.

Decision

The First Tier Tribunal reported John Wardle had produced a limited number of documents to support his case as he:

- did not want to advertise the profitability of the business;
- claimed that certain documents were commercially sensitive and the subject of confidentiality agreements; and
- argued that supplying the details of one of the LLP's 56 contracts was sufficient evidence to provide.

To be eligible for entrepreneurs' relief on the disposal, the LLP must have been trading for at least one year prior to that disposal.

The Tribunal referred to the principles set out in *Mansell v HMRC [2006] Sp C551*, where the Special Commissioner had stated:

> "I conclude that a trade cannot commence until it has been set up …. and that acts of setting up are not commencing or carrying on the trade. Setting up trade will include setting up a business structure to undertake the essential preliminaries, getting ready to face your customers, purchasing plant, and organising the decision making structures, the management, and the financing."

At the time of disposal, although it was claimed that a number of contractual commitments existed, construction of the plant had yet to begin. The site of the plant was a disused industrial site. It would take some two years to build after which the project would enter into a 6 to 12 month commissioning phase, where the contractor would test the plant. During that period feedstock would be burnt and electricity generated but only to test the plant. Once the commissioning process was completed the operator would take over and power generation proper would start. Further, John Wardle confirmed that the detailed design of the plant was still being worked on. The trade had not been 'set up" and was not 'operational'.

The First Tier Tribunal dismissed the appeal

John Douglas Wardle v HMRC (TC08485)

Trust registration **(Lecture P1322 – 14.02 minutes)**

Since the EU's Fourth Money Laundering Directive (4MLD) came into force in 2017 there has been a requirement to register all UK trusts which have a liability to any relevant taxes (being CGT, income tax, IHT, LBTT, SDLT, SD).

However, this has now been superseded by 5MLD, the fifth directive. This changed the type of trusts which need to be registered and took effect from 6 October 2020 but without having a deadline for when the trust had to be registered. This has now been confirmed as being 1 September 2022.

The guidance is in the Trust Registration Service Manual which has recently been updated by HMRC.

It is important to understand the type of trusts which have to register to ensure that there is compliance with these rules.

Two types of trusts must register:

1. All UK express trusts and some non-UK express trusts unless they are explicitly excluded from registration; and

2. Any UK or non-UK trust with a liability to UK taxation even if it is not required to register under the first heading.

The trustees of registrable taxable and express trusts are then also required to keep the information held on TRS up to date. The conditions for registration and the information required are different for the two options.

Personal representatives of estates may also need to register the estate in some circumstances.

For the avoidance of doubt, the following terms are defined as indicated:

- A UK trust is a trust where all the trustees are resident in the UK or there is a mixture of UK resident and non-UK resident trust but the settlor of the trust was resident and domiciled in the UK at the time the trust was set up (or when the settlor has added funds to the trust).

- A trustee or settlor is treated as resident in the UK if they are a UK body corporate or in the case of an individual, they are UK resident for the purposes of one or more relevant tax (income tax, capital gains tax, inheritance tax, SDLT, LBTT, LTT or SDRT).

- The question of whether a settlor is domiciled in the UK does not take account of deemed domicile.

- An express trust is a trust which is created deliberately by a settlor either during their lifetime or by a will to take effect on their death. It does not include express trusts which come into being through the operation of law.

- Non-UK express trusts are liable to be registered if they are not excluded trusts but where they acquire an interest in UK land or enter into a business relationship with a UK relevant person assuming at least one of the trustees is resident in the UK and the trust is not an EEA registered trust. A relevant person includes auditors, insolvency practitioners, accountants, tax advisors, legal professionals, estate agents, cryptocurrency exchange providers and other similar business (see list in TRSM24020).

- If there are no UK resident trustees, the trust is only liable to be registered if they acquire UK land, assuming they are not an excluded trust.

The following trusts do not have to be registered as they fall to be treated as 'excluded trusts' as long as they do not have a liability to UK taxation:

- A trust created by will that holds only property from the estate of the deceased person is excluded from registration for a period of two years from the date of death. If a trust created by a will commences at a later date, either during or before the end of the administration period, the trust is not required to register until assets have been transferred from the estate but only from two years following the date of death.

- Trusts for bereaved minors and age 18-to-25 trusts as long as they meet the conditions in s71A or s71D IHTA 1984 respectively. It should be noted that trusts created on intestacy for minors are not express trusts and would not be registrable express trusts.

- Trusts holding life insurance policies which will only pay out on the death, terminal or critical illness or permanent or temporary disablement of the person assured or to meet the costs of healthcare provided to the person assured are not registrable during the lifetime of the person assured. This could apply to a whole of life or term policy. This extends to policies which have a surrender value until such time as the policy is surrendered (on the assumption that the cash sum is retained in the trust after this date such that it would become registrable). If the policy is effectively an investment bond with a small life assurance element payable on death which is largely incidental to the benefits to be provided through partial or full surrenders, then it is HMRC's view that the exclusion will not apply.

- A trust holding a healthcare insurance policy where the policy only pays out to meet the cost of healthcare services provided to the person assured.

- A trust holding prospective death benefits payable under a retirement policy.

- Any trust holding a policy excluded from registration during the life of the person assured continues to be excluded from registration if, following the death of the person assured, the trust continues following receipt of the pay-out from the policy. This exclusion applies for two years following the date of death.

- Trusts arising from personal injury payments made to a person as a result of a personal injury to them is excluded from registration as long as it is from capital under the Income Support Regulations which will apply for two years or a longer period if it is considered to be reasonable in the circumstances. The time limit runs from the date of payment if the claimant is already in receipt of income related benefits or from the date on which such income related benefits become payable.

- Trusts arising from employee share schemes which is either part of a share incentive plan or any share option scheme.

- Co-ownership trusts where the trustees and beneficiaries are the same persons. This only applies where property is held as tenants in common.

- Property held on behalf of minor children or property owned by more than four persons.

- Trusts that are registered as a charity in the UK or any charitable trust which is not required to register (broadly exempt charities, excepted charities or those with income of less than £5,000 a year). Charities which are waiting for registration confirmation do not need to register on TRS so long as the trustees have a genuine expectation that the trust will be accepted for registration as a charity.

- UK registered pension schemes.

- Trusts where a disabled person is the beneficiary are excluded during the lifetime of the disabled person.

- Pilot trusts set up before 6 October 2020 which hold assets with a total value of £100 or less so that registration is delayed until the added funds mean the value is above this figure.

- Trusts created in the course of provision of professional services created for the purpose of enabling or facilitating the holding of sums, assets or documents or for the purposes of holding client money or to support commercial transactions or for the purposes of the registration of assets.

- Trusts holding tenants' contributions for the purposes of s42 Landlord and Tenant Act 1987 to hold service charges.

- Approved maintenance funds for historic buildings.

- Certain trusts relating to the financial and capital markets are excluded if they meet certain conditions. Details can be found in TRSM23100.

- Trusts created for the purposes of enabling or assisting named public bodies to carry out their functions.

- Legislative trusts such as those created on bankruptcy or intestacy.

- Trusts imposed by court orders for example consent orders in matrimonial disputes.

- Trusts which are established in an EEA member state which is required to be registered in that member state.

- Bare trusts to hold bank accounts or similar organisations who hold cash deposits (for example credit unions) for minors or person lacking mental capacity.

Examples

The following are all examples from the TRS Manual and give a clear view of the type of cases where HMRC accept (or do not accept) that registration is needed.

<u>Example 1</u>

John dies in England on 1 June 2022. He leaves his estate to his executors and trustees to hold on trust to pay his debts and funeral expenses and to divide the remainder between his wife and brother in equal shares absolutely. Under English law this creates a trust. As a trust created by will, the trustees are not required to register the trust immediately on John's death.

The estate is fully administered and all property in the residuary estate is distributed to his wife and brother by December 2023. As this is within two years of John's death, there is no need for the trust to be registered on the Trust Registration Service (TRS).

<u>Example 2</u>

Sunita sets up a trust on 1 May 2012 with a nominal £10. The trust lists her sister and her child as beneficiaries. Sunita also amends her will so that her share portfolio will transfer to the trust on her death.

Sunita dies on 1 February 2023 and the shares are transferred into the trust. The exclusion from registration does not apply as the trust was not created by the will. During Sunita's lifetime the trust was excluded from registration as a historic pilot trust, but the trust is required to register from the point the assets are transferred into the trust following her death.

Example 3

Alice and Bob own a property with a declaration of trust confirming they own as tenants in common. This trust is excluded from registration during Alice's lifetime as an exempt co-ownership trust.

Alice dies and by the terms of her will leaves her share of the property on trust to Bob to occupy for the remainder of his life; and thereafter to her daughter Clara. Alice's son David is appointed as executor and trustee of the will and also appointed as a second trustee of the property with Bob.

There are two trusts: 1) the new trust created by Alice's will; and 2) the ongoing trust of the property.

1. The trust created by Alice's will is excluded from the requirement to register for two years following Alice's death. If the trust is still in existence two years after Alice's death, the trust is required to register from that point.

2. The ongoing trust of the property is no longer an exempt co-ownership trust as the trustees and beneficiaries are not the same persons. Registration is required 90 days after Alice's death.

If Clara was appointed as the second trustee of the property instead of David, then this would still be an exempt co-ownership trust as the trustees and beneficiaries would be the same persons, and therefore registration would not be required.

Example 4

Charles and Debra live together in a property owned outright by Charles. Charles dies and by the terms of his will creates a trust which gives Debra a life interest in the property, with the trustees having the power to sell and purchase a replacement property on the same terms. As a trust created by will, the trustees are not required to register the trust immediately on Charles' death.

12 months following Charles' death, the trustees sell the property and use the proceeds to purchase another property of similar value on the same terms, with Debra retaining her life interest.

As the trust fund still consists only of property from Charles' estate (there has been a substitution but no additions), the trust is still excluded from registration. If the trust is still in existence two years after Charles' death, the trust will be required to register from that point.

Example 5

Karl takes out a 40-year term life insurance policy, which is written into trust at commencement. The policy will only pay out on the event of Karl's death within the 40-year term, and the policy is not able to be surrendered during that term. As this meets the conditions set out above, the trust holding the policy is excluded from registration on the Trust Registration Service (TRS). [In fact, this would be exempt even if the policy could be surrendered although it would need to be registered as soon as the policy was surrendered and the trust then held just cash. If it paid out on death, there would be a two year window for the trust to be wound up before registration was necessary.]

Example 6

Margaret takes out an investment bond which she places in trust. Under the terms of the policy, Margaret is able to withdraw up to 5% of the funds invested per year in the form of a part-surrender of the policy. As these withdrawals are anticipated as an integral part of the design of the policy, they do constitute pay outs from that policy. As these pay outs are on occasions other than those listed, the exclusion from registration on TRS does not apply.

Example 7

Alice and Bob wish to purchase a property together. They elect to hold the property as tenants in common, allowing them to declare that Alice owns 70% of the property and Bob owns 30%. To achieve this, they create a trust for ownership as tenants in common. As Alice and Bob are both the only trustees and the only beneficiaries of the trust, the trust is not required to register on TRS.

Example 8

Martha and Mary set up a trust in order to buy a property to rent, with family members as the beneficiaries of the income of the trust. One family member manages the day-to-day running of the property and is the trustee of the trust. As the beneficiaries and trustees of the trust are not the same, the exclusion from registration does not apply.

Example 9

Francisco transfers the legal and beneficial interest in a property to his three children Antonia, Sofia and Dolores to hold equally as joint tenants. Dolores is under the age of 18 and is unable to hold the legal title to the land. Antonia and Sofia therefore are treated by the Trusts of Land and Appointment of Trustees Act 1996 as holding the property on bare trust for the benefit of themselves and Dolores, until such time as Dolores reaches the age of 18. As a trust imposed by legislation, this trust is not required to register on TRS.

Example 10

A charitable trust is set up in Wales to provide new household items for those struggling financially in the local area. For the first two years the income of the charity remains below £5,000. The charity is therefore not required to register with the Charities Commission in England and Wales. It is not required to register on TRS either.

In its third year the work of the charity expands considerably and its gross income is £50,000. The charity therefore applies for registration with the Charities Commission in England and Wales which the trustees have a genuine expectation will be accepted.

The application takes several months to be processed and accepted. The trust is not required to register on TRS, neither during the period when waiting for the request to be processed nor going forward.

Example 11

Nikita enters into a commercial transaction to sell business assets to Christine. The contract identifies some assets as excluded from the sale and has a 'wrong pocket' clause which confirms that, if an excluded asset ends up in the hands of the buyers, it would be held on trust by the buyer for the seller and must be transferred back. Such a trust would be excluded from registration.

Example 12

Rubina and Stefan enter into a commercial transaction in relation to property development, with a conditional funding agreement and provision for Rubina's funds to be held on trust by an escrow agent whilst certain pre-conditions are satisfied. Once the conditions are satisfied, the escrow agent will release the money to Stefan. If on the other hand the conditions are not satisfied, the money returns to Rubina. This creates a trust arrangement which is excluded from registration.

Practicalities of registration

There has been a different time limit for registration for taxable and non-taxable trusts but this is aligned going forward.

For non-taxable trusts, the normal time-limit for registration of trusts is going to be 90 days from the establishment of the trust. However, any trust created on or before 6 October 2020 has until 1 September 2022 to register.

For taxable trusts, the time limit for those created on or after 6 April 2021 will also be 90 days from commencement or 1 September 2022, whichever is later. For those created before that date, the registration date was 31 January after the end of the tax year if already registered for SA or 5 October following the end of the tax year if incurring an income tax or CGT liability for the first time (or 31 January following the end of the tax year if the liability is for any other tax).

Once registered, updates will be necessary every time there is a change in beneficial ownership information, including changes in trustees or beneficiaries. Where there is a trust tax liability, trustees must confirm that the information held on the TRS is up to date and this is done on the SA900 return form, although there is no requirement to update information about the trust assets following initial reporting.

There is an initial penalty of £100 for failing to register a trust with additional penalties becoming payable if the non-compliance continues.

For trust to register, there is an extensive list of information to be provided about the settlor, the trustees and the beneficiaries as well as any individual who has control over the trust although this will be rare.

One important point to note about the current transitional regime is that this registration requirement applies to any trusts that was in existence on or after 6 October 2020. This is a register of beneficial ownership of trusts and it needs to include details of anyone who has been a beneficial owner since that date even if they are no longer so. If they have ceased to be a beneficial owner, they will be immediately removed from the record but they do have to be included in historical data. Historical data is to be retained for 10 years.

The following is a (brief) list of the type of information which needs to be included.

For the trust:

- Name of trust
- Date it was created
- Whether trustees and/or settlors are based in the UK
- Whether the trust has acquired UK land since 6 October 2020
- Whether the trust is listed on an EEA register
- Whether the trust has a business relationship in the UK

For the trustees:

- Full name, DOB of all trustees and contact details for lead trustee
- Country of nationality of trustees and country of residence
- NINo for lead trustees
- For trustees who are not individuals, need business name, UTR, contract details for the lead trustee and country of residence.

For the settlor:

- Full name, DOB and DOD if relevant
- Country of nationality and residence
- Mental capacity

For the beneficiaries:

This information varies depending on whether the beneficiary is an individual, a class of beneficiaries, a charity or other trust, company or employment related trust, or other.

- Individual beneficiary
    - Full name
    - DOB
    - Country of nationality and country of residence
    - Mental capacity
- Class of beneficiaries
    - Description of class with details of members of that class if they can be reasonably identified

- Charities or trusts
  - Name
  - Country of residence
- Companies or employment related
  - Name of company or business
  - Country of residence
  - Description of beneficiaries
- Other
  - Description of beneficiary
  - Country of residence

Additional information is also required for trusts with a UK tax liability including:

- Details of liability to income tax and CGT
- Information on assets held by the trust.

Who can access the information?

Information on the Trust Register can be subject to a third-party access request unless the trust is registered only because there is a liability to UK taxation in which case the information is only available to relevant law enforcement agencies.

A third party can only access the information if they can demonstrate they have a legitimate interest which means they must be looking for information relating to money laundering or terrorist financing.

Other countries may be able to access the information if the trust has a controlling interest (50% or greater) in a third country entity.

Trustees may be provided with a copy of their entry on the TRS if it is needed for confirmation for business purposes.

Contributed by Ros Martin

Flexible Reversionary Trusts (Lecture P1323 – 7.56 minutes)

Flexible reversionary trusts (FRTs) are a relatively new development that most tax advisors probably won't have encountered yet. They are very similar to discounted gift trusts (DGTs), which are a long-standing form of IHT planning vehicle. Both involve the settlor transferring an investment bond into trust and retaining the right to certain benefits from it, which may be in the form of (inter alia) a percentage amount, a cash sum or an entitlement to one or more individual policies.

These benefits only become payable to the settlor provided they are alive at the date the payment falls due. The other benefits under the bonds are held for the chosen beneficiaries.

Under a DGT, the rights retained by the settlor are indefeasible. Thus, the transfer of value made by the settlor when entering a discounted gift scheme is reduced by the value, if any, of those retained rights.

In contrast, under an FRT, the settlor's retained rights can be defeated or deferred by the trustees. The settlor can therefore ask the trustees to defer their entitlements from vesting, which is therefore why the trusts are referred to as 'flexible'. This lack of certainty over whether the payments will actually be made to the settlor means that the settlor's retained rights have no open market value. The settlor therefore makes a transfer of value equal to the full sum invested when a FVT is set up; no discount is applied for IHT purposes.

Most importantly for investment managers, the option not to take withdrawals may affect investment policy compared to a DGT, as if no withdrawals are expected, the whole fund can be invested for the long term.

Contributed by Kevin Read

Selling company shares - consideration (Lecture B1322 – 17.18 minutes)

Where company shares are sold, there will be a disposal of that asset by the shareholder. If the proceeds of that sale exceed the acquisition cost for the shareholder there will be a capital gain arising. The actual liability arising on that capital gain will depend on the circumstances of each individual shareholder. The rate of CGT will be 10%, 20% or 10% if business asset disposal relief (BADR) is available. Availability of BADR is a very important facet of company sales although less so since the lifetime limit was reduced to £1m.

Business asset disposal relief (BADR)

BADR is available where there is a material disposal of business assets by an individual. One of the material disposals is the disposal of shares and securities in a company.

In order to be a qualifying disposal, either condition A or B must be met:

- Condition A is that throughout a period of two years ending on the date of disposal the company is:
    - the individual's personal company;
    - is either a trading company or a holding company of a trading group; and
    - the individual is an officer or employee of the company or the trading group.
- Condition B is that those conditions are met throughout a period of 2 years ending with date of ceasing to trade or ceasing to be part of a trading group (without becoming a trading company) and that cessation is within 3 years of the date of disposal. This does not necessarily mean the cessation of all activities but just cessation of qualification as a trading company.

A company is an individual's personal company if the individual concerned holds at least 5% of both the ordinary share capital and the voting rights plus 5% of rights to income and assets on a winding up (or 5% of sale proceeds).

It is obviously key that the company is a trading company or the holding company of a trading group.

This is defined as follows:

1. A trading company means a company carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities (considered by HMRC to mean any activity contributing more than 20% of turnover, profit, asset value or time employed in the business).

2. A holding company means a company that has one or more 51% subsidiaries.

3. A trading group means a group of companies one or more of whose members carry on trading activities and the activities of whose members taken together do not include to a substantial extent activities other than trading. Effectively you take the single company definition and apply it to the group as if it were a single company (ignoring inter-company transactions).

4. Trading activities mean activities carried on by a company:

   - In the course of carrying on its trade

   - For the purposes of preparing to trade

   - With a view to acquiring or starting to acquire a trde

   - With a view to acquiring a significant interest in the share capital of another company which is a trading company or the holding company of a trading group and which is not a member of the same group of companies as the company acquiring the shares.

Types of consideration

Where shares are being sold, there are a number of ways in which the deal can be structured with different types of consideration available to the purchaser. The tax treatment will depend on the nature of the consideration.

The types of consideration we are normally looking at are:

a) cash;

b) loan notes issued by the acquiring company (QCBs and NQCBs);

c) shares in the acquiring company

Each type of consideration will give rise to different tax effects for the purposes of capital gains tax and should be considered in turn to determine which consideration may be most tax efficient and desirable for each of the shareholders in this situation.

Cash consideration

If any part of the consideration is in cash, that proportion of the gain will immediately crystallise as an immediate liability to CGT.

If the consideration is only partly cash for a share sale, the allowable costs to set off against the proceeds will be calculated using the A/A+B formula where A is the cash consideration received and B is the value of the non-cash consideration received. It will be chargeable in the tax year/chargeable period in which the sale takes place.

Example

Mr A sells shares for £1,000,000 cash. He had previous purchased those shares for £100,000.

Disposal proceeds	£1,000,000
Less cost	(100,000)
Gross gain	£900,000

If he had sold for £1,000,000 cash plus shares worth £600,000, the cost of £100,000 would have been apportioned using formula A/A+B:

100,000 x (1,000,000)/(1,000,000 + 600,000) = £62,500

The initial gain then increases to £937,500 due to a lower cost price. The £37,500 of cost is carried forward as the base cost for the new shares received (see below).

Consideration satisfied in shares

Where the shareholder vendor in question chooses to receive shares in the acquiring company in exchange for his shares, the CGT liability on the disposal of the original shares will be deferred if the conditions are met. In fact, the legislation does not actually defer the gain, rather treats the disposal as if it had not taken place. The acquisition cost of the original shares is simply transferred to the new shares.

This treatment is mandatory although it is possible to elect for it to be disapplied.

As the original shares are treated as if no disposal is made there is a continuous holding period for BADR assuming other conditions continue to be met.

The primary condition for the no disposal/no acquisition rule to apply is that there must be an issue of shares or debentures by the predator company to a person in exchange for shares or debentures in the target company.

One of three other conditions must then be satisfied:

1. the acquiring company already holds, or as a result of the transaction will hold, more than 25 per cent of the ordinary share capital of the target or

2. the acquiring company makes a general offer for the shares in the target with the intention of gaining control of the target or

3. the acquiring company already holds, or will hold as a result of the transaction, the majority of the voting power in the target

There is an overriding condition is that the exchange must be carried out for bona fide commercial reasons and not as part of a tax avoidance scheme. However, this only applies where the shareholder together with persons connected with him hold 5% or more of the shares in the target company. This anti-avoidance rule will not apply if, on an application being made in advance of the transaction, HMRC are satisfied that the exchange or reconstruction will satisfy the conditions set out above.

There is a problem, however, if the target company shares qualify for BADR but the acquiring company's shares will not. In this instance, the shareholder can elect to disapply the provisions of s135 so that the share exchange constitutes a disposal. This would enable the BADR to be claimed. The consideration would be the market value of the shares being acquired. This may seem like a sound idea but will obviously mean the potential of crystallizing a tax liability without the corresponding income to pay the tax. This would need to be factored into any negotiation.

Consideration as loan notes

Loan notes can be qualifying corporate bonds (QCBs) or non-qualifying corporate bonds (NQCBs).

If the loan notes are short dated, it may be considered to be consideration as cash.

A corporate bond is a qualifying corporate bond if it is issued after 13 March 1984 and corporate bond is defined by s117 TCGA 1992 as:

'a security ...

(a) The debt on which represents and has at all times represented a normal commercial loan and

(b) Which is expressed in sterling and in respect of which no provision is made for conversion into, or redemption in, a currency other than sterling'

It should be noted that conversion at the prevailing exchange rate would be ignored for the purposes of this definition.

'Normal commercial loan' has a specific definition and excludes loan notes where there is an ability to convert the loan note to shares and where interest is payable according to results.

The default position will therefore be that loan notes are QCBs, with specific clauses having to be inserted into the loan note to make it an NQCB.

Where shares in a company are swapped for loan notes the normal share exchange rules apply in basic terms. It would therefore be usual to apply for the relevant clearances to ensure that s135 TCGA 1992 applied (see above).

Where the loan note is an NQCB, the treatment is identical to shares. Whether ER is due on the eventual encashment of the NQCB will depend on whether the issuing company meets the necessary conditions at the point of encashment.

However, there are special rules for QCBs. Where consideration is satisfied by the issue by the acquiring company of loan notes which are QCBs, no immediate CGT liability arises. The gain or loss is calculated as at the date of disposal but does not crystallise until the QCB is redeemed.

For deals involving QCBs from 23rd June 2010 onwards, the gain which comes into charge on the encashment of the QCB will only be eligible for BADR if the qualifying conditions are met at the point of encashment. This will necessitate the QCB holder being an officer or employee of the company and for the company to be the personal company of that individual (which will not be possible via the loan note holding as they will never be vote bearing so would only apply if the individual retains sufficient voting shares).

In reality, the QCB holder will have two options: elect to disapply the share exchange provisions so that the gain crystallises immediately or to accept the default for QCBs but risk not having BADR on the eventual encashment.

Deferred consideration

The comments above regarding the taxability of the different types of consideration assume that the shareholder will be paid immediately on completion. However, consideration may be offered on a deferred basis. Deferred consideration may be structured either as fixed, or variable, for example, in an earn-out arrangement it may be dependent on future profits.

Fixed deferred cash consideration

If a fixed part of the cash consideration is deferred this has to be included in the calculation of CGT initially, with no regard for the delay in receipt or for the fact that it may not be paid. The same applies even if the deferred consideration is contingent upon a specified event.

Example

Mr B sells his company for £500,000. Of this, £250,000 is to be paid immediately and then he is to receive £50,000 every six months until the debt is paid. He will be subject to CGT as if the full £500,000 had been paid initially. This would be the same even if the additional payments were contingent upon the company meeting certain targets at each six-month point.

The CGT liability can be repaid if the consideration becomes irrecoverable. S48 TCGA 1992 states that a claim can be made for discharge or repayment of tax and there are no other specific provisions within the legislation other than that.

In fact, a claim can also be made to adjust the CGT computation where a contingent liability may become payable. This legislation is at s49 TCGA 1992 and states the taxpayer may lodge a claim for repayment of tax where a contingent liability has to be paid. This would normally cover payments been made under warranties and indemnities.

Having said that, there is currently some uncertainty in this area following the case of *R& C Commissioners v Sir Alexander Fraser Morrison. This case was about the deductibility of a contingent liability. Whilst the taxpayer lost in the FTT (which* was reported in the anonymised decision of *Nevis)*, and the Upper Tribunal, he has recently won his appeal in the Court of Sessions. The taxpayer was the Chief Executive of Matalan who provided a profit forecast to a potential purchaser of that company. He was also a minority shareholder. The purchaser accepted the forecast and completed the purchase.

Sometime later the purchaser brought an action against the taxpayer for misrepresentation in respect of the profit forecast. The action was settled by agreement with the taxpayer paying the purchasers the sum of £12m, which he then claimed as a deduction under s. 49 on the basis that it was a contingent liability in respect of a 'representation' made on a disposal by way of sale.

HMRC argued that the representation had been made in the taxpayer's capacity as a director of the target company and for it to fall within s49 it had to be made in the capacity of a vendor. The First-tier Tribunal found that, on the balance of probabilities, the representation had been made in that capacity in that he would have provided the profit forecast even if he had not been a shareholder. The FTT therefore accepted that this was a representation made on the disposal of shares and also held that the taxpayer's liability was contingent.

When the case went to the Upper Tribunal there were two issues in dispute from the FTT. First, was the payment of £12m a contingent liability within the meaning of s49, and second, were the taxpayer's costs of defending the proceedings brought by the purchaser also such a contingent liability. For the Upper Tribunal, the fundamental question was whether the payment of £12m was 'directly related to the value of the consideration' received by the taxpayer on the disposal of his shares in the target company. The taxpayer received his price for his shares by virtue of his ownership of the shares and he received the same price per share as was received by any other shareholder. That price was not adjusted to reflect the taxpayer's position as chairman of the target company, or any other factors. There was no direct relationship between the payment of £12m and the consideration for the disposal and so the payment was not a contingent liability. As it was not suggested that the taxpayer could succeed on the second issue if he failed on the first, the taxpayer failed on the second issue also.

The Court of Sessions, however, felt that it was clearly a liability arising out of the sale notwithstanding that it was personal to the taxpayer. They took a more generous view although they did refer the case back to the FTT to establish if the whole of the compensation related to the representations made or whether there were other matters covered.

Obviously, the requirement to bring into the original CGT computation the deferred consideration and pay tax on it before it has been received or even confirmed, may lead to cash flow difficulties. However, it is possible for the vendor to claim to pay the tax by instalments where the deferred consideration is payable over a period of more than 18 months, the tax may be paid in instalments. The legislation that allows this is at s280 TCGA 1992. The instalments must be payable over a period exceeding 18 months. The instalments can be made, if agreed by HMRC, over a period not exceeding 8 years but each instalment must be more than 50% of the consideration that has been received.

Variable deferred consideration

An earn-out deal is one example of variable deferred consideration. This typically involves the vendor receiving a fixed sum on completion, with additional sums being paid over the next two or three years, calculated on a formula based on the actual results of the business over this period. The vendor normally continues to be employed in the business during the earn-out period in a key management, technical or sales position. Consequently, the vendor has the incentive to increase his disposal consideration thereby ensuring that the purchaser's acquisition is successful.

Such consideration will still be treated as unascertainable even if there is a maximum put on the potential earn-out.

The tax treatment of an earn-out transaction is based to a large extent on the *Marren v Ingles [1980] STC 500* decision. It was decided in this case that where a taxpayer sells an asset with a right to receive a future unquantifiable sum (e.g. the formula on an earn-out), then a valuation of that right should be included as part of the CGT consideration received for the main asset, together with any immediate proceeds. It was also held that the taxpayer is acquiring a 'right' or 'chose in action', as an entirely separate asset.

When the additional amount is eventually received this is a capital sum is derived from an asset.

The actual amount received is therefore assessable to CGT after deducting the valuation of that right which was originally included in the first computation (that is then treated as being acquired at the date of the disposal of the main asset).

In practice this caused difficulties because if the right was overvalued, a capital loss arose on the disposal of the chose in action. In many situations, the original vendor could not utilise that capital loss in any way. This led to significant arguments with HMRC about valuation issues. However, the legislation was amended. A capital loss incurred on or after 10 April 2003 on disposal of a right to 'unascertainable deferred consideration' can be carried back and offset against earlier capital gain from the same asset.

If there is an increase in the value on payment of the earnout this will not be eligible for BADR as it is not a qualifying asset. This gives an incentive to maximise the original value of the earnout even though there is a timing disadvantage in doing that.

Example

Ms C receives £500,000 initial cash consideration plus an earn-out right which will see her receive a proportion of profits made by the company over a pre-set figure. The earn-out is set at a maximum figure of £1,000,000 but she feels it is more likely that she will receive around £600,000. It is assumed that she holds a single £1 share purchased for par at the time the company was incorporated. BADR is available on the shares.

The initial consideration is taken to be £500,000 plus the value of the deferred consideration. She values the deferred consideration at £600,000.

Her initial capital gain is £1,100,000.

Let us assume she receives

(a) £1,000,000

(b) £600,000

(c) £400,000

If she received £1,000,000 there is a further capital gain arising of £400,000 on which she will pay £80,000 (assuming the liability is taxed at 20%).

If she received £600,000, there is no further liability.

If she received £400,000 there is a capital loss on the earn-out of £200,000. This can be carried back and set off against the original gain, thus earning her a repaying of £20,000 of tax.

Earn-outs satisfied in shares or loan notes

Often, earn-outs are structured so that all or part of the vendors earn-out can only be satisfied by shares or loan notes in the purchasing company. In this event, a corresponding part of the capital gain on the future earn-out right, which would otherwise be taxed under the principles in Marren v Ingles, can be deferred.

S.138A will only apply where the earn out can only be satisfied by paper ie shares or loan notes. If an identifiable amount only can be satisfied as cash, then the remainder is eligible for s.138A relief.

The deferral relief in s138A TCGA 1992 can only operate if the share exchange rules in s135 would apply but for the intermediate earn-out right that is, assuming the earn-out right is shares or loan notes issued by the acquiring company.

Consequently, the detailed requirements of s135 must also be fulfilled.

It is possible to elect that s.138A does not apply.

Earn-outs as employment income

Care must be taken to make sure that HMRC are not going to try and argue that the earn-out is actually employment income, on the assumption that the individual is working for the purchaser after the transaction. The type of issues that might lead HMRC to make this argument would be:

- The earnout is dependent on personal performance criteria
- There is a difference in payment for individuals who will be employees after the deal and those who will not
- The market value of the shares is already paid out on the original deal (although this is often a very difficult issue for HMRC to tackle).

Contributed by Ros Martin

Administration

Debilitating fear of making a mistake (Lecture P1321 – 17.50 minutes)

Summary – A debilitating fear of making a mistake, which was caused by the taxpayer's earlier experience of a criminal investigation into his tax affairs by HMRC, was not a reasonable excuse for the subsequent late filing of tax returns.

Michael Breen accepted that he had filed his 2014/15 tax return 27 months late but challenged the late filing penalties of £10,664.69 that were issued.

He argued that he had a reasonable excuse for his late filing, claiming that an earlier HMRC enquiry and criminal investigation had resulted in him having a 'debilitating fear of making a mistake' in his return'. Consequently, he did not wish to submit a return until he was confident that it was completely correct.

In October 2012 Michael Breen received a notice from HMRC entitled "Notice to Attend a Voluntary Interview Under Caution". He was suspected of having committed a criminal offence, 'viz the fraudulent evasion of income tax and national insurance contributions with regard to an offshore investment account with a bank in Switzerland.' In 2013 a criminal investigation was replaced with a civil investigation. He received a Code of Practice 9 enquiry asking him to disclose the tax fraud he had committed. In February 2014 HMRC raised an assessment for the 1994/95 tax year totalling £520,000 and in February 2015 issued a further assessment for nearly £1.1million.

Decision

The First Tier Tribunal stated that mental health could constitute a reasonable excuse, provided that the taxpayer's health had deteriorated to such an extent that they could not deal with his affairs, including preparing and submitting a tax return.

The First Tier Tribunal found that, to date, HMRC had acted in a proper manner at all times, and that Michael Breen had not produced any medical evidence to support his claim that HMRC's behaviour had caused a 'debilitating fear of making a mistake' when submitting his returns.

Michael Breen did not have a reasonable excuse and the appeal was dismissed.

Michael Breen v HMRC (TC08482)

Careless behaviour by tax agents? (Lecture P1324 – 10.36 minutes)

Where an individual's tax return is submitted online to HMRC within the normal time limit of 31 January following the end of the relevant tax year, HMRC may generally open an enquiry into the return up to the end of the 12-month period after the day on which the return was delivered (TMA 1970, s 9A).

Discovery assessment time limits

If this enquiry 'window' has closed because the time limit for opening an enquiry has expired, HMRC may use its 'discovery' powers to assess closed years. This may happen broadly if (for example) HMRC discovers that tax has been under-assessed due to either of the following (TMA 1970, s 29(4), (5)):

- careless or deliberate conduct of the taxpayer or a person acting on his behalf; or
- something of which the HMRC officer could not have been reasonably expected to be aware when the enquiry window closed (or a closure notice was given) based on the information made available to them before that time

For income tax and CGT purposes, the ordinary time limit for HMRC to make a discovery assessment is four years after the end of the tax year to which it relates (TMA 1970, s 34(1)). However:

- a discovery assessment in a case involving a loss of income tax or CGT brought about carelessly may generally be made up to six years after the end of the tax year (TMA 1970, s 36(1));
- In cases of lost income tax or CGT involving an 'offshore matter' or 'offshore transfer', the assessment time limit increases to 12 years (TMA 1970, s 36A); and
- where the loss of income tax or CGT has been brought about deliberately, HMRC may make a discovery assessment up to 20 years after the end of the relevant tax year (TMA 1970, s 36(1A)).

Taxpayer or person acting

Where the normal four-year time limit for a discovery assessment has passed, HMRC sometimes contend that a tax return error was careless (or possibly deliberate), even though it may be highly arguable that it was neither. There is no statutory definition of 'careless' in the context of discovery assessments, although the legislation relating to penalties for errors states that a 'careless' inaccuracy is due to a failure to take 'reasonable care' (NB for the purpose of these notes, it is assumed that carelessness is involved).

The legislation dealing with discovery assessments for a careless loss of income tax or CGT refers to the loss being brought about by the person who is the subject of the assessment. In this context, that person is the individual self-assessment taxpayer. However, for discovery assessment purposes, the reference to the loss being brought about by the 'person' is extended to include a person acting on the taxpayer's behalf.

What does it mean?

What does "acting on the taxpayer's behalf" mean? HMRC guidance on this point in its Enquiry manual (at EM3232) refers to the First-tier Tribunal's definition of a person acting on behalf in the case *The Trustees of Bessie Taube v HMRC* [2010] UKFTT 473 as "a person who takes steps that the taxpayer himself could take or would otherwise be responsible for taking". The tribunal added: "Examples would in our view include completing a return, filing a return, entering into correspondence with HMRC, providing documents and information to HMRC and seeking external advice as to the legal and tax position of the taxpayer. The person must represent, and not merely provide advice to, the taxpayer".

This definition was later approved by the Upper Tribunal in *HMRC v Hicks* [2020] UKUT 0012. In that case, Mr Hicks entered into a tax avoidance scheme operated by a firm of tax consultants. HMRC received the taxpayer's tax returns for 2009/10 and 2010/11 in January 2011 and January 2012 respectively. When preparing the returns, for any entries or information regarding the scheme, Mr Hicks's agent simply included whatever the tax consultants provided him with. In March 2015, HMRC issued discovery assessments for 2009/10 and 2010/11.

When the case reached the Upper Tribunal, it was concluded that the insufficiency in the relevant assessments was brought about because Mr Hicks's agent gave advice which a reasonably competent tax adviser could not have given on an aspect of the avoidance scheme and, similarly, the agent failed to give the advice which a reasonably competent tax adviser ought to have given to the effect on another aspect of the scheme. The insufficiency in the assessments was brought about not by the taxpayer, but by a person acting on his behalf, within the discovery assessment condition regarding carelessness (in TMA 1970, s 29(4)).

HMRC's appeal was allowed on that basis. HMRC could therefore rely on the extended time limit assessment period of six years in respect of the discovery assessments for 2009/10 and 2010/11.

'Careless' adviser

HMRC relied on the Upper Tribunal's decision in *Hicks* in the subsequent case *Callen v Revenue and Customs* UKFTT 40 (TC). In that case, Mr Callen had also participated in a tax avoidance scheme, during the tax year 2008/09. He attempted to set off scheme losses against his trading income in 2008/09, and to carry forward the balance against income of the same trade in 2009/10.

Unfortunately for Mr Callen, the avoidance scheme did not work. HMRC raised a discovery assessment for 2009/10 on 30 March 2015, on the basis that the loss of tax was brought about carelessly. On appeal, the First-tier Tribunal noted that Mr Callen's accountant had barely any prior experience of marketed tax avoidance schemes. He did not carry out any research himself regarding the tax legislation relied upon or the matters addressed in a Counsel's Opinion produced for the tax consultants, even though the accountant had never advised about that legislation or about any marketed tax avoidance schemes.

The First Tier Tribunal noted that Mr Callen's accountant did not review any scheme documentation and simply relied on a spreadsheet provided by the tax consultants for the figures to insert into Mr Callen's tax returns. His accountant didn't check the underlying documentation and simply relied on the tax consultants to provide reassurance that the scheme worked and provided the relevant figures. The tax return preparation process simply involved Mr Callen's accountant asking the tax consultants what figures to put in the boxes, which they then checked and returned before the return was sent for the appellant to sign. The accountant did not carry out any independent consideration of what entries should be completed in Mr Callen's tax return.

The First Tier Tribunal concluded that the accountant acting on behalf of Mr Callen carelessly brought about the insufficiency in Mr Callen's tax liability as a result of compiling tax returns on the basis of deductions claimed in Mr Callen's tax return without adequate consideration of them. Mr Callen's accountant had also included trading deductions for professional fees of £250,000 even though the appellant only spent £95,000, and the remaining fees were contingent on the success of the scheme transactions, without any indication on the returns to that effect. The discovery assessment for 2009/10 was made within the statutory time limits by HMRC. Mr Callen's appeal was dismissed.

Contributed by Mark McLaughlin

The Let Property Campaign (Lecture P1325 – 14.00 minutes)

The Let Property Campaign is a disclosure facility to allow residential property landlords to bring their tax affairs up to date. The process was introduced by HMRC in 2013 and was intended to last for a finite period. However, the Let Property Campaign is still here, and that is likely to be the case for the foreseeable future.

HMRC is in receipt of a significant amount of data on landlords, and they will contact those individuals who they think have not declared their income, usually inviting them to use the Let Property Campaign to do so. Advisers should note that also use other methods to follow-up on what they believe to be errant landlords.

The Let Property Campaign is only open to landlords with undeclared rental income relating to UK or overseas residential property. The process can be used by various landlords, including the following:

1. Those with one or more residential properties;
2. Landlords renting rooms in their main home using the Rent-a-Room scheme;
3. Landlord who specialise in property lets for students;
4. Landlords with holiday lettings.

The Let Property Campaign is not open to landlords letting out commercial properties unless they also have unreported income from residential property. The process cannot be used to disclose income on behalf of a company or a trust.

HMRC have produced guidance on the Let Property Campaign, and the guidance is updated from time to time. The disclosure process is now online.

Advisers should note that the Let Property Campaign does not provide preferential terms, and the normal penalty rules apply. In particular, the process does not provide immunity from prosecution.

How does the Let Property Campaign work?

HMRC may invite the taxpayer to participate in the process, typically following the issue of a nudge letter to the individual. Alternatively, a taxpayer can request inclusion in the Let Property Campaign, which an adviser can do on their behalf.

Notification is made to HMRC for the individual (where a relevant property is in joint ownership, separate disclosures will be needed), although details of the disclosure are not provided at this stage. HMRC will, if the person is permitted to use the process, issue a Disclosure Reference Number. HMRC allows 90 days from receipt of the reference number to submit the disclosure, make a formal offer to HMRC (to cover the tax, interest and penalties that have been calculated), and to pay the amount due. Where payment cannot me made within this timescale, a request for time-to-pay must be made before the expiry of the 90-day period.

HMRC will, following receipt of the disclosure, issue an acknowledgement, usually within two weeks. They will conduct further checks, including comparing the submitted disclosure with information already held. HMRC will then either accept the disclosure, as submitted, or raise any queries. Taxpayers are expected to provide assistance to HMRC if more information is needed to enable consideration of the disclosure.

The disclosure

The adviser must determine the number of years to be included in the disclosure, and this is often an area that causes significant practical difficulties. That will depend on the relevant behaviour. The standard position is that the last four years need to be considered. Where there has been careless behaviour, the last six years must be considered, and where there has been deliberate behaviour, the adviser needs to consider the position for the previous 20 years. Where there has been a failure to notify the income, the default position is that the last 20 years need to be considered (unless there is a reasonable excuse for the failure, in accordance with the normal rules).

When the number of years to be included has been determined, the adviser must work out the rental income and allowable expenses for each year (to the extent not previously disclosed). Submitting a disclosure may mean that losses that would otherwise be lost can now be used.

Where there are incomplete records you should seek to obtain the missing information, otherwise estimates will need to be used. The estimates, and the basis on which they have been calculated, should be disclosed. As with other aspects of the disclosure, any such estimates can be challenged by HMRC.

The disclosure must include any other undisclosed income or capital gains, including income from non-residential property. Certain types of liability must be indicated in the disclosure but will be dealt with separately (including VAT/Employer Tax and IHT liabilities).

Practical considerations

Advisers should be aware of HMRC's extensive use of nudge letters. This subject was covered in another session, but it is important to note that such correspondence should not be ignored.

A key issue is determining the number of years to be included in the disclosure, and I have encountered many agents who have accepted that they are not detached enough to form an objective view of the client's behaviour. There is limited HMRC guidance on this aspect, and the onus is firmly with the adviser, and their client, in this regard. It is important to establish the facts, and, if necessary, obtain a second opinion on the view that HMRC are likely to take.

The limited time period to submit the disclosure, etc., can cause practical problems, although an extension can be requested. There is a limit as to what can be included with the online process, and advisers need to ensure that sufficient disclosure is being made.

The Let Property Campaign is not the only option for disclosing, and advisers should consider the options available. The options may include the Contractual Disclosure Facility, which can provide immunity from prosecution in cases involving deliberate behaviour.

As noted above, advisers should consider obtaining specialist advice (ideally before submitting the disclosure) where they have any concerns or want a second opinion on their client's position.

Contributed by Phil Berwick, Director at Berwick Tax

Deadlines

1 July 2022

- Corporation tax for periods to 30 September 2021 if not liable to pay by instalments

5 July 2022

- Application for a PAYE settlement agreement for 2021/22
- Report non-cash benefits not from a registered pension scheme

6 July 2022

- Forms P9D, P11D, P11D(b) 2021/22
- Taxed award scheme returns
- Redundancy packages 2021/22 worth more than £30,000 to HMRC
- File annual share scheme returns

7 July 2022

- Electronic filing and payment of VAT liability for 31 May 2022
- Election to aggregate beneficial loans in 2021/22
- File forms EMI40

14 July 2022

- CT61s for quarter ended 30 June 2022

19 July 2022

- PAYE liabilities for month ended 5 July 2022 if by cheque
- PAYE for q/e 5 July 2022 if average monthly liability is less than £1,500

21 July 2022

- Online monthly EC sales list – businesses based in Northern Ireland selling goods
- June 2022 Supplementary intrastat declarations for businesses in Northern Ireland

22 July 2022

- PAYE liabilities if paid online

31 July 2022

- Accounts to Companies House:
  - private companies with 31 October 2021 year end
  - plcs with 31 January 2022 year end
- Second 5% surcharge for unpaid 2020/21 balancing payments
- 2021/22 second instalment Self Assessment liabilities due
- Tax credits claims to be renewed

News

New homeowners warned over tax refund claims

HMRC has issued a Press Release warning new homeowners about cold calls from rogue tax repayment agents who are advising them to make speculative Stamp Duty Land Tax refund claims.

Where HMRC raise enquiries and the claims are found to be incorrect, the SDLT must be repaid with interest, with some potentially also facing penalties.

Taxpayers have been advised they might be enticed into making incorrect claims for the following reasons cases:

- claims for multiple dwellings relief;
- claims that the purchase includes non-residential property;
- claims that the homes are uninhabitable;
- claims that homes allow access to a communal garden; and
- claims there is no SDLT due on the transfer of property to pension schemes

HMRC advise that, if approached, taxpayers should seek independent advice before deciding whether to proceed with a claim.

https://www.gov.uk/government/news/new-homeowners-warned-over-tax-refund-claims

Business Taxation

Direct tax issues for property developers (Lecture B1321 – 19.51 minutes)

Accounting and tax treatment

This article considers both accounting and tax matters to be considered by property developers.

The purchase of the property, including all purchase -related costs, is posted to current assets.

As the property is developed, all development costs are posted to current assets as incurred so we have a running cost of the development in current assets. The balance on the current asset is then transferred to P&L account when the property is sold.

Finance costs are frequently written off to the P&L account as incurred, although it is possible to defer these costs by including them in the current asset account. This delays the relief until the asset is sold. With rising corporation tax rates it is worth capitalising the finance costs so that they are matched with the profits on sale.

Property appropriations

Property appropriation occurs where an asset that was initially held a s fixed asset but subsequently becomes stock. If a trader moves a property from fixed assets to current assets, this must be treated as a market value appropriation.

This may be the case where a property developer has a fixed asset premises which he uses in his trade, but later decides to develop that property and sell it on.

For CGT purposes, the trader will be deemed to have disposed of the fixed asset (to himself) at market value so a capital gain will arise. In this instance, the trader can elect not to have a CGT disposal but instead to have the cost of the stock reduced by the chargeable gain. This will reduce the gain to nil but will result in the stock having a lower cost (and therefore a higher trading profit when the stock is eventually sold).

Illustration 1

Mentos Accountants Limited operate from two offices in East Sussex. Due to changing working practices as a result of Covid-19, the practice feels it can operate from just one office going forward.

There is limited demand for office buildings so the practice has decided to develop the property with a coffee shop on the ground floor and flats above. The original office building cost £250,000 in June 2006. Budgeted development costs are £120,000 plus VAT. The intention is to sell the retail unit and flats post development for £600,000.

On 15 March 2022 all staff moved to the main office and the development began. The office was worth £400,000 in March 2022.

What are the tax implications of the decision to redevelop the office for resale?

Mentos Accountants Limited has taken a fixed asset used in their business and has appropriated this to trading stock at £400,000. A gain of £150,000 (400,000 - 250,000) is realised.

The company now has trading stock in current assets at a value of £400,000. Once developed any resultant profit will be taxed at 19% (if sold pre 1 April 2023).

Alternatively Mentos Accountants Limited can make an election under s.161(3) TCGA 1992, in which case:

- The gain of £150,000 is reduced to nil; and
- The cost of the stock in her property development business is reduced by £150,000 and will now be £250,000.

The resultant profit will be £150,000 higher with the election but this simply replaces the gain they were looking at.

Note that no election is possible if a CGT loss is in point i.e. a CGT loss stays as a CGT loss.

It would be advisable for Mentos Accountants Limited to make the election if they expect to sell the developed property before 1 April 2023 as it will defer their 19% tax bill. However, if the sale is expected to occur on or after 1 April 2023 it would be beneficial not to make the election and crystalise £150,000 of profit to be taxed at the lower corporation tax rate of 19%.

Individuals would rarely make the election as income tax rates on development profits are higher than the CGT rates – best pay 20% on the £150k gain.

Appropriating to fixed assets

If the developer company appropriates property from trading stock to fixed assets, there is a market value disposal at the time of appropriation but there is no tax relief available in this case. Corporation tax will be paid on the profit at the rate in force at the time of appropriation. This could be where a developer company intends to let their developed, converted or renovated property.

However, if the developer company chooses to temporarily let the property until the market improves then it can remain in current assets for the time being – do include a letter of representation point to confirm that they still intend to sell.

Dealing with a property crash

What if residential developers experience a slow-down in the next 12 months? They may be minded to temporarily let until the market recovers. Temporarily letting the property will be exempt from a VAT perspective and input tax is at risk (subject to HMRC de-minimus rules).

To protect developers, we should advise them to trade through a limited company. This will give them the greatest flexibility to deal with a downturn in the property market. If the developer needs to temporarily let the new homes, they could simply set up a letting subsidiary. The property would then be sold to the newly formed letting subsidiary.

This would be a zero rated sale from a VAT perspective and input tax recovery in the development company is secured. The sale would be free of SDLT due to the SDLT group exemption for supplies between a parent company and their 75% subsidiary. The subsidiary will be 100% owned but you only need 75% for the SDLT group exemption.

It should be noted that when moving property between 75% group companies, property moves under the no gain/no loss rules. So if it is sitting in current assets in one company but another company wants to occupy (or let) the property then it must be appropriated to fixed assets first and then moved under the no gain/no loss rules. This will result in a profit (or loss) in the transferor company. With the corporation tax rate rising to 25% from 1 April 2023 it will be an advantage to have an uplift as the uplift is currently taxed at 19%.

Careless music composer/ producer

Summary - The taxpayer had acted carelessly, rather than deliberately, in bringing about a loss of tax despite failing to file his tax returns on time. Consequently, only one discovery assessment was validly issued; the others were dismissed.

Robert Dougan was an Australian national whose home and family were based in London.

He was a successful music composer and producer who operated as a sole trader. However, he had concerns about the future viability of his music business and so he bought a vineyard in the Languedoc. His plan was to supplement or even replace his music-related income.

He invested significant amounts of time and money in setting up the new wine business. He sought advice on an appropriate structure that would allow the heavy costs of starting the wine business to be offset against his UK income.

As a result of the purchase of the new wine business, he had two businesses in the tax years that were subject to appeal: his music business and his wine business.

Robert Dougan had a history of filing late tax returns. In December 2011, HMRC wrote asking him to file a return for the year ended 5 April 2008. He failed to meet the deadline set and so HMRC issued a determination for that year totalling some £98,000. He paid the the sum due, without questioning the figure. This raised HMRC’s concerns about the actual level of his tax liability and source of money to pay the tax. Consequently, HMRC then wrote requesting all outstanding returns. He failed to file the requested returns and so HMRC raised discovery assessments, determinations and penalties. Subsequently, in June 2013, Robert Dougan’s accountants filed tax returns for 2004/05 to 2009/10, claiming ‘sideways loss relief’ for relief of Robert Dougan’s partnership losses against his general income for the tax years 2004/05, 2005/06 and 2006/07.

HMRC denied the claim and Robert Dougan appealed.

Decision

The decision relating to the discovery assessments depended on Robert Dougan’s behaviour. HMRC argued that he had deliberately not submitted tax returns so that they could not assess the correct amount of tax. This would make all of the assessments issued within time.

The Tribunal found that failing to file a return that results in a loss of tax was not enough to make it a deliberate intention. The Tribunal found that his behaviour was careless, accepting that Robert Dougan's focus was on his wine business, children and litigation in relation to his music business; he intended to catch up with his tax affairs later, as he had done in the past. On this basis, only the 2006/07 discovery assessment had been validly issued.

Having established that the discovery assessment for 2006/07 was validly issued, the next step was to determine the quantum of Robert Dougan's liability for that year. He claimed that he was entitled to relief for sideways loss relief and that certain pre-trading expenditure was deductible from the assessment.

The First Tier Tribunal found that the partnership trade was the promotion, marketing and sale of wine. The growing of grapes and wine production took over two years, and as a result the partnership trade started later, once there was a product to promote and market. As a result, they found that the trade started in 2007/08 and so the 2006/07 discovery assessment was correct.

The First Tier Tribunal also concluded that consultancy fees paid by the partnership for advice on setting up his wine business were not incurred wholly and exclusively for the purposes of the partnership trade. They did not represent reasonable payments for the services provided.

Finally, the Tribunal cancelled the penalties, finding that the fact that Robert Dougan was aware of a penalty or had paid them did not mean that HMRC had necessarily proved that the penalty was properly notified. The evidence provided supported Robert Dougan's claim that they had not been notified.

The appeal was allowed in part.

Robert Don Hunter Dougan v HMRC (TC08471)

Super-deduction or special rate first year allowances

The Government introduced a temporary super-deduction and special rate first year capital allowance that can be claimed by companies on the cost of qualifying plant and machinery incurred on or after 1 April 2021, but before 1 April 2023.

HMRC has now published guidance on these allowances explaining who is eligible for the allowances, how much can be claimed, how to calculate the balancing charge on disposal of such assets.

https://www.gov.uk/guidance/check-if-you-can-claim-super-deduction-or-special-rate-first-year-allowances

https://www.gov.uk/guidance/disposing-of-a-super-deduction-or-special-rate-first-year-allowance-asset

Loan relationship had an unallowable purpose

Summary - The loan relationship unallowable purpose rule applied to disallow debits in respect of interest on loan notes issued by a company under a series of transactions by which a multinational group acquired a US company.

A multinational group of companies in the mining industry wished to purchase LeTourneau Technologies Inc, a Texan company.

As part of a nine-step series of transactions, JTI Acquisition Company was incorporated in the UK as a special purpose vehicle to be the holding company of the Texan company. Funding was channelled to JTI Acquisition Company in several ways, including the issue of $500m in loan notes to its immediate US parent company. The loan notes were then assigned from the parent company to a group company incorporated in the Cayman Islands. JTI Acquisition Company applied to HMRC for an advance thin capitalisation agreement and HMRC granted the application.

However, HMRC subsequently contended that JTI Acquisition Company was a party to the loan notes for an unallowable purpose. Under s.441 CTA 2009, the non-trading loan relationship debits brought into account by the company in respect of interest on the loan notes should be disallowed and could not be surrendered as group relief to other UK group companies.

Decision

The First Tier Tribunal considered the test in s 441 in three parts:

1. It concluded that there was a UK tax advantage to JTI Acquisition Company by being a party to the loan relationship in the form of the group relief which would be available.

2. It then considered whether securing the tax advantage was a purpose for which the company was a party to the loan relationship. This would depend on the subjective intentions of the decision makers. The First Tier Tribunal held that there was no genuine decision making at the UK level. The decision makers were at the group level and their object in implementing the series of transactions was to bring into existence the loan relationship so as to secure a UK tax advantage.

3. The First Tier Tribunal rejected all of the company's contentions that there were a number of business and commercial purposes for its being party to the loan relationship and could find no such genuine purposes. The company had therefore failed to establish that the tax advantage was not the main purpose, and this was sufficient to dismiss the appeal. In case it was wrong in considering that it was for the taxpayer to establish that the main purpose test was not met, however, the First Tier Tribunal went on to consider whether in fact securing the tax advantage was the main purpose. It concluded that such was the case.

JTI Acquisition Company (2011) Limited v HMRC (TC08493)

Adapted from the case summary in Tax Journal (13 May 2022)

Debt release not taxable

Summary - The release of £3.5million of debt owed by the company to a bank was not taxable under the loan relationship provisions as it was part of the settlement for a damage's claim brought by the company against the bank.

In 2007, Hexagon borrowed £5million from a bank to refinance its existing debt and to finance property developments. At the same time, the company bought an interest rate hedging product (IRHP) from the bank.

Following the financial crash, the effect of the product was to lock the company into artificially high effective interest rates, with the result that its credit rating was affected and it was unable to complete the developments.

The company's business was further damaged when the bank appointed receivers and sold some of its properties. The Financial Conduct Authority subsequently established a redress scheme for mis-sold IRHPs and the bank offered the company a payment under the scheme. The payment included only £600 in respect of the company's consequential losses, however, and it commenced proceedings for damages.

The proceedings were settled by an agreement under which the company paid the bank £1.5million and the bank waived all claims in respect of the company's debt. As a result, the company included a credit of £3.5million in its accounts but treated that amount as non-taxable on the basis that it represented the netting-off of the company's claim for damages, it was capital in nature and fell within ESC D33.

HMRC considered that the bank debt was a loan relationship and the release of the debt was a 'related transaction' within the loan relationship rules. There was no suggestion that the credit was in conflict with GAAP and therefore the credit was a trading receipt under those rules.

Decision

The First Tier Tribunal agreed with HMRC that the release of the debt fell within the definition of 'related transaction'. The fact that it could be described as the settlement by the bank of its liability to damages was not relevant to that issue.

However, the First Tier Tribunal held that the amount was not a profit which 'arose from' the company's loan relationships and related transactions as required under s.306A CTA 2009. Any objective consideration of what the £3.5million arose from would conclude that it was from the claim in damages.

The question of whether or not the £3.5million was taxable as a capital receipt or was exempt under ESC D33 was not considered by the First Tier Tribunal and was left for further argument between the parties.

Hexagon Properties Limited v HMRC (TC08468)

Adapted from thew case summary in Tax Journal (13 May 2022)

Notifiable arrangements under DOTAS

Summary – The First Tier Tribunal granted HMRC's application under s.314A FA 2004 of the DOTAS provisions, holding that the arrangements in question were 'notifiable arrangements' and that both of the companies which were the subject of the application were promoters of them.

HMRC's application involved two companies, one UK-resident (UKCO) and the other resident in the Isle of Man (IOMCO). The arrangements were a 'contractor loan scheme' under which an individual user became an employee of one of the companies and UKCO entered into a contract with a UK intermediary to provide the individual's services to an end user client. Via further steps, the ultimate outcome would be that the individual would receive two payments from IOMCO, a sum representing minimum wage and a loan.

Decision

The First Tier Tribunal first considered whether the arrangements were notifiable.

The main issue in dispute was whether the arrangements fell within one of the DOTAS hallmarks (as required by s.306(1)(a) FA 2004.

The judge held that they fell within the premium fee hallmark, rejecting UKCO's argument that it had not received a premium fee and would not have been able to do so for the services it provided. Those were considerations of UKCO's subjective condition; the correct test was an objective one applied to a hypothetical promoter of the same arrangements.

The First Tier Tribunal went on to consider whether each of the companies was a promoter of the arrangements.

- UKCO argued that it was not carrying on a 'relevant business' within s.307(2) FA and so could not be a promoter at all. It claimed to carry on two separate businesses, an 'umbrella company' business and a 'contract management' business, neither of which was related to taxation. However, the First Tier Tribunal considered that the contracts being managed were the 'nuts and bolts' of the arrangements, which simply could not have existed without them. In managing the contracts, therefore, UKCO was administering the scheme and in doing so providing services relating to taxation. UKCO was also responsible for the management of the arrangements, even if it was acting as an agent of IOMCO, and so was a promoter.

- IOMCO argued that it could not be a promoter because the purpose of identifying a person as a promoter under s.314A FA 2004 was to enable the making of an order for disclosure under s.308. Since IOMCO was outside the territorial ambit of the legislation, no such order could be made. However, the First Tier Tribunal concluded that there was no need to consider whether a person identified as a promoter would be caught by s.308. The order under s.314A was a preliminary step and only the matters expressly set out in that section had to be considered. IOMCO was a promoter.

HMRC v Smartpay Ltd and another (TC08477)

Adapted from the case summary in Tax Journal (27 May 2022)

Research & Development Tax Credit payments

The Chartered Institute of Taxation published the following message from HMRC about the recent pausing of Research & Development Tax Credit payments.

HMRC say:

> "We previously notified agents that we have paused some Research & Development Tax Credit (RDTC) payments while we investigate an increase in irregular claims. Our investigations are continuing, but we are now able to provide an update.
>
> To prevent abuse of the relief we will be enhancing our extensive compliance checks. These additional checks will mean our standard processing times will increase.
>
> For the vast majority of claims, we will aim to either pay the payable tax credit or contact you regarding the claim within 40 days. It is our ambition to return to our standard 28-day processing times as soon as we can. Our gov.uk guidance will be updated shortly.
>
> We wanted to share this update to notify legitimate claimants that their RDTC payments will take longer to be processed. We appreciate agents' and claimants' patience while we handle these claims and continue to offer the guidance below:
>
> To help us process your R&D payment quickly, please ensure you have completed all entries on the R&D section of your Corporation Tax return (CT600 form). Submitting additional information to support the claim, such as the R&D report will help HMRC process the claim quicker. Review the latest guidance on completing your CT600 form on GOV.UK. If you submit a claim that is incorrect, inflated or fraudulent, then you may be liable to a penalty. Read HMRC: standards for agents
>
> We ask R&D claimants to bear with us and kindly ask them not to contact the R&D helpline/mailbox to chase their claims. We also ask you not to contact any HMRC official about a claim. Instead, agents should check the company's online account to check the status of their claim.
>
> We will continue to share updates when we have further information."

https://www.tax.org.uk/research-development-tax-credit-rdtc-payment-delays-an-update

Purchase of own shares: multiple completion (Lecture B1323 – 30.15 minutes)

It will be recalled that CTA 2010 spells out numerous conditions which have to be satisfied in order for an own share purchase to qualify for CGT treatment in the hands of the exiting shareholder.

One of the more important requirements is that, immediately after the purchase, the vendor must not be 'connected with' the purchasing company or any other company within the same 51% group (S1042 CTA 2010).

For this purpose, ‘connected with’ means possessing, directly or indirectly, more than 30% of the company’s:

- issued ordinary share capital; or
- total share and loan capital; or
- voting power (S1062 CTA 2010).

Interests held by ‘associates’ (e.g. a spouse, civil partner or minor child) have to be taken into account, but adult children and their parents, along with brothers and sisters, are not included as associates (Ss1059 – 1061 CTA 2010).

Note that, by virtue of S1063 CTA 2010, the term ‘loan capital’ is given an extended meaning such that an immediate loan back of all or part of the vendor’s proceeds can be caught.

In addition, if the exiting shareholder still holds some shares after the own share purchase transaction, his proportionate interest in the company must be ‘substantially reduced’ (S1037 CTA 2010). ‘Substantial’ in this context means 25% or more. It is necessary to determine the vendor’s interest in the company immediately prior to the share repurchase and, provided that it comes down by at least one-quarter, a substantial reduction is deemed to have taken place. Once again, interests held by associates have to be considered when measuring this reduction.

HMRC’s view is that the company must pay for the shares which it buys back in cash and not in kind. The speaker has had experience many years ago of a situation where three shareholders were being bought out, partly for cash and partly by having a property transferred to them. HMRC argued, following submission of the clearance application, that there was no ‘purchase’ if the company did not use cash to pay for the shares.

They said:

> ‘The word “purchase” in S690(1) Companies Act 2006 must in that context bear its primary legal meaning as being the correlative of “sale” and involving the acquisition of property for a price in money.’

The main implication is that, if a company purports to purchase its own shares but does not make payment in full and in cash at the time, it will not have effected a valid own share buy-back. Thus, the vendors retain legal title to their shares and the company, if close, will have incurred a S455 CTA 2010 tax charge until such time as the resulting debt is cancelled by a proper purchase. This situation is confirmed in Para CTM17505 of the Company Taxation Manual.

It has been suggested that the decision in BDG Roof-Bond Ltd v Douglas (2000) is authority for the proposition that a purchase of own shares can be made by a payment in kind as well as in cash. Park J stated that he did not think the word ‘payment’ in the context of company law to be limited to payment in money. It would appear that HMRC have yet to catch up with this development!

A related point, which is particularly relevant in the current economic climate, is where a company wishes to buy out a shareholder but lacks the necessary funds to do so.

The obvious solution to resolve this cash flow constraint might be for the vendor to lend all or part of the share payment back to the company. Unfortunately, this arrangement will nearly always fall foul of the 30% ‘no continuing connection’ test referred to above.

A useful solution to this dilemma has been for the company to enter into a single unconditional sale contract with the vendor and for legal completion of the buy-back to take place on a series of future dates in respect of separate tranches of shares within the agreement. This is known as a multiple completion contract. The effect of the procedure is that the ‘substantial reduction’ test only has to be considered once, i.e. at the date of the contract. The vendor has to give up his beneficial interest in the repurchased shares on entering into the contract and so he could not subsequently take dividends or exercise voting rights over the shares. He must also satisfy the ‘no continuing connection’ test. However, it should be emphasised that completion of the contract in stages does not create a debt for this purpose.

For CGT purposes, the disposal of the entire beneficial interest in the shareholding takes place at the date of the contract. Therefore, the vendor should always ensure that he has sufficient cash resources with which to meet the full tax liability by the 31 January following the tax year in which the multiple completion contract is made. In ICAEW TR745 (which was published in April 1989), HMRC accepted that multiple completion contracts represented valid tax planning arrangements provided, of course, that beneficial ownership passed at the contract date.

More recently, a new difficulty arose in that HMRC expressed an opinion that company law still entitled the vendor to vote on his shares, notwithstanding that he had contracted to sell them and had lost beneficial ownership. If this view is correct (which is by no means certain), a vendor would be connected with his company under S1062(2)(c) CTA 2010 if the voting rights on what might be called the ‘non-completed’ shares exceeded the 30% limit. However, it did not take advisers long to find a way around this predicament: the problem can be resolved by converting the relevant holding into a separate class of non-voting shares.

This potential trap is unfortunately not the end of the story. In the last few months, HMRC have started to argue that the word ‘possesses’ in S1062(2) CTA 2010 refers to legal, as opposed to beneficial, ownership. When shares are sold by way of a multiple completion contract, the vendor will lose beneficial ownership of all his shares on the date of the contract, but he will retain legal ownership of the shares until completion. This, HMRC say, ‘is the case even if those remaining shares are converted to so-called deferred shares with no voting or economic rights in the company on completion of the first tranche (of the deal)’. Therefore, as long as the vendor remains the legal owner of sufficient ‘non-completed’ shares in excess of the 30% limit, he is still connected with the company under S1062(2)(a) CTA 2010 and cannot qualify for CGT treatment.

HMRC continue:

> ‘In the past, (we) may have issued clearances under S1044 CTA 2010 where the connection test might not have been met due to retained legal ownership of the shares. For the avoidance of doubt, HMRC will not treat such clearances as void purely on the basis of retained legal ownership of the shares. However, going forward, HMRC will apply the connection test as described above which may result in . . . applications being rejected.’

The Company Taxation Manual will be updated shortly to reflect HMRC's latest interpretation.

In this context, one commentator has said:

> 'We understand that this has been HMRC's view for many years. For some reason, however, for the last several years this aspect has been overlooked such that clearances for capital treatment have been granted when, according to HMRC's analysis, the technical conditions were not satisfied. HMRC have, however, recently "rediscovered" their original analysis and are now enforcing it so that multiple completion transactions where a shareholder retains legal ownership of more than 30% of the ordinary share capital of a company will not be granted clearance.'

What is now to be done where a company cannot afford to make payment for the shares in one go.

The CIOT and other professional bodies believe that there are technical arguments which will show HMRC's new approach to be mistaken. These are in the process of being developed and will be presented to the tax authorities in due course.

In the meantime, the simplest way out is to structure the own share purchase tranches so that the vendor initially sells rather more shares in the first tranche which will result in the taxpayer limiting his holding to 30% or less. See the illustration below.

Another option is for the legal ownership of the shares in question to be transferred to a nominee. By virtue of S60(1) TCGA 1992, this would involve the company as the beneficial owner of the shares, and not the shareholder.

Illustration

RST Services Ltd is an unlisted company which has been trading since 1972. It is currently owned by three unrelated shareholder directors as detailed below:

Shareholder directors	Number of £1 ordinary shares	Holding
Robert	45,000	45%
Simon	30,000	30%
Thomas	25,000	25%

In view of his approaching 75th birthday, Robert has decided to retire from RST Services Ltd, leaving his younger colleagues in control of the business.

Simon and Thomas have an option to buy Robert's shares, but they all agree that it would be more tax-efficient for the company to purchase Robert's holding of 45,000 ordinary shares at an agreed fair value of £1,800,000, being £40 per share. These shares will then be cancelled.

In order to avoid any adverse impact which the deal might otherwise have on RST Services Ltd's working capital requirements, the company will buy back Robert's shares under a multiple completion contract which will be structured as follows:

Proposed completion dates	Purchase	
	Number of shares	Consideration
1 August 2022	15,000	£600,000
1 August 2023	15,000	£600,000
1 August 2024	15,000	£600,000

Under HMRC's current interpretation of the 30% 'no continuing connection' test, Robert will possess (i.e. be the legal owner of) more than 35% of RST Services Ltd's ordinary share capital immediately after the own share buy-back contract is entered into (and the purchase of the first tranche is completed).

At this stage, Robert's holding comprises 45,000 – 15,000 = 30,000 shares and the company's total ordinary share capital stands at 30,000 + 30,000 + 25,000 = 85,000 shares.

Thus:

$$\frac{30{,}000}{85{,}000} \times 100 = 35.294\%$$

Robert possesses more than 30% of RST Services Ltd's ordinary share capital and he is therefore connected with the company under S1062(2) CTA 2010. He will not be eligible for CGT treatment. He has also not met the 'substantial reduction' test.

However, it may be possible to modify the own share purchase agreement by increasing the amount of 'first tranche' shares purchased by the company so that Robert is left with 30% or less of the various parameters. Thus, if, for example, Robert was to sell 22,500 shares back to RST Services Ltd as an initial tranche, he would satisfy the 'no continuing connection' test. Thus:

$$\frac{22{,}500}{77{,}500} \times 100 = 29.032\%$$

And he has clearly effected a 25% substantial reduction.

Contributed by Robert Jamieson

Is there a duty of care? (Lecture B1234 – 10.20 minutes)

The case of McLean v Thornhill (2022) deals with a series of tax avoidance schemes involving participation in film distribution LLPs which were sold, via independent financial advisers, to various wealthy investors 20 years ago. The schemes were unsuccessful and HMRC pursued the investors for the tax which they had underpaid, together with substantial interest charges. It was heard in the High Court towards the end of 2021 and a 117-page judgment was handed down by Zacaroli J on 8 March 2022.

The claimants were a group of wealthy individuals who, between them, invested more than £100,000,000 in the film schemes, seeking to offset tax liabilities of approximately £40,000,000. When the schemes failed to deliver the intended tax advantages, the participants brought claims in negligence against Andrew Thornhill QC (T), a well-known tax barrister, who had acted as adviser to the promoters of the schemes. Although T had not advised – or indeed interacted with – them, the claimants argued that T owed them a duty of care because his advice had been referred to in the information memoranda, through which the schemes were promoted and which were made available to potential investors on request.

Zacaroli J ordered a trial of 10 sample claimants' claims in order to determine common issues which would bind all the claimants together and also to highlight any issues which were specific to the sample. However, in the end, the High Court judge rejected the claims at almost every level, holding that there was:

- no duty of care;
- no breach of duty; and
- no causation of loss.

For example, on the duty of care issue, the judge, applying the principle derived by the House of Lords in Hedley Byrne & Co Ltd v Heller & Partners Ltd (1964), held that T owed no duty of care to potential investors.

The circumstances of the investments made it clear that it was:

- not reasonable for investors to rely on T rather than on their own tax advisers; and
- not reasonably foreseeable to T that they would rely on him.

In particular, the information memoranda had clearly advised potential investors to consult their own advisers on the tax aspects of the film schemes and no investor was allowed to subscribe without warranting that he or she had relied solely on their own independent advisers.

Additionally, such wealthy investors could reasonably be expected to have access to skilled advice. And, of course, they knew that T was acting for the promoters who were selling the schemes.

It should be remembered that the Hedley Byrne case examined the situation where there had been negligent misstatements and negligent advice. The claimants had relied to their detriment on references provided by the defendant bank. The House of Lords recognised that, although, in that particular case, the defendant did not owe a duty of care to the claimants in view of the fact that the references had been given 'without responsibility', in principle such a duty could be owed where there was no contractual relationship between the parties.

However, the five judges in the House of Lords were concerned to ensure that any claim for negligent misstatement leading to economic loss should be contained and, in order to achieve this, they introduced the principle that liability depended on the existence of a 'special relationship' between the parties based upon 'an assumption of responsibility' by the maker of the statement.

As mentioned above, Zacaroli J stated that T owed no duty of care to the claimants in respect of the advice which he gave in relation to the film schemes. The investors were not T's clients and his advice was never communicated to them. In the judge's words:

> 'No reasonable investor could have understood that T was making any statement or providing any advice to them at all. An implicit statement by (the promoters) that the tax analysis in the information memoranda was consistent with T's advice to (the promoters) is insufficient, in my judgment, to amount to the provision of advice by T to any potential investor.'

Furthermore (and, in the speaker's opinion, probably as important as anything else in the case), each of the claimants had warranted that they had read and understood the terms of the information memoranda and were aware of the risks involved.

It is difficult to see how this case could have turned out in any other way.

Contributed by Robert Jamieson

VAT and indirect taxes

Installation of pre-formed burial vaults (Lecture B1321 – 19.51 minutes)

Summary - A company that installed pre-formed burial vaults at a burial site was making an exempt supply within item 2 Group 8 Schedule 9 VATA 1994.

Hodge and Deery Limited installed pre-formed burial vaults at a 20-acre burial site in East London for RED Landscapes. These pre-formed flexible vaults are used to prepare graves in unstable soil areas. Once installed, the burial plots are ready for use and the land above the plots is landscaped which, in this case, was work undertaken by RED Landscapes.

The company argued that their services were an exempt supply within Item 2 Group 8 Schedule 9 to the VATA1994 which states:

> "*Burial and cremation*
>
> *Item No:*
>
> 1. *The disposal of the remains of the dead.*
> 2. *The making of arrangements for or in connection with the disposal of the remains of the dead."*

HMRC disagreed arguing that the exemption did not extend to sub-contractors but rather, was confined to:

- those supplies directly involved with the disposal of the remains of a particular dead person;
- supplies directly made by the funeral director with care and custody of the deceased.

HMRC sought to rely on their published guidance in Notice 701/32 referring to:

- para 3.1 (that the digging of a grave would be an exempt service if provided by an undertaker);
- para 5.1 (services are exempt if they comprise "Brick, block or concrete lining of a grave when constructed as a requirement of the cemetery management (or in the case of a churchyard, the church authorities) where for example the soil is unstable.

Both parties understood that if the exemption was available, some input tax may be disallowed. The quantification of the disallowed input tax was not within the scope of the hearing.

Decision

The First Tier Tribunal confirmed that the correct starting point in identifying whether services fall within items 1 and 2 was to identify the result of the service. To be exempt the services must directly lead to the disposal of the remains of the dead or be in connection with the disposal of the remains of the dead.

As the company did not actually dispose of the remains of the dead, the services they provided did not fall within Item 1.

However, as the digging of graves is central to the disposal of the remains of the dead, the services were made in connection with the disposal of the remains of the dead and so fell within Item 2.

As was pointed out by Moses J in Network Insurance Brokers Limited v HMRC [1998] EWHC, STC 742, it did not matter that the services were provided in advance, and nor did it matter that the services were not provided in connection with a specific funeral. Further, CJ Williams v Telford [2000] BVC 2111 confirmed that the funeral director or undertaker need not provide all the services himself. Here, cold storage services and chapel of rest facilities were provided by CJ Williams to fellow undertakers in the locality without such facilities.

The Tribunal confirmed that HMRC's guidance did not have the force of law and also was not a guide on how to interpret the law. The Tribunal stated that:

- it was difficult to accept that the digging of a grave by another person should be regarded as anything other than an exempt supply as 'Digging of graves is pivotal to the disposal of the remains of the dead by burial';

- it should make no difference that the modern method of dealing with unstable soil requires the advance preparation of multiple graves to deal with that problem. The legislation must be construed in a manner to enable new technology to be adopted to achieve the result expected by the legislation.

The appeal was allowed.

Hodge and Deery Limited v HMRC (TC08484)

Vehicles sold to scrap companies

Summary – The taxpayer's claim for output tax incorrectly paid to be repaid by HMRC was denied as it would cause unjust enrichment.

The Mayor's Office for Policing and Crime was a public body that seized privately owned vehicles under various powers contained within legislation.

A statutory process had to be followed before vehicles could be released back to their owner/driver and that process involved the payment of a statutory fee.

Where the statutory fee was not paid, the Mayor's Office for Policing and Crime authorised the disposal of the vehicle in satisfaction of the statutory fee that was payable. Where vehicles were not returned to owners, they were sold to scrap companies for the statutory fee plus VAT. Each of the scrap companies was VAT registered and so were able to reclaim the input VAT suffered.

However, when the Mayor's Office for Policing and Crime disposed of vehicles seized under these powers, it was actually operating under a special legal regime and did not carry-on business within the meaning of s 4(1) VATA 1994. VAT had been wrongly accounted for and so it submitted a claim for a VAT refund totalling £1.7 million.

HMRC rejected the claim arguing that:

- the refund would 'unjustly enrich' the claimant as currently, neither the appellant nor scrap companies were current out of pocket. The scrap dealers had reclaimed their input tax suffered and the appellant had paid the output tax on to HMRC;
- the unjust enrichment legislation applied to all entities and organisations. There were no exceptions;
- the Mayor's Office for Policing and Crime and HMRC were separate bodies.

The Mayor's Office for Policing and Crime appealed, arguing that unjust enrichment provisions did not apply as both it and HMRC were part of government, meaning that payments between them were simply a reallocation within the body public, meaning that there was no enrichment to the public body.

Decision

The First Tier Tribunal found that the Mayor's Office for Policing and Crime would be unjustly enriched because it passed on the VAT which it wrongly charged to the scrap companies who themselves recovered it from HMRC. The Tribunal stated that “if the music stops now, no one is out of pocket”.

The Tribunal also noted that the Mayor's Office for Policing and Crime was a recognised body within s.33 VATA 1994 and so could not be treated as a single body with HMRC.

The appeal was dismissed.

The Mayor's Office for Policing and Crime v HMRC (TC08425)

Transfer of property business? (Lecture B1321 – 19.51 minutes)

Summary - The sale of TV studios to a property developer was not the transfer of a business as a going concern for VAT purposes as the seller and buyer were carrying on different businesses.

The Haymarket Group was formed in 1995 as a publisher of magazines. It is now an owner of brands in a variety of media including exhibitions and online content. It was accepted that until 2015, the Group was also a property owner, using its properties for its own offices, as investments and as rental opportunities.

Haymarket Group Properties Limited was a member of a VAT group whose representative member was Haymarket Media Group Limited.

The company owned land and property at Teddington Studios, which it had opted to tax. Prior to its sale, the site was occupied by the Haymarket Group as its business premises, as well as a number of tenants to whom leases had been granted or assigned by the company.

Haymarket Group Properties Limited planned to sell the site but in order to increase its value prior to sale, in 2013 the company applied for planning permission to be able to construct 213 flats and six houses.

With planning consent in place, the company then sold the site to Pinenorth Properties Limited for £85 million, treating the disposal as the transfer of a going concern and so outside the scope of VAT. It was neither the supply of goods nor a supply of services.

The buyer went on to complete the development.

HMRC later concluded that the sale of land and property at Teddington Studios was a supply of an asset, and not the supply of a business as a transfer of a going concern. There was no dispute that if the transaction in question did not fall within the transfer of a going concern provision, then the VAT payable by the purchaser was £17 million, and that this would be fully reclaimable. The real tax that was at stake was the additional Stamp Duty Land Tax of £680,000.

Haymarket Group Properties Limited appealed arguing that it was carrying on a business before the sale of the Teddington site, which consisted of two elements: property development and property lettings. As a result, the transfer of a going concern treatment was available in respect of the sale.

Decision

To be eligible for the transfer of going concern VAT treatment, the buyer must use the transferred assets to continue the same kind of business as the seller.

The First Tier Tribunal found that Haymarket Group Properties Limited was not carrying on a property development business prior to the transfer. Although the company held the Teddington site as an investment, generating passive rental income, it had never intended to develop the site prior to sale. It was always the company's intention to sell the site to a developer, with the planning permission in place. The property was marketed as a development opportunity, not a development business. The £870,000 spent to obtain planning permission prior to sale was to enhance the value of the site as an investment This was not development.

The First Tier Tribunal moved on to consider whether a property lettings business was being transferred. The Tribunal concluded that it was not as under the terms of the sale, the Teddington site was to be transferred to Pinenorth Properties Limited with vacant possession.

The appeal was dismissed.

Haymarket Media Group Limited v HMRC (TC08495)

Items used for business purposes **(Lecture B1321 – 19.51 minutes)**

Summary - Input VAT claimed relating to two luxury cars, a private number plate and pilates clothing was disallowed as these items were not used for business purposes.

Maddison and Ben Firth registered for VAT from 8 December 2017 as Church Farm whose trading activity was "subcontracting glam/camping, weddings and events".

The October 2020 VAT return was submitted and included a claim for Input VAT totalling £28,374 for two cars, a personalised number plate (BS70 BEN) for a motorbike used for promoting the business and clothing purchased for use whilst Maddison Firth trained as a pilates instructor.

HMRC refused the input tax claim on the basis that the items claimed were not allowable business expenses.

On investigation, HMRC established that the cars were insured for 'Social, Domestic and Pleasure' only, implying there must be some private use. The couple claimed that the vehicles were only used for travel to and from business meetings or on the farm, as shown on the business' agricultural insurance for all of the farm's vehicles.

Decision

The First Tier Tribunal stated that the test of whether a car is available for private use is a test of the intention of the business when the car was bought and in particular whether a car has the potential for private use rather than if such use is likely. The Tribunal found that there was insufficient evidence to prove a business-only intention at the time of purchase. In addition to the 'Social, Domestic and Pleasure' only insurance, the Tribunal noted the impracticality of using an Audi TT for private hire.

The input tax relating to the number plate was disallowed as it did not refer to the business or its name in any way. Further, there was no evidence to prove that the business was known as "Ben's business or Ben's farm or Ben's anything", which might bring it within the ambit of the decision in BJ Kershaw Transport Ltd and within the classification of promoting Church Farm.

Finally, the Tribunal stated that normally a person is responsible for their own clothing at work. Although the pilates clothing was also worn while working on the farm, the clothes were neither protective nor did they represent a uniform. No input VAT could be recovered.

The appeal was dismissed

Maddison and Ben Firth T/A Church Farm v HMRC (TC08496)

Associated company failed to account for output tax

Summary – HMRC had correctly disallowed the input tax claimed by one group company as the invoicing associated company had failed to pay the related output tax to HMRC.

Grantham Ceilings & Interiors Limited was a long-established construction company. In 2016, a new company was formed called Grantham Holdings Ltd which held all of the contracts and received invoices from subcontractors working on Grantham Ceilings & Interiors Limited jobs.

Grantham Holdings Ltd raised monthly invoices for management services to Grantham Ceilings & Interiors Limited, correctly charging 20% VAT as a standard-rated supply.

Grantham Ceilings & Interiors Limited claimed input tax but Grantham Holdings Ltd failed to account for output tax on its VAT returns from June 2017 to December 2017.

HMRC concluded the directors of Grantham Ceilings & Interiors Limited 'knew or should have known' that Grantham Holdings Ltd would not pay its VAT liabilities to HMRC and disallowed the input tax claimed by Grantham Ceilings & Interiors Limited under the Kittel principle.

The director claimed that there was never any intention that Grantham Holdings Ltd would be used to evade VAT fraudulently. Rather, commercial factors had caused the VAT problem – there were major disputes with three Grantham Ceilings & Interiors Limited contracts which created serious cash flow issues. Grantham Holdings Ltd went into voluntary liquidation in May 2018.

For the inter-company invoices, Grantham Ceilings & Interiors Limited paid Grantham Holdings Ltd only the net amount of invoices it received. So, for an invoice for £100 plus £20 VAT, only £100 was paid. HMRC therefore disallowed input tax of £100 x 1/6 – in this example – on the basis that the other £20 was covered by the bad debt relief provisions.

Grantham Ceilings & Interiors Limited appealed.

Decision

The First Tier Tribunal found the unpaid VAT had, in effect, been treated as a loan from HMRC but without the lender's approval. Grantham Ceilings & Interiors Limited had submitted returns that included input tax claims on invoices from Grantham Holdings Ltd which the directors knew would not be paid to HMRC by Grantham Holdings Ltd. As a result, HMRC was correct to disallow the input tax claimed by Grantham Ceilings & Interiors Limited.

The appeal was dismissed.

Grantham Ceilings & Interiors Limited v HMRC (TC08429)

Adapted from the case summary in Taxation (2 June 2022)

VAT on gifts and samples (Lecture B1325 – 16.16 minutes)

Business gifts

Many clients will buy gifts with a view to giving them to valued customers, or even suppliers, in an attempt to improve their business relationship. Provided their business is fully taxable, the input tax on such gifts is recoverable as the items are bought for a business purpose.

However, where the goods cost more than £50 (net), a gift to a customer is treated as a deemed supply with the value of the supply being the cost of the goods. As a result, output tax must be accounted for which negates the original input tax claim.

Where the cost of the gift exceeds £50, output tax is due in the quarter that the gift is made.

Note it is irrelevant whether the goods are branded or not.

The £50 limit is per customer and works on a rolling 12-month basis so businesses must consider cumulative gifts to the same person in a 12-month period. Where the £50 limit is exceeded in this rolling 12-month period, the deemed supply rules will be in point.

Example

ESN Limited is a regular buyer of business gifts and on 20 March 2022 the company bought 100 boxes of golf balls, costing £40 plus VAT per box.

In the quarter to 31 March 2022, input tax of £800 was recovered in respect of golf balls bought.

Their accountants identify this golf ball purchase and ask to see their gifts register. The client will rarely have such a register. At this time, ESN Limited still has 92 boxes in stock and the directors are able to verbally recall where the other eight boxes went:

- One box was given to the director of their biggest supplier, XYZ Limited. No output tax is due as the business gift cost less than £50;

- Two boxes were given to the two directors of a key customer and again no output tax is due as the business gift costs less than £50 per director;

- The director took two boxes for himself and gave another to his brother. These boxes are not business gifts and so £24 (£8 x 3) of output tax must be accounted for as they do not qualify for the £50 business gifts exemption;

- Two boxes were given to the managing director of a potential new customer, making gifts to the same person of £80. With the £50 gifts to the same person limit exceeded, output tax is due of £16 (£8 x 2).

Gifts register

Where a client recovers input tax on business gifts, they should keep a gifts register, so as to establish whether a deemed supply is in point. HMRC will need proof of where the golf balls have gone.

If the business chooses not to recover input tax on the business gifts, there is no deemed supply when those goods are given away and there is no requirement for a gifts register.

Where a business only makes a small number of business gifts with cost of less than £50, the input tax at stake will not be significant. Such business may choose not to recover the input tax on these gifts, removing the administrative burden of maintaining a gift register.

Further gifts

Remember, in the earlier example, the director of XYZ Limited was given one box of golf balls and with the cost of the gift falling below £50, there was no deemed supply at that point. But what would happen if he was given another box six months later?

By giving this director a second box of golf balls, the cost of goods given to that director in a rolling 12-month period is now £80, and the rolling £50 limit per person has now been exceeded. Consequently, output tax of £16 (£8 x 2) is due in the VAT quarter in which the second box is gifted.

Note that the £50 limit is for goods given in a 12 month period and so the type of goods given might not be golf balls. Where the total cost of any goods given exceeds the £50 limit and input tax has been reclaimed, there will then be a deemed supply.

Samples

Giving stock away with a view to it promoting further sales of that item is a sample and regardless of the value of the sample, no output tax liability arises. However, giving away end of season or end of line stock is not a sample as there will be no further stock to sell. In this case, output tax will be due unless the cost is less than £50.

Barter transactions

Barter transactions are often confused with gifts. Barter is when something is supplied in return for something else. This is a VAT supply for both parties.

Be careful if you are giving stock to a celebrity or influencer in return for marketing exposure as this is a barter transaction where:

- the supplier has sold goods and has an output tax liability on the sale of goods;
- the influencer has provided advertising services and has an output tax liability on these services.

The value of a barter transaction needs looking at very carefully.

Example

A VAT registered accountant provides accountancy services to a VAT registered electrician. Rather than raising an invoice, the electrician agrees to re-wire the accountant's home.

The accountant has still supplied his accountancy services and must account for output tax on those services. The value received for those services is the value of the electrician's work for rewiring his home. The electrician can make an input tax claim based on this value provided that the accountant issues a VAT invoice to reflect this transaction.

The electrician must account for output tax on the rewire services provided based on the value of the accountancy services received in return. This would be what they normally pay their accountants for the accountancy services provided. The accountant is unable to reclaim the input tax on the electrician's invoice as the rewire is in respect of their home.

Barter and the non- VAT registered trader

A non- VAT registered trader, who undertakes a large number of barter transactions, could inadvertently breach the VAT registration threshold.

What if the electrician in our earlier example is not VAT registered? For the electrician, the rewire work undertaken will count as income for VAT registration threshold purposes and will be valued as the value of the accountancy services.

Article created from the online seminar presented by Dean Wootten

Revenue and Customs Brief 10 (2022)

This brief explains HMRC's new policy on determining whether or not an activity is a business activity for VAT purposes.

HMRC will apply the two-stage test considered by the Court of Appeal in Wakefield College:

> Stage 1: The activity must result in a supply of goods or services for consideration as without consideration, the activity cannot be a business activity for VAT purposes.
>
> Stage 2: The supply must be an economic activity so it is made for the purpose of obtaining income, even if the amount is below cost.

The Brief confirms that HMRC will no longer apply the six 'business test' indicators previously adopted from Lord Fisher [1981] STC 238 and Morrison's Academy Boarding Houses Association [1978]. Although, these indicators can be used as a set of tools designed to help identify those factors which should be considered.

https://www.gov.uk/government/publications/revenue-and-customs-brief-10-2022-vat-business-and-non-business-activities

Avoiding MTD penalties

On 31 May 2022, HMRC published compliance checks factsheet (CC/FS69), which explains how to avoid penalties under Making Tax Digital (MTD) for VAT.

Using functional compatible software

Under MTD, VAT returns must be filed using functional compatible software that can:

- record and store digital records;
- provide HMRC with information and VAT returns from the data held in those records;
- receive information from HMRC.

Failing to use such software may result in a penalty of up to £400 for every return that is filed.

Keeping records digitally

Each taxpayer has an electronic account that keeps certain records digitally within their functional compatible software. This includes:

- business name, address and VAT registration number;
- adjustments made for relevant VAT accounting schemes;
- VAT on goods and services supplied;
- VAT on goods and services you received;
- any adjustments made to a return;
- 'time of supply' and 'value of supply' for everything you bought and sold;
- rate of VAT charged on goods and services;
- details of reverse charge transactions;

- copies of documents that cover multiple transactions.

Failure to keep these records digitally, will result in a penalty of between £5 to £15 for each day that the requirement is not reached.

Using digital links to transfer or exchange data

Whenever data is transferred or exchanged within and between software programs, apps or products that make up functional compatible software, and that information forms part of the taxpayer's electronic account, they must do this using digital links to transfer or exchange data electronically. This must not be done manually.

HMRC provide some examples of such digital links:

- linked cells in spreadsheets, including the use of 'cell number/return' functions
- emailing a spreadsheet containing digital records so the information can be imported into another software product
- transferring a set of digital records onto a portable device, such as a pen drive or memory stick, and physically giving this to someone else to import that data into their software
- XML, CSV import and export, and download and upload of files
- automated data transfer
- Application Programming Interface (API) transfer

Use of 'cut and paste' or 'copy and paste' to select and move information is not a digital link.

Failure to do this correctly, may result in a penalty of between £5 to £15 for every day on which the requirement is not met.

Using the checking functions within software

HMRC stress the importance of using the checking functions within software to ensure that returns are correct.

Where a return is filed with errors, any VAT owed must be paid back.

https://www.gov.uk/government/publications/compliance-checks-how-to-avoid-penalties-for-making-tax-digital-for-vat-ccfs69/compliance-checks-how-to-avoid-penalties-for-making-tax-digital-for-vat-ccfs69