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Personal tax

Football commentator and IR35 (Lecture P1436 – 17.59 minutes)

Summary - The IR35 intermediaries legislation applied to arrangements between the individual's personal service company and Sky TV.

Neil McCann was a former Scottish Premiership footballer who had also played international football for Scotland. He provided his services as a commentator to British Sky Broadcasting Ltd (Sky) through his personal service company, McCann Media Limited.

During this time, the only other activity undertaken by Neil McCann was for a six-week period when he acted as interim manager of Dundee FC. This work was agreed to at a time when McCann Media Limited was in the process of negotiating a new three-year contract with Sky.

HMRC raised assessment to collect PAYE and NICs on the basis that the IR35 rules applied to the services provided and the company appealed.

The First Tier Tribunal found that Neil McCann "could not be considered to be in business on his own account and concluded that the provisions of the hypothetical contract were consistent with a contract of employment."

Having lost the case at the First Tier Tribunal, the company appealed to the Upper Tribunal arguing that:

1. The First Tier Tribunal had erred in law with respect to the issue of mutuality of obligation, arguing that Neil McCann's engagement with Dundee FC affected his availability to provide services to Sky;

2. The First Tier Tribunal had erred in law by failing to take into account other factors of the contractual relationship which were inconsistent with employment.

3. The First Tier Tribunal had erred in law in applying the three-stage test set out in the Kickabout Productions Ltd case and that the analysis of the actual and hypothetical contracts was 'blurred'.

Decision

The Upper Tribunal considered whether the First Tier Tribunal had made errors of law when considering whether there was mutuality of obligation.

It concluded that it was possible for an employee to serve more than one employer at any point in time.

The Sky Contracts specified an annual fee to be paid in equal monthly instalments upon submission of an invoice. McCann Media Limited were entitled to submit a similar invoice while Neil McCann was engaged by Dundee FC to those submitted in April and June 2017, the months either side of Dundee FC engagement.

Further, there were 'clearly significant contractual restrictions on services'. Neil McCann informed Sky in advance of taking the Dundee interim role which was consistent with the restrictive covenants to seek mutual agreement. Further he made himself available to work for Sky during the six-week period. Neither McCann Media Limited and/or Neil McCann had ‘contractual autonomy and free agency’ to do what they wanted. The Tribunal found that there was no error of law in the First Tier Tribunal's decision over mutuality of obligation.

The Upper Tribunal found that the First Tier Tribunal had carried out a thorough analysis of the relevant contract clauses and had taken into account the core provisions of the actual contracts between the two companies.

The Upper Tribunal found that the First Tier Tribunal had separately considered the actual contractual terms and those of the hypothetical contract. Indeed, McCann Media Ltd was unable to provide specific examples of where the two had been ‘blurred’.

The company’s appeal was dismissed.

McCann Media Limited v HMRC [2024] UKUT 00094 (TCC)

IR35 IT consulting case **(Lecture P1436 – 17.59 minutes)**

Summary – With material errors in law made by the First Tier Tribunal, this IR35 case has been remitted back to a differently formed panel of the First Tier Tribunal.

RALC Consulting Limited was the personal service company of Richard Alcock, an IT consultant who was the company’s sole director and shareholder.

The company provided his services for fixed periods of time under three sets of contractual arrangements. In each case, there were four parties to the chain of contracts:

1. Mr Alcock;
2. RALC Consulting Limited;
3. an agency (Networkers Recruitment Services Limited and Capita Resourcing Limited); and
4. the end client (Accenture (UK) Limited and the Department for Work and Pensions).

On the basis that the intermediaries legislation applied, HMRC had raised assessments to collect PAYE and NICs.

RALC Consulting Limited appealed to the First Tier Tribunal, who found in the taxpayer’s favour.

HMRC appealed to the Upper Tribunal arguing that the First Tier Tribunal:

- failed to properly identify the terms of the hypothetical contracts and to apply the common law test of employment status to those terms as required by section 49(1) ITEPA 2003; and

- had erred in law by reaching its conclusions over mutuality of obligation, control, other terms of the hypothetical contract being inconsistent with a contract of employment, and whether Neil Alcock was in business on his own account.

Decision

The Upper Tribunal found that the First Tier Tribunal clearly directed itself that it should adopt the three-stage process identified by the Court of Appeal in *Atholl House*. The issue was whether this approach had been correctly carried out.

In considering mutuality of obligation, the Upper Tribunal stated that:

> 'The FTT appears to conduct Stage 1 of the three-stage process …. and then to reach a conclusion on sufficiency of mutuality of obligation in the hypothetical contract …. without first having determined the terms of that contract.'

The Upper Tribunal found that the First Tier Tribunal applied the mutuality of obligation test to the terms of the actual contracts rather than the hypothetical contracts.

The Tribunal stated that 'the construction of the hypothetical contract is more than a transposition of the actual contract terms into the hypothetical contract.

The First Tier Tribunal did not consider what other relevant 'circumstances' needed to be taken into account in constructing the hypothetical terms as required by section 49(1)(c) and section 49(4) ITEPA 2003.

The First Tier Tribunal had erred in law by not properly constructing a hypothetical contract for each of the engagements and by failing to apply the employment status test to those terms.

The Upper Tribunal moved on to consider whether the errors found in the approach taken had a material effect on the outcome of the case and decided that they had.

On mutuality of obligation alone, the Upper Tribunal found that the First Tier Tribunal's decisions included several significant errors. For example, the fact that the employer was not obliged to provide further work and the employee was under no obligation to accept further work offered 'did not prevent mutuality of obligation existing within an engagement under which work is offered, the worker does the work offered, and the worker is paid'.

Similarly, the lack of any guarantee of a minimum number of hours' work and the right of the employer to terminate the arrangement were not inconsistent with mutuality of obligation in relation to an individual engagement.

The Upper Tribunal considered no further grounds of appeal, concluding that looking at mutuality of obligation alone, the First Tier Tribunal had made material errors of law. The case was set aside and remitted it to a differently formed panel of the First Tier Tribunal

HMRC v RALC Consulting Limited [2024] UKUT 00099 (TCC)

Flexible and hybrid workers **(Lecture P1436 – 17.59 minutes)**

HMRC guidance now states:

> "Modern information and communications technology has allowed many more employees to work from home on a flexible or hybrid basis. Under such arrangements, the employee will have a base office and journeys from home to that location will be ordinary commuting."

This means that such employees will continue to have the office as their permanent workplace and journeys made from the employee's home to their office will be classed as ordinary commuting and the employee will not be able to claim tax relief.

https://www.gov.uk/guidance/ordinary-commuting-and-private-travel-490-chapter-3#employees-who-work-at-home

Loan notes to a trust (Lecture P1436 – 17.59 minutes)

Summary – With no business or commercial purpose to the arrangements, tax and NICs were due on the loan notes when they were transferred to the trust.

Christopher Pinto was director and controlling shareholder of Lynx Forecourt Limited, a garage construction company.

During the tax year ending 5 April 2003, two bonuses were paid to the director as loan notes, issued by a newly incorporated company. The loan notes were transferred to a trust in which Christopher Pinto was the beneficiary. In the event of his death within 12 months following the award, he would cease to be entitled to the loan notes.

The company argued that the transfer of the loan notes fell within s.140A ICTA 1988 (repealed from 6 April 2003). As a conditional acquisition of shares, the loan notes were only taxable after the condition expired.

HMRC disagreed, saying that the condition should be ignored as it had no commercial purpose and sought to collect PAYE of £800,000 of income tax and NICs totalling £153,400 when the loan notes were transferred to the trust.

The company appealed.

Decision

The First Tier Tribunal found that there was no business or commercial purpose for the arrangements. Christopher Pinto and Lynx Forecourt Limited simply sought to pay less income tax and NICs than would have been the case if they had paid the bonuses in cash.

The Tribunal found that 'as a result of the terms of the loan notes, the market value of the loan notes when the conditionality period in relation to each bonus ended would be very much less - approximately 80% less - than the market value of the loan notes on their issue and initial transfer".

Adopting a purposive approach, a commercially irrelevant condition inserted solely to ensure that the arrangements fell within s 140A ICTA 1988 should be ignored. Lynx Forecourt Limited should account for PAYE and National Insurance on the loan notes when they were transferred to the trust.

At the hearing, it was agreed that the Tribunal would leave the question of quantum to be determined by the parties by agreement.

The taxpayer's appeal was dismissed.

Lynx Forecourt Limited v HMRC (TC09124)

Bonuses and the annual allowance charge (Lecture P1438 – 20.22 minutes)

F(No2)A 2023, which took effect on 6 April 2023, included the following changes relating to pension contributions:

1. An increase from £40,000 to £60,000 in the maximum amount of tax-deductible pension savings which can be made on behalf of an individual in a tax year (S20 F(No2)A 2023);

2. A rise from £4,000 to £10,000 in the money purchase annual allowance for those individuals who have already flexibly accessed their pension savings (S21 F(No2)A 2023);

3. An uplift from £240,000 to £260,000 in the 'adjusted income' threshold after which the annual allowance starts to be tapered for high-income individuals (with the minimum tapered annual allowance being pushed up from £4,000 to £10,000) (S22 F(No2)A 2023). The 'threshold income' figure of £200,000 was unaltered for 2023/24.

This case study looks at how the third of these changes could affect individuals today where their income rises, maybe as a result of receiving a bonus.

Example 1

In 2023/24, Eden's taxable remuneration (including benefits in kind) from his employment amounts to £250,000. He has no other income.

Eden is planning to make a pension contribution under a 'relief at source' scheme of £48,000 (net). He has no unused pension relief from any of the three previous tax years.

Before considering Eden's 'adjusted income', it is customary to determine his 'threshold income' for 2023/24.

This will normally be his total income less the gross amount of any pension contribution for which he is entitled to be given relief under S192 FA 2004.

In Eden's case, this is:

	£
Total income	250,000
Less:Gross pension contribution (48,000 x 100/80)	60,000
	190,000

Provided that the individual's 'threshold income' comes to £200,000 or less, the taper rules do not apply and there is no need to calculate his 'adjusted income'.

Eden is therefore entitled to 45% tax relief on his pension contribution, being:

	£
Basic rate relief at source (20% x 60,000)	12,000
Higher and additional rate relief ((45 – 20)% x 60,000)	15,000
	27,000

However, if Eden's employer also paid him a bonus of £50,000, this would take his annual earnings for 2023/24 to £300,000. His 'threshold income' then becomes £300,000 – £60,000 = £240,000 and so the 'adjusted income' calculation has to be made.

Eden's 'adjusted income' is:

	£
Total income (250,000 + 50,000)	300,000
Add: Pension contribution	60,000
	360,000

As a result, Eden's annual allowance of £60,000 is reduced by one half of the excess of his 'adjusted income' over £260,000, i.e. by ½ x (360,000 – 260,000) = £50,000.

In other words, Eden's annual allowance for 2023/24 is £10,000 (£60,000 – £50,000).

Eden's income tax position for 2023/24 is:

	£
Salary and benefits in kind	250,000
Bonus	50,000
Taxable income	300,000

	£
97,700 (37,700 + 60,000) @ 20%	19,540
87,440 (125,140 + 60,000 – 97,700) @ 40%	34,976
114,860 @ 45%	51,687
300,000	106,203

Note:

Eden is not entitled to a personal allowance, given that his income is too far in excess of the £100,000 limit.

By paying £48,000, Eden obtains basic rate relief for his pension contribution of £60,000.

He receives higher rate relief by having his basic rate band extended from £37,700 to £97,700. Similarly, his higher rate band is extended from £125,140 to £185,140 in order to provide him with additional rate relief.

However, Eden's tapered annual allowance for 2023/24 is £10,000 and his pension inputs were £60,000. He is therefore subject to an annual allowance charge at his marginal tax rate of 45% on the excess of £50,000 (£60,000 – £10,000). This further tax liability is:

45% x £50,000	£22,500

The effect of this clawback is that Eden ends up with tax relief on only £10,000 of his pension contribution of £60,000.

Eden's total income tax liability is:

	£
Income tax	106,203
Add: Annual allowance charge	22,500
	128,703

On the other hand, if Eden had not received the bonus, his income tax position for 2023/24 would be:

Taxable income	£250,000

	£
97,700 (37,700 + 60,000) @ 20%	19,540
87,440 @ 40%	34,976
64,860 @ 45%	29,187
250,000	83,703

In other words, the receipt of the £50,000 bonus has increased Eden's income tax liability by £45,000 (£128,703 – £83,703).

Contributed by Robert Jamieson

Unauthorised payment charge (Lecture P1436 – 17.59 minutes)

Summary – A loan made by a taxpayer's pension scheme resulted in an unauthorised payment charge as well as an unauthorised payment surcharge.

David Foulkes, 49, had a pension with the West Midlands Pension Fund, a local government pension scheme, with a transfer value was £18,309.

Following advice, on 20 June 2017 he transferred the fund to Alderley Wealth Management Pension Scheme, who in turn invested in a company called Haimachek UK Limited.

David Foulkes was informed that "that investors could receive a loan, if required, which was totally unconnected to the pension fund" and a few days later he received a payment of £11,819, representing a loan from a company called Lendtech Limited. The loan was for £13,040 less an administration fee of £1,000 and advance interest of £195.

HMRC initially considered that the transfer of £18,309 was an unauthorised member payment and enquired into his tax return for 2017/18. HMRC issued a closure notice charging David Foulkes to an unauthorised payments charge (40%) and an unauthorised payments surcharge (15%) totalling £10,069. However, by the time of the appeal, HMRC agreed that the charge and surcharge should be calculated on the amount of the loan (£13,040) rather than the fund transfer value (£18,309)

David Foulkes argued that there was no unauthorised member payment or that it was not just and reasonable that he should be liable to the unauthorised payments surcharge.

Decision

The First Tier Tribunal found in HMRC's favour concluding that there was a sufficient causal link between the loan from Lendtech Limited and the fund's investment in Haimachek UK Limited. In reaching that conclusion the Tribunal found that:

- The investment in Haimachek UK Limited and the possibility of a loan were first discussed at the same meeting;
- There was clearly some link between the investment in Haimachek UK Limited and the loan from Lendtech Limited;
- While the loan agreement was not expressly conditional on any investment in Haimachek UK Limited, the Tribunal was satisfied that without the investment in Haimachek UK Limited, no loan would have been made available to David Foulkes;
- It was not relevant that David Foulkes was unaware of any connection between the investment of his fund in Haimachek UK Limited and the loan which he received from Lendtech.

For these reasons the Tribunal were satisfied that the payment of £13,040 received by David Foulkes was an unauthorised member payment and that an unauthorised payments charge calculated at 40% was payable.

Moving on, the Tribunal found that it was just and reasonable for David Foulkes to be subject to the unauthorised payments surcharge as he could have identified a link between the investment and the loan as:

- The investment in Haimachek UK Limited and the possibility of a loan were first discussed at the same meeting;
- The funds were only made available after the pension transfer took place with instructions to invest the fund in Haimachek, but before he had signed the loan agreement;
- The loan agreement referred to David Foulkes as having an account balance with a company, which he knew was connected with the investment in Haimachek UK Limited;
- He took part in the arrangements, which gave rise to an unauthorised member payment, which amounted to a significant proportion of the fund.

The Tribunal stated that:

> "Even accepting that he could not reasonably have known of a connection between the investment in Haimachek and the loan, he did sign an indemnity …. which stated that he would not take a loan as a result of the pension transfer. It was unwise to negotiate a loan at the same time as dealing with the pension transfer."

On balance, it was just and reasonable for David Foulkes to be liable for the unauthorised payments surcharge.

David Foulkes v HMRC (TC09139)

Transactions in securities case (Lecture P1439 – 13.11 minutes)

The 'transactions in securities' legislation (Ss.682 – 713 ITA 2007) first saw the light of day in 1960 at a time when CGT did not exist, but, in the years since 1965, the ability to realise capital gains at lower tax rates than income has meant that HMRC have been more than ready to use these rules to counteract arrangements which have been structured to give shareholders a non-commercial tax advantage.

This regime applies where the following conditions are met in relation to a shareholder:

- he must be a party to a transaction in securities – this means that the person must receive 'relevant consideration' (see s.685(4) and (5) ITA 2007) in connection with the distribution, transfer or realisation of assets of a close company;

- he cannot take advantage of the 'fundamental change of ownership' exemption in s.686 ITA 2007 which was introduced in March 2010; and

- a main purpose (or one of the main purposes) underlying the transaction is to obtain an income tax advantage (which must actually be obtained).

Note that the 'income tax advantage' requirement was widened on 6 April 2016 to include *any* person seeking to obtain such an advantage (and not merely the selling shareholder).

These provisions have spawned a multiplicity of case law over the years, but it is still helpful to examine the leading decision of the House of Lords in *CIR v Cleary (1967)*, given that it demonstrates as clearly as anything the main principles used by HMRC in their application of the rules.

The *Cleary* case involved two sisters (Mrs Cleary and Mrs Perren) who needed cash and who each held 50% of the shares of two companies:

1. Gleeson Development Co Ltd; and

2. MJ Gleeson Ltd.

Gleeson Development Co Ltd had cash reserves of over £130,000 and, in 1961, the sisters sold most of their shares in MJ Gleeson Ltd to Gleeson Development Co Ltd for £121,000, with each receiving £60,500. This represented the proper market value of the shares.

However, the tax authorities subsequently issued a counteraction notice to the sisters under what is now s.684 ITA 2007, charging the entire sale proceeds of £121,000 on a grossed-up basis to income tax.

They considered that the three preconditions for the legislation to apply had been satisfied, namely that the:

- sale of the shares was a transaction in securities;
- sale fell within the prescribed condition in what used to be s.689 ITA 2007 – the company was under the control of five or fewer persons and the sisters had received consideration which would have been available for distribution by way of a dividend (had it not been applied in acquiring the shares in MJ Gleeson Ltd);
- there was a tax advantage, given that income tax had been avoided (andCGT did not exist until 1965).

The House of Lords agreed with the tax authorities. The sale of the shares in MJ Gleeson Ltd had come within the strict wording of the anti-avoidance legislation. The sisters therefore lost their case on the basis that the capital sums received represented amounts which could otherwise have been paid out as taxable dividends.

It should be mentioned that the *Cleary* case would still be caught by the 'transactions in securities' rules today. In particular, the sisters would not have satisfied the 'fundamental change of ownership' let-out since they subsequently remained connected with MJ Gleeson Ltd through their control of Gleeson Development Co Ltd.

Contributed by Robert Jamieson

Capital taxes

Sale of garden to a property developer (Lecture P1437 – 18.37 minutes)

Summary – The deemed disposal of part of a garden to trading stock crystalised a gain that was eligible for principal private residence relief.

In 1995 Andrew Nunn bought a property in Oxfordshire for £120,000 which he lived in as his main residence. Its garden was less than 0.5 of a hectare.

In 2015, he agreed to sell part of garden to a property developer for £295,000, who obtained planning permission in April 2015 to build two houses on the land.

By 2 June 2016 formal contracts for sale had still not been agreed but the developer was keen to begin work, in order to make progress during good weather. At that time, Andrew Nunn signed a letter from the developer agreeing that construction work could commence. The builder erected a fence to partition the land from the remaining garden and began construction work.

A formal contract of sale was signed and completed on 7 September 2016. The agreed terms of the sale were that £195,000 would be paid immediately and a further £100,000 on the completion of the sale of the second house to be built on the land.

By 7 September 2016 the foundations of the houses had been poured and brick walls built sufficiently high that scaffolding had been erected for the construction of the second storey.

In 2018, Andrew Nunn submitted his 2016/17 Self Assessment tax return, declaring sale proceeds of £195,000 and allowable costs of £222,000, resulting in a loss of £27,220.

On 18 December 2018, HMRC opened an enquiry into the 2016/17 tax return, later issuing a closure notice denying any loss relief. HMRC stated that the disposal date for CGT was 7 September 2016 and by that date the land was a building site, no longer part of the garden. Consequently, HMRC sought to collect CGT of £72,634 on the basis that principal private residence relief was denied.

Andrew Nunn appealed, arguing that disposal of the 'garden' took place on 2 June 2016, when the land was part of his garden that formed part of the permitted area of his main residence.

Decision

The First Tier Tribunal found that the letter that was signed on 2 June 2016 was not a contract for sale. Rather it simply allowed the developer to commence work on the development on the new houses. The Tribunal noted that there was nothing in it which showed a definite intention to bring about the immediate disposal of the land.

The Tribunal found that under normal circumstances, the CGT date of disposal was 7 September 2016, the date on which Andrew Nunn no longer owned the property.

However, the First Tier Tribunal found that as a result of the 2 June 2016 letter and the construction work commencing, Andrew Nunn was no longer using the land as part of his garden. The Tribunal stated that Andrew Nunn 'did not dig the foundations or lay the bricks himself' but he was carrying out development activities, through an agreement with a professional property developer. If the sale had fallen through, he 'would likely need to find a buyer' and was willing to take the risk of development works being begun in order to enable the reward of realising a profit on the sale of the land.

Consequently, there had been a deemed disposal of the property to trading stock (s.161 TCGA 1992). As the land was still a garden and not separated from his house at that time, Principal Private Residence relief applied. The Tribunal noted that 'Any further disposal of that land would normally be subject to tax as a trading transaction.'

Andrew Nunn v HMRC (TC09127)

Negligible value claim **(Lecture P1437 – 18.37 minutes)**

Summary – Shares were acquired at a time when they were already of negligible value, meaning that the taxpayer's subsequent negligible value claim was denied.

Kleos (Holdings) Ltd was incorporated on 19 December 2013 with two directors, Abigail Tan and Dr. Valeria Cinaglia. Two ordinary shares were allotted, one to each director.

On 30 September 2017 Abigail Tan applied for 150,000 Ordinary shares of £1.00 each in the company, stating in writing "I hereby confirm that payment for the aforementioned shares shall be capitalisation of the director's loan account." This was approved at a board meeting on 30 September 2017.

The company's Annual report and Unaudited Financial Statement for the year ended 31 December 2017 stated:

> "The principal activity of the company was to be that of Licensed restaurants which was closed down in November 2017."

The Notes to the Financial Statements in relation to Going Concern stated:

> "The company meets its day to day working capital requirements through the shareholder providing the funds."

In July 2019 Silver Levene filed a DS01 (strike off) form with Companies House for the company. There was no evidence that the company went through any form of insolvency procedure.

Abigail Tan submitted her tax return for 2017/18 on 1 August 2018, arguing that her shares had become of negligible value and claiming a negligible value loss of £150,000.

HMRC denied the claim believing that the company had ceased trading on 30 September 2017 and that at this date Abigail Tan's shares already had no value. HMRC stated:

> "The £150,000 shares subscribed for do not meet the conditions for a negligible value claim as they were worthless at the time of acquisition on 30/09/2017 when the loan conversion took place. S251(3) of TCGA 1992 limits the acquisition cost of

> the shares subscribed for to their market value at the time of the loan conversion."

Abigail Tan argued that when the capital sums were introduced, the company was solvent and hence the share value would be at £1 each, and one had to look at the company's position not as at 30 September 2017 but when the £150,000 capital was introduced.

Decision

The First Tier Tribunal found that the earliest date at which she could have owned the shares was 30 September 2017, when the company resolved to allot them.

However, as at that date, the shares were already of negligible value, as the company was insolvent and so the shares could not "become" of negligible value whilst owned by the Appellant."

The appeal was dismissed.

Abigail Tan v HMRC (TC09112)

Entrepreneurs' relief and rectification **(Lecture P1437 – 18.37 minutes)**

Summary – Rectification for an error would be allowed, meaning that entrepreneurs' relief was available.

On 26 February 2019 Jonathan Cooke disposed of his entire shareholding in ISG Holdings Limited to a third party, realising a chargeable gain of about £600,000.

At that time, entrepreneurs' relief was available on gains arising on a share disposal provided certain conditions were met, including that the person making the disposal had held at least 5% of the "ordinary share capital" in the company for a period of one year prior to the disposal.

Jonathan Cooke explained he had known the founders of ISG Holdings Limited since 2012. For a number of years, he had acted as 'friendly adviser' to them, helping them grow the business by giving them the benefit of his expertise in the property industry and also introducing them to his industry contacts.

In 2017 he became a formal investor in the company by acquiring shares in the company, with the agreement made with the founders stating that he was to buy 5% of the business for £500,000.

Jonathan Cooke was very focussed on the 5%, as he was well aware of the benefits of entrepreneurs' relief, should he sell his shares in the future. Indeed, he requested an anti-dilution clause to be included in the documents so his shareholding would not fall below 5%.

Following the share sale in 2019, Jonathan Cooke declared on his tax return that the sale qualified for entrepreneurs' relief.

However, following an enquiry by HMRC, he became aware for the first time that his holding of 245,802 D shares in ISC Holdings Limited was one share short of 5% of the ordinary share capital of the company. This was a mistake that had occurred due to the fact that a spreadsheet was used to calculate the number of shares acquired, but this spreadsheet rounded the percentage from 4.99998% to 5%. On this basis, HMRC denied the relief.

Jonathan Cooke appealed, arguing that he should be entitled to entrepreneurs' relief relies as if appropriate proceedings were brought in the High Court, it would order the rectification of documents to secure that he had held at least 5% of the ordinary share capital for the required period. He argued that the First Tier Tribunal should proceed as if such rectification had been ordered.

Decision

The First Tier Tribunal found that the taxpayer's intention was to transfer "a minimum of 5%" and that this "was a clear red line for Mr Jonathan Cooke, due to the fact that he wanted to qualify for entrepreneurs' relief. The fact he asked for (and received) an anti-dilution clause in the shareholders' agreement further points to this fact."

In the case Lobler v Revenue and Customs Commissioners [2015] UKUT 152 (TCC) it was found that:

> "although the FTT did not itself have power to order rectification, it could determine that if rectification would be granted by a court who does have jurisdiction to grant it, Mr Lobler's tax position would follow as if such rectification had been granted."

Consequently, in this case the Tribunal considered that it did have the jurisdiction to consider what the High Court would do, were it to be asked for rectification.

- The Tribunal found that the parties had a common intention to transfer a 5% holding which was clearly shown in various documents including the Heads of Terms and confirmed in oral evidence by all parties. The Tribunal found that the High Court would treat this matter as one that was capable of rectification.

- There was little delay between finding out that the problem existed and taking action to remedy this problem. It was very clear that all parties acknowledged and accepted that small cash adjustments would be necessary to effect the rectification.

- The Tribunal found that if rectification was allowed, no other third party would be left in an unjust position and that it was "highly unlikely that the High Court would consider them to be anything but neutral in this situation."

For these reasons, the First Tier Tribunal considered that the High Court would, if asked to consider the matter, grant rectification of these documents. As a result, the conditions for entrepreneurs' relief would then have been met.

The appeal was allowed.

Jonathan Cooke v HMRC (TC09118)

Property bought by brother (Lecture P1437 – 18.37 minutes)

Summary - An individual who bought a property on behalf of his bankrupt brother was holding it on resulting trust. As legal, but not beneficial owner, he was not subject to tax on its disposal to his sister-in-law.

Rasiah Raveendran had owned the leasehold of a property since 1989 from which his brother, Mr Indraraj, traded from.

In 2005, his brother was approached by the freeholder who wanted to sell the property but, having been declared bankrupt in 2004, Mr Indraraj could not obtain a loan to buy it. As a result, Rasiah Raveendran bought the property for £300,000 with the bulk of the purchase price paid from a loan taken out in Rasiah Raveendran's name. Mr Indraraj did contribute a sum, roughly the equivalent to 10% of the purchase price, to pay for further improvements in the property.

In 2014, with the loan affecting his credit score, the property was sold to his sister-in-law for £350,000 and the loan was repaid. At this time, the property was valued at £1,080,000.

HMRC enquired into Rasiah Raveendran's tax return for 2014/15 but found no mention of the property sale. HMRC started from the position that as Rasiah Raveendran was the legal owner of the property, he should be assumed to be the beneficial owner of the property in the absence of evidence to the contrary. There was no trust deed to show beneficial ownership held by Mr Indraraj. HMRC raised a valid discovery assessment for £191,974.

Rasiah Raveendran appealed, arguing that he was only the legal owner of the house, not the beneficial owner, who was his brother. It was understood that he was holding the property on trust for his brother. When asked why £350,000 was paid, rather than the original purchase price of £300,000 he claimed that the extra was to compensate him for the stamp duty land tax paid.

Decision

The First Tier Tribunal found that the evidence provided showed that:

- It was entirely plausible that Mr Indraraj could obtain no credit due to his bankruptcy;
- The entire mechanism of the purchase had been arranged for the brother, with the transaction described by Rasiah Raveendran as 'my brother using my name';
- From the outset, there was a clear understanding by both parties that the property was held for Mr Indraraj.

Despite there being no trust deed to show beneficial ownership, all of the evidence pointed towards his brother having beneficial ownership of the property. Costs were funded by Mr Indraraj via direct contribution or by paying the mortgage. The only funds contributed by Rasiah Raveendran were the loan, which was repaid when the property was transferred to the sister-in-law in May 2014.

The Tribunal stated:

> "There is no evidence, in our opinion, that points to the original transaction being anything other than a resulting trust."

With the entire purchase price funded by Mr Indraraj, he was the sole beneficial owner of the property and the appeal was allowed.

Rasiah Raveendran v HMRC (TC09119)

Carried interest transitional provision

Summary - Carried interest 'arose in connection with' a disposal made after 8 July 2015, and so the transitional provision did not apply.

The appellants appealed against assessments to CGT in respect of carried interest amounts arising in 2015/16 on the basis that the carried interest amounts in question fell within a transitional provision and accordingly were not subject to taxation under the rules for carried interest which applied from 8 July 2015.

The appeals were lead cases under Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Regulations, SI 2009/2739, rule 18 behind which the appeals of 24 other individuals who were limited partners of the relevant limited partnership are stayed.

The appeals concerned whether the provisions of s.103KA et seq. TCGA 1992 (the 'carried interest legislation' which applied to carried interest arising on or after 8 July 2015) applied in respect of the relevant carried interest amounts or whether the transitional provision at s.43(2) F(No. 2)A 2015 applied which would result in the carried interest amounts being taxed in accordance with the position prior to the introduction of the carried interest legislation. If the relevant carried interest amounts fell within the scope of the transitional provision, then no chargeable gain would have arisen in the circumstances.

The carried interest legislation was introduced to remove the base cost shift for taxation of carried interest, i.e. the position, pursuant to HMRC Statement of Practice D12, of a change in capital profit sharing ratios of a partnership (where there has been no revaluation of assets in partnership accounts and no consideration passing between partners) that the partner whose share increases is allocated an increased share in the base cost of underlying assets on a no gain/no loss basis. The effect of the base cost shift is that the relevant partner can ultimately accrue a chargeable gain which is lower than the economic gain calculated by reference to his actual contribution to the partnership assets.

The transitional provision only applied in respect of carried interest arising in connection with the disposal of an asset or assets of a partnership before 8 July 2015.

The appellants, focusing on the disposals which generated the underlying profits reflected in the carried interest amounts, argued that the carried interest legislation constituted an entirely new statutory regime for the taxation of carried interest and accordingly the correct interpretation was that as the carried interest in question was a share of actual gains which were all derived from disposals of assets prior to 8 July 2015 (with the only post-8 July 2015 disposal being effected at a loss) then the carried interest was within the scope of the transitional provisions (and the carried interest legislation should not apply).

HMRC argued, focusing on the disposal which triggered entitlement to payment of the carried interest under the arrangements, that it was only the post-8 July 2015 disposal which gave rise to the entitlement to the payment of the carried interest amounts (and notwithstanding that transaction being effected at a loss it was essential to meeting the applicable internal rate of return (IRR) hurdle) and that no entitlement to carried interest had arisen as a result of the pre-8 July 2015 disposals

Decision

The First Tier Tribunal concluded that the transitional provision did not apply on the basis that it was a disposal of an investment (at a minimum sales price) after 8 July 2015 which resulted in the IRR hurdle being satisfied and entitlement to carried interest arising, notwithstanding the fact that that particular disposal was effected at a loss and the profits reflected in the carried interest amounts were generated solely by disposals occurring before that date.

Accordingly, the First Tier Tribunal dismissed the appeals.

*Charles Ferguson-Davie and Nick Edwards*v HMRC *(TC09138)*

Adapted from the case summary in Tax Journal (3 May 2024)

Annexe under construction (Lecture P1437 – 18.37 minutes)

Summary – A garage converted to a self-contained unit was not a dwelling and so multiple dwellings relief was denied.

On 7 June 2021, Yisroel Dreyfus exchanged contracts to buy a property in London and at the same time agreed a "key undertaking" document allowing him to convert the garage into a self-contained unit.

On 22 June 2021, he completed on the £1.8 million purchase; this was the effective date of the transaction for SDLT purposes.

The week before, various works had been carried out to create a door, to introduce a cold-water supply pipe and a soil pipe for waste.

Yisroel Dreyfus submitted his SDLT return and paid tax, claiming multiple dwellings relief. He argued that on the effective date for SDLT, the annexe was in the process of being constructed, meaning it was a second dwelling facilitating his claim.

HMRC rejected the multiple dwellings relief claim and increased the SDLT payable by £74,750.

The taxpayer appealed, maintaining that the property included two self-contained dwellings, with each including “all the amenities required for everyday living”. Further, each dwelling had its own supply of electricity and gas which could be used independently of the other dwelling.

Decision

Both parties agreed that the appeal centred around the interpretation of paragraph 7(2)(b) Schedule 6B FA 2003 which explains 'what counts as a dwelling'.

It states:

(2) A building or part of a building counts as a dwelling if—

(a) it is used or suitable for use as a single dwelling, or

(b) it is in the process of being constructed or adapted for such use."

The Tribunal considered the work planned and undertaken before and after purchase, concluding that these did not provide sufficient evidence of construction or adaptation stating that:

> "The minimal work referred to … does not provide sufficient evidence of construction or adaptation".

After two years, the annexe was complete but still not let. Water, light and heat were all shared with the main property; there were no separate meters. No council tax was being paid in respect of the annexe and there was no evidence to prove that the annexe had a lockable door.

Concluding that the annexe was not usable as a single dwelling, the appeal was dismissed.

Yisroel Dreyfus v HMRC (TC09113)

Unused woodland **(Lecture P1437 – 18.37 minutes)**

Summary – 3.4 acres of woodland were found to be part of the grounds of a property bought in a semi-rural location. SDLT was payable at the residential rates.

On 12 March 2018, the couple bought a property in Potters Bar for £1.5 million, submitting the SDLT return on the basis that the property was 'residential'.

The property was located in a semi-rural location and consisted of a five-bedroomed house, attached double garage, a garden set in approximately half of an acre and 3.4 acres of woodland.

Nearly a year later, their agent sent HMRC a letter requesting that the return be amended on the basis that there was non-residential property, woodland, included in the purchase, which was not being used.

Following an enquiry, HMRC issued a closure notice concluding that the "woodland" was residential property.

The couple appealed to the First Tier Tribunal arguing that neither they nor the previous owners used the woodland, which was overgrown and inaccessible.

Decision

The First Tier Tribunal used the "pointers" in Faiers v HMRC that set out the principles, derived from various SDLT cases, to use when considering whether a particular piece of land can be said to be grounds "of" a dwelling.

- Historic use - there was no suggestion that the Woodland had been used otherwise than as woodland;

- Layout/proximity - The Woodland was at the top of the garden but contiguous with it and could be seen from the house, enhancing the rural character of the Property;
- Extent - 3.4 acres was considered to be appropriate for a dwelling of this size in a semi-rural location, being consistent with properties in the area;
- Legal factors/constraints – on purchase, there were no legal factors or constraints preventing the use of the Woodland with the house and the garden;
- Connection - the Woodland was connected directly with the garden;
- Common ownership - the Woodland was in common ownership;
- Contiguity - The Woodland was contiguous to the garden.
- Functionality - the Woodland gave a degree of security and privacy to the property;
- Unconnected purpose - the Woodland was not used or occupied for a purpose separate from and unconnected with the garden.

Having considered all of these factors, the First Tier Tribunal dismissed the appeal.

Mihalakis and Dora Michael v HMRC (TC09130)

Administration

Taxpayer in prison (Lecture P1436 – 17.59 minutes)

Summary – Despite being in prison and being prevented from running his own property business, he was beneficially entitled to receive the property income generated which was still taxable on him.

In May 2019, believing that Stanley Herrmann had received property income which has not been declared, HMRC opened an enquiry into his tax affairs.

He agreed that he had purchased three properties on 10 November 2000, 12 November 2001 and 16 November 2001and admitted that he had income from these properties.

In February 2020, HMRC issued discovery assessments for the years 2002/03 and 2004/05 to 2017/18 together with penalties.

Stanley Herrmann disputed the assessments which related to employment income, pension income as well as his property income. He claimed that:

- he had not received either the employment pension income on which he was being assessed;
- he could not be taxed on his property rental business income as the years assessed included periods when he was in prison (December 2002 to December 2012). As he was not permitted to conduct business from prison, he should not be responsible for the failures of his agent to deal with the relevant tax matters.

Decision

The First Tier Tribunal stated that there was no statutory exemption from tax for people in prison.

Although he was not directly conducting the business, he had engaged an adviser to do so on his behalf. He continued to be beneficially entitled to the income which remained taxable in him throughout his time in prison.

He claimed that he had a reasonable excuse for failing to notify his rental income as HMRC should have written to his agent while he was in prison. The Tribunal confirmed that it was for him to notify his liability to tax. HMRC was not obliged to locate non-compliant taxpayers. With no evidence to support the claim that his estate agent was qualified to deal with tax matters or that that this agent had in fact been engaged to deal in such matter, there was no reason for HMRC to make contact with them.

The First Tier Tribunal dismissed Stanley Herrmann’s appeal, upholding HMRC’s assessments and penalties.

Stanley Augustine Herrmann v HMRC (TC09132)

Code of Practice 9 – Case studies (Lecture P1440 – 12.11 minutes)

Code of Practice 9 is HMRC's process for the civil investigation of fraud, currently operated through the Contractual Disclosure Facility, the workings of which I have covered in a previous session. This session will look at three case studies, suitably anonymised, taken from the many hundreds of cases that I have dealt with in nearly 30 years of assisting clients who are subject to investigation under Code of Practice 9.

Case study one

The first example is one where I was not formally appointed, but the circumstances are so horrendous that they merit sharing.

I was approached by an accountant who had a client that had received a letter from HMRC saying that they suspected fraud. The accountant, who did not have any experience of dealing with Code 9 investigations, asked me to provide him with a template for the preparing of a disclosure report to HMRC. The accountant was openly brazen about his position, and said he was conscious that the fees for dealing with a Code 9 case can be significant, and he wanted those fees himself, and would not be engaging my services, as an investigation specialist. I explained that there wasn't a template for such cases, as each one is different, but that I was prepared to work with him, so that he, and his client, were protected, and could benefit from my experience. I did not hear from the accountant.

Roll forward two years, and I received another call from the accountant. He wanted to discuss the "template" case. He explained that he had not made progress in dealing with the matter, a disclosure report needed to be submitted to HMRC the following week, and the inspector had told him that he would be seeking a penalty of 80% (on a £1 million tax liability) from the client because of the lack of co-operation. He asked me what he could do.

I was extremely concerned, not least because, at the time, I would have expected a penalty in the region of 30%. I again offered to help, even at this very late stage, and offered to work with the accountant. The accountant decided to go it alone with HMRC, and I don't know the outcome of the case. It may be that the client was subject to a criminal investigation. If the matter continued along civil lines, the client paid, at least, £500,000 more than he needed to in penalties. Unfortunately, the accountant was more concerned about his fees than protecting the client. The accountant did not have sufficient knowledge or experience to deal with the Code 9 investigation, he did not appreciate the seriousness of the situation, and that was not conveyed to the client. However, the accountant also seriously compromised his professional indemnity insurance position, by dabbling in what is a specialist area. If the client had contacted me, or another investigation specialist, after settlement, they would have been advised that the penalty was excessive.

Case study two

In this case, I was approached by an accountant. Their client was being investigated under the Code 9 process. The client had appointed an investigation "specialist", and the client was due to meet with HMRC the following week for a settlement meeting. The accountant forwarded me a copy of the letter of offer that the client was going to sign – the amount to be paid to HMRC was £1.2 million. The accountant asked me to have a look at the disclosure report prepared by the "specialist", as the client thought the proposed settlement figure was too high.

I reviewed the document and was concerned by the content. There were numerous areas which I felt had not been covered in sufficient detail, and there were other areas where obvious questions had not been addressed. I explained to the client that I thought there were limitations in the report, but I was not sure what could be done, given the advanced stage of the investigation.

I was appointed by the client, and approached HMRC, to say that the settlement meeting would not be going ahead. I explained to the inspector that I would be carrying out further investigations and would update him in due course. I met with the client to discuss his disclosure in detail. Over the course of the next few months, I conducted further investigations, and asked the client to obtain further supporting documents and address matters not covered by the previous “specialist”. To cut a long story short, a few months after my appointment, the client signed a different letter of offer, for £300,000, considerably lower than the figure put forward by the “specialist” who was previously advising the client. Also, the client did not attend a settlement meeting with HMRC, and the matter was concluded by correspondence. The previous “specialist” had failed to adequately investigate or consider all relevant areas and had failed to obtain documentation to support the client’s position.

Case study three

The third case involves a client who was previously subject to a tax fraud investigation and had reached a settlement with HMRC for the relevant offences. I was asked to assist the individual, as they had committed further offences, again involving fraud. There was another aggravating factor, in that the individual was a professional, and would be deemed to be in a position of trust or responsibility under HMRC’s criminal investigation policy. The client made a voluntary request for inclusion in the Contractual Disclosure Facility and was invited to participate in that process by HMRC.

An Outline Disclosure was submitted to HMRC, in accordance with the requirements of the Contractual Disclosure Facility. The submission was accepted by HMRC, and a formal disclosure report was subsequently sent to HMRC, following further investigation work into the irregularities. The report was accepted by HMRC without significant challenge, and, because of the client’s circumstances, a settlement equating to, approximately, 20% of the accepted liability was agreed with HMRC.

Contributed by Phil Berwick (Director at Berwick Tax)

Deadlines

1 June 2024

- Corporation tax for periods ended 31 August 2023 (SMEs with no instalments)

7 June 2024

- Electronic filing and payment of VAT for quarter ended 30 April 2024

19 June 2024

- PAYE/NICs/CIS/student loan liabilities for month to 5 June 2024 (non-electronic)
- File monthly construction industry scheme return

21 June 2024

- File online monthly EC sales list – business based in Northern Ireland selling goods
- Supplementary intrastat declarations for May 2024
    - arrivals only for a GB business
    - arrivals and despatch for a business in Northern Ireland.

22 June 2024

- Electronic payment of PAYE/CIS liabilities for month ended 5 June 2024

30 June 2024

- Accounts to Companies House
    - private companies with 30 September 2023 year end
    - public limited companies with 31 December 2023 year end
- CTSA returns for companies with accounting periods ended 30 June 2023
- Savings institution returns made under the European Savings Directive for 2023/24

News

New voluntary NICs online checker and payment portal

Historically, taxpayers were required to phone HMRC to obtain a reference number before making voluntary NICs. However, HMRC has now launched an online service that enables taxpayers to:

- check their State Pension forecast;
- understand how their State Pension could increase by making voluntary contributions;
- make voluntary contributions to fill gaps in their National Insurance record;
- receive confirmation upon successful receipt

The service is accessed via the 'Check your State Pension forecast' link on GOV.UK or the HMRC app. Customers will need to log in to the new digital service using their Personal Tax Account login details.

HMRC remind taxpayers and agents of the extended time limits to pay retrospective contributions: 'Those who are eligible have until 5 April 2025 to pay voluntary contributions to make up gaps in their NI record between 6 April 2006 and 5 April 2018. From 6 April 2025, people will only be able to pay voluntary contributions for the previous 6 tax years, in line with normal time limits.'

https://www.gov.uk/check-state-pension

https://www.gov.uk/guidance/download-the-hmrc-app

HMRC wrongly refunding voluntary NICs

The ATT has reported that some voluntary payments of class 2 NICs are unexpectedly being refunded.

Collected through Self Assessment, Class 2 payments then need to be transferred to the individual's National Insurance record, which is done automatically by HMRC. For such payments to be accepted in this way, they must be paid by 31 January.

However, it seems that this year, the transfer process was run late. Consequently, some taxpayers who had paid their voluntary Class 2 contributions by the 31 January 2024 deadline have been informed that their payment was late and have been issued with a revised income summary and tax calculation rejecting the Class 2 payment and refunding the £163.80 paid.

In order to correct the position, taxpayers must ring up the NI Contributions office (0300 200 3500) to obtain a payment reference and then make a special payment direct to them. It is not possible to simply pay the amount back onto the Self Assessment account.

https://www.att.org.uk/technical/news/hmrc-wrongly-refunding-some-voluntary-class-2-nic-payments

Bad Tax Planning—and how to deal with it (Lecture B 1439 – 25.20 minutes)

2024 marks twenty years since Dawn Primarolo as Financial Secretary to the Treasury threatened retrospective legislation if taxpayers continued to engage in what the Treasury considered as aggressive tax avoidance. The avoidance related primarily to transactions in shares and securities. This led to larger accountancy reviewing and reducing some of the tax planning activities that had been commonplace.

Since 2004 we have seen other changes which have made aggressive tax planning considerably less attractive. This includes the implementation and expansion in DOTAS (Disclosure Of Tax Avoidance Schemes) where promoters, under pain of penalties, need to notify HMRC of tax planning schemes. We have also seen general anti-abuse rule and the GAAR Panel formed. To date, they have only given one ruling in favour of the taxpayer. We have also seen the attitudes of the courts towards tax planning change with 90% of tax avoidance cases being won by HMRC. In terms of legislation, we have seen a plethora of targeted anti-avoidance rules. Perhaps one of the more notable legislative changes has been to deny a tax advantage where a taxpayer is taking advantage of a failing in the legislation.

You would have thought that this would have deterred advisors from pursuing aggressive tax planning, they also have to contend with the Code of Conduct which had been imposed on them with regards to tax planning. However, it does not seem to stop a minority of tax advisors who seem to possess more marketing than technical skill in promoting various plans which are not necessarily to the advantage of the taxpayer.

The regular advisor – as opposed to the fly by night promoter, has a duty of care which may extend over decades; if not generations. When it comes to aggressive tax planning prevention is better than cure.

The client needs to be made aware that not only are they likely to incur substantial professional fees but in circumstances where they lose, they could end up with interest and penalties as well as potentially paying more tax than would have been the case if no planning had been undertaken.

A number of cases have shown how tax planning can go horribly wrong. The Bhaur Case was where a couple transferred 35 properties into a Trust which was conveniently offshore. The details are covered in more depth in Tolley's updates. When the plan was shown not to be effective for IHT purposes, the couple tried to get the arrangement rescinded. Both the High Court and the Court of Appeal refused the application. This not only meant that the couple had spent substantial fees on an ineffective plan, but it also meant that the properties were not held directly by the family which could lead to substantial issues in the future.

In the Darvel Case a company tried to pay monies as dividends, which the courts agreed was remuneration subject to income tax and national insurance. The company tried then to get a tax deduction for the "dividends" paid. This was refused meaning that the company had not only suffered a corporation tax disallowance but was also on the hook for the national insurance and under deducted PAYE as well.

Spotlights

Sometimes HMRC becomes aware of a plan and tries to warn taxpayers from implementing it because they do not believe that this works. In this case HMRC often issues spotlights, which highlight schemes which are being marketed and which HMRC believes are ineffective.

Any advisor who has a bright idea should as a matter of course consult the spotlight to see if HMRC has had the same idea and has taken a view as to whether the plan works or not (usually not!).

Recent examples of this included a plan for school fees which routed money or shares via the grandparents in order to avoid the settlement charges on the parents. Unfortunately, if the funds have originated from the parents and there is a transfer of value via shares at discounted values, then the scheme is ineffective. By all means, grandparents can settle funds and assets on their grandchildren without creating a settlement charge. However, the funds cannot originate from the parents of those grandchildren. Another perhaps more alarming plan is one which involves a hybrid partnership to which landlords transfer their properties. The partnership is supposed to be constructed as a mixed partnership where individuals are paid up to the higher rate threshold and beyond that the company recognises the income at CT rates. This plan is designed, according to the promoters, to:

1. Achieve the full interest deduction on the loans as they are supposedly with the company.

2. Achieve a step up in the CGT base cost.

3. Avoid SDLT on the transfer of properties and

4. Achieve Business Property Relief (BPR) from IHT.

HMRC's analysis is, in the author's view, pretty spot on to show that none of these tax advantages actually stack up. Indeed, the very expansiveness of the claims covering so many taxes should lead most tax advisors to go back to the old adage that if it sounds too good to be true it almost certainly is.

The unfortunate fact is that these plans are still being punted by here today gone tomorrow advisors who conveniently disappear when HMRC start asking questions.

Clearing the Mess

So, what should respectable advisors do where a client has been lured into one of these plans.

The first element is to obtain all the details of the plan and arrangements, however painful that is for the client.

Secondly, one needs to prepare a case to try and settle with HMRC.

The third point is to manage client expectations that this is unlikely to be an easy process or without some painful consequences. Stories that end happily ever after tend to be fairy tales, although it is quite possible that your client has already fallen for one.

Dealing with HMRC

It is important to take the initiative and be on the front foot for HMRC. Unprompted disclosures will always be more favourably treated than disclosures prompted by HMRC.

Building up, if possible, a relationship of trust and within limits openness with HMRC will often be the best strategy where the client has clearly messed up in a right royal fashion.

Realism

For those devotees of the Lincoln Lawyer who seems to get his clients out of impossible scrapes, I would remind them that that is fiction and that generally life does not follow that path particularly in tax planning matters that go wrong. Preparation of the case is likely to result in a better position for clients, but no one should be under any illusion that bad tax planning normally ends in tears.

Contributed by Jeremy Mindell

Spotlight 64 - Employment agencies using umbrella companies

HMRC is aware of some umbrella companies who use employment and recruitment agencies to promote their tax avoidance schemes. Most of these schemes do not work and are successfully challenged by HMRC in the courts and tribunals.

Employment and recruitment agencies should consider taking independent professional advice if they are unsure if an umbrella company is compliant.

The Spotlight highlights some signs that an umbrella company may be operating a tax avoidance scheme which includes:

- offering financial incentives significantly higher than industry standards;
- providing workers and agency with different versions of the payslip;
- making payments to workers that are higher than the amount on their payslips;
- making payments to third parties, who then make payments to the workers.

https://www.gov.uk/guidance/warning-for-employment-agencies-using-umbrella-companies-spotlight-64

Business taxes

Training costs for sole traders (Lecture B1437 – 14.33 minutes)

Background

The tax legislation on deductions from trading income relating to sole traders includes the general rule (in ITTOIA 2005, s.34) that in calculating the profits of a trade, no deduction is allowed for expenses not incurred 'wholly and exclusively' for the purposes of the trade, or for losses not connected with or arising out of the trade. Furthermore, ITTOIA 2005, s.33 states that in calculating the profits of a trade, no deduction is allowed for items of a capital nature.

The lack of statutory guidance on the 'wholly and exclusively' rule and the capital expenditure restriction has resulted in a number of tax cases over the years. A key principle established from case law is that expenditure is capital in nature if it has an 'enduring benefit' for the trade (*British Insulated and Helsby Cables Ltd v Atherton* [1926] 188, 192, HL).

Where profits are calculated on the cash basis, the capital expenditure provision does not apply (ITTOIA 2005, s.32A(1)). However, the cash basis rules include their own restriction, which states that no deduction is allowed for capital expenditure incurred on, or in connection with, training (ITTOIA 2005, s.3(3)).

HMRC's view on the tax treatment of training courses for business proprietors changed on 13 March 2024.

Tax Bulletin 1

Prior to this change, HMRC (then the Inland Revenue) set out its view on the allowability of training costs in Tax Bulletin 1 in 1991, and in its Business Income Manual. Tax Bulletin 1 is reproduced below:

> **'Expenditure on training courses for the proprietor of a business**
>
> There is some uncertainty whether the cost of proprietors of a business attending a training course, directly related to the business activity, is deductible in arriving at the profits chargeable to tax under Schedule D Cases I or II.
>
> Where attendance at a course is intended to give business proprietors new expertise, knowledge or skills which they lack, it brings into existence an intangible asset which is of enduring benefit to the business. We take the view that the expenditure is therefore of a capital nature, and deduction is prohibited by ICTA 1988, s 74(f).
>
> On the other hand, where attendance is merely to update expertise which proprietors already possess, the expenditure is normally regarded as revenue expenditure and will be deductible if it satisfies the "wholly and exclusively ... for the purposes of the trade".
>
> [ICTA 1988, s 74(a), (f)]'

Business income manual

As mentioned, HMRC’s guidance on the topic has recently been updated. Prior to this change, HMRC’s Business Income Manual expanded on Tax Bulletin 1 by instructing its officers (at BIM42526) that they should not take an unduly narrow view of whether the content of any course only updates an individual’s existing skills.

However, it went onto say that if a completely new specialisation or qualification was acquired as a result of the expenditure, it was unlikely that the expenditure would be wholly and exclusively for the purposes of the existing trade.

HMRC also pointed out that expenditure on new skills may also be capital if what was acquired could be viewed as an identifiable asset of sufficient substance and endurance. HMRC referred to a tax case relating to this capital test, *Dass v Special Commissioner and others* [2006] EWHC 2491 (Ch).

Dass v Special Commissioner

In *Dass*, the taxpayer traded as an English tutor and as an adviser on bringing appeals before various tribunals. In or around 1997, he started a two-year part-time college course, which would have resulted in a law diploma on passing the exams. Unfortunately, although Mr Dass twice enrolled for the examinations, he was unwell on both occasions and so was unable to sit them. However, he still incurred the cost of the examination fees of £200 in both 1998 and 1999.

Mr Dass claimed that the college course improved his communication and analytical skills and widened his knowledge. He said that the course would ultimately broaden his work options. However, HMRC disallowed tax relief for an exam fee. Mr Dass appealed. The Special Commissioner dismissed the taxpayer’s appeal, concluding that the course wasn’t a “refresher” course to brush up or “hone” the taxpayer’s existing expertise, but was aimed at equipping Mr Dass with a new qualification enabling him to enter into a new area of practice. In dismissing the taxpayer’s subsequent appeal, the High Court stated that the line between the two may often be difficult to draw, but that in this case the Special Commissioner was fully entitled to draw the line where he did and was clearly correct.

HMRC’s Business Income Manual guidance (at BIM35660) referred fairly extensively to the *Dass* case, as well as its 1991 Tax Bulletin article. It stated that HMRC’s officers should disallow expenditure that provides new expertise or knowledge, particularly where it brought into existence a recognised qualification like a Master of Business administration.

HMRC’s revised view

HMRC updated its Business Income Manual guidance on 13 March 2024. HMRC’s revised guidance in BIM42526 reaffirms that expenditure on training is normally revenue expenditure if it updates or provides expertise or knowledge in the individual’s existing business area.

In addition, HMRC’s revised guidance states that costs incurred on training to acquire new skills or knowledge to keep pace with advancements in technology and changes in industry practices, which are related to the owner’s existing business area, will usually be allowable.

Furthermore, expenditure on training courses which are ancillary to the main trade, such as introductory bookkeeping or digital skills courses may also be accepted as constituting revenue expenditure, depending on the specific circumstances of each case.

On the other hand, HMRC's guidance at BIM35660 states that expenditure incurred on training that is unrelated to the business owner's existing business area (such as expenditure that allows them to start a new business or expand into a new, unrelated area of business) is unlikely to be an allowable deduction. Once again, HMRC cites the *Dass* case in support of its approach.

HMRC's expanded guidance features 11 examples, seven of which illustrate the types of scenarios where the cost of training is likely to be an allowable business expense for a self-employed individual, and four scenarios where the cost is likely to be disallowed. Whilst these examples are intended to be helpful and instructive, HMRC caveats them by adding that whether an expense is allowable will depend on the individual facts and circumstances of each case, including the purpose of the owner in incurring the costs.

Conclusion

HMRC's guidance and their examples seemingly attempt to draw a line between on the one hand, not only updating current skills or providing new skills or knowledge in an individual's existing trade but also the costs of keeping up with technical changes and training ancillary to their trade; and on the other hand, the costs of training that would allow the individual to begin a separate business in a new and unrelated area. The latter would, in HMRC's view, seemingly be capital expenditure.

Of course, HMRC's guidance does not carry the force of law, and as the guidance indicates, every case is different and needs to be considered on its own facts.

Contributed by Mark McLaughlin

Research and development enhanced credit (Lecture B1436 – 13.02 minutes)

Summary – An R&D expenditure claim was rejected as the company was unable to show any advance in science or technology.

Flame Tree Publishing Limited was a publishing company that published books in bound paper form including encyclopaedias and music guides, all archived on CDs and DVDs.

With customers preferring access to material in digital form, the company undertook research to make its books available as searchable resources in digital form.

On 30 June 2020, it filed an amended Corporation Tax return for the period ended 30 June 2018, claiming an enhanced deduction of £266,644 in respect of expenditure on research and development. This reduced the corporation tax payable by £50,662.

HMRC enquired into the amended return, and on 1 July 2022, issued a closure notice refusing the claim and requiring the company to repay the £50,662.

Flame Tree Publishing Limited appealed to the First Tier Tribunal, initially arguing that it had carried out seven separate "projects", each of which had met the requirements published by the Department for Business, Innovation and Skills to be able to claim the relief. However, at the hearing the company argued its case on the basis that there had been only a single composite project.

Decision

The company’s claim failed as the First Tier Tribunal found that its work did not result in an 'advance in science and technology' as defined in the guidelines, but rather that the technology had been invented by others and was merely new to the company. No one involved in the project possessed skills in software, programming or computing and no patents had been registered as a result of the project.

The appeal was dismissed.

Flame Tree Publishing Limited v HMRC (TC09149)

Entitlement to share in partnership assets (Lecture B1436 – 13.02 minutes)

Summary – Following her resignation, the taxpayer remained entitled to her quarter share of the partnership assets, despite no financial terms having been agreed.

The Procter family owned about 600 acres near Skelton consisting of farmland, a golf course, farmhouses and ancillary buildings. By the time of this case, and in an attempt to avoid the payment of tax, the land was “owned and managed through a complex web of trust, partnership and company structures”.

Suzanne Procter and her brothers, Philip and James, were partners with their father. The mother had previously been a partner but she had retired from the partnership in April 1997, with her profit share being distributed to the three children, so that at the time of this case each partner held a quarter share.

In 2010, Suzanne Procter wrote resigning from the partnership. There was no provision in the partnership agreement for one partner unilaterally to resign, but the other three partners accepted she had ceased to be a partner. Nothing was discussed about any financial terms at the time of her resignation.

Following her father’s death, in 2014, Suzanne Procter brought a claim in the High Court against her brothers and the other entities which owned or occupied the land. She sought her share of the value of the partnership's assets as at the date she had resigned in 2010. Her claim subsequently was limited to a quarter share in the then value of the 1994 tenancy over the land.

The brothers appealed to the Court of Appeal

Decision

The Court of Appeal found that when a partner wishes to resign from a partnership, they are saying that they wish to cease to be a partner and no longer carry on business in common with the other partners.

In this case the other partners accepted this resignation but what was the effect on the outgoing partner’s share in the partnership property?

The Court of Appeal found that since the partnership is a collective name for the partners trading together, the partners together own the partnership assets. That means that each partner has a proprietary interest in the partnership property.

What happens to this interest when a partner retires depends on what the parties have agreed.

In this case, there was no express provision in the partnership agreement for the outgoing partner to receive a payment in respect of their partnership share, or indeed that it shall vest in the continuing partners without payment.

There was no '*ad hoc* agreement' made at the time of resignation. As the judge stated Suzanne Procter 'never agreed that she would hand over her share in the partnership assets to the other partners without payment, and never agreed the terms on which she might do so.'

- By resigning, she was saying was that she wished to cease being in partnership with her father and brothers, not that she was agreeing to give up her proprietary interest in the assets;

- By accepting her retirement all that the other partners were agreeing to was that she should cease to be a partner.

The Court of Appeal stated:

> "The other partners have in effect taken over the assets, but she has not assigned or lost her interest in the net assets as they stood in 2010."

Had all of the partners retired and the partnership been wound up, she would have received her share of the assets and liabilities at that time. Consequently, the Court of Appeal concluded that she was entitled to her share of the assets and liabilities at the date of resignation or retirement based on their value at that time, together with 5% interest from 8 July 2010.

The appeal was dismissed.

Suzanne Procter v Philip and James Procter & Others [2024] EWCA Civ 324

Construction industry scheme changes (Lecture B1438 – 13.31 minutes)

The *Income Tax (Construction Industry Scheme) (Amendment) Regulations 2024* supplement the changes brought in to the CIS by FA 2024. That added compliance with VAT obligations to the statutory compliance test for being granted, and for keeping, gross payment status. The new regulation sets out the compliance obligations in relation to VAT that must be met to receive and retain GPS and ensures minor VAT compliance failures will not result in GPS refusal or removal. It does this by amending regulation 32 within the CIS Regulations that sets out the prescribed compliance obligations and the failures that HMRC will overlook. The exceptions proposed for VAT are in line with the allowances made for slightly late filing of CIS returns and slightly late payment of other taxes due.

The regulations took effect on 6 April 2024.

SI 2024/308

Transfer pricing and unallowable purpose

Summary - Interest payments on intra-group loans put in place as part of the funding structure for a commercial acquisition were not restricted by transfer pricing rules but were disallowed under the loan relationships' unallowable purpose rule.

LLC5 was a Delaware-incorporated, UK resident company formed as part of the structure for the acquisition by the BlackRock group of the Barclays Global Investor business in 2009.

LLC5 issued several tranches of loan notes to its immediate parent company, LLC4, and claimed non-trading loan relationship debits for the interest paid on the loans over a period of years. It acquired preference shares in LLC6, which made the acquisition.

HMRC disallowed the debits arising to LLC5 on two grounds:

1. The loans differed from those that would have been made between independent enterprises;

2. Securing a tax advantage was a main purpose of the taxpayer being a party to the loan relationship and the debits were attributable to that purpose.

The First Tier Tribunal allowed LLC5's appeal on both grounds.

- On transfer pricing, it found that, although an independent lender would not have entered into the loans on the same terms as the actual transaction, it would if certain third-party covenants had been given (from the target and LLC6) and found, on the evidence, that these would have been obtained. The provision of these covenants was established as being important as, without them, LLC5 had no control of the dividend flow to it from LLC6 and therefore its ability to service its debt.

- On unallowable purpose, the First Tier Tribunal found that the taxpayer had two main purposes, a commercial purpose and one of securing a tax advantage, but it attributed the entirety of the debits to the commercial purpose with the effect that they were deductible in full.

On appeal, the Upper Tribunal concluded that the First Tier Tribunal had erred in allowing third party covenants to be taken into account when considering whether an independent lender would have made the loans, as to do so materially changed the surrounding circumstances and economically relevant characteristics of the transaction. As such, because no third party would have made the loans without the covenants, the Upper Tribunal concluded there was no comparable arm's length transaction and therefore interest deductions were denied.

The Upper Tribunal also overturned the First Tier Tribunal's decision on unallowable purpose, finding that although the First Tier Tribunal had correctly concluded that there was both a commercial and a tax main purpose for the loans, it had erred in its application of just and reasonable apportionment and all debits were attributable to the tax purpose. The Upper Tribunal's central focus was on why the UK was chosen for LLC5's jurisdiction of tax residence, and why that entity existed at all.

The case moved to the Court of Appeal.

Decision

On transfer pricing, the Court of Appeal:

- considered that the Upper Tribunal had been wrong to conclude that the legislation did not permit the existence of the third-party covenants to be hypothesised.

- found that nothing in the domestic legislation or OECD guidelines required the position of third parties to be ignored if it was otherwise relevant. On the contrary, it found support for the relevance of third parties in both. The covenants in the hypothetical transaction effectively brought the risks in the hypothetical transaction into line with the real-world situation that existed for the parties to the actual transaction, so that comparison was rendered possible.

Accordingly, LLC5's appeal on the transfer pricing issue was allowed.

On unallowable purpose, the Court of Appeal found that both the First Tier Tribunal and Upper Tribunal had made errors when approaching the question of whether obtaining a tax advantage had been one of LLC5's main purposes in being party to the loans.

In particular, it noted that the Upper Tribunal had made references to the purpose of LLC5's existence and inclusion in the transaction without making it clear that the statutory test required a focus on LLC5's purpose or purposes for being party to the loans.

In the circumstances, the Court of Appeal decided to re-make the decisions of both tribunals. In doing so, it concluded on the facts that LLC5 had both a commercial and a tax main purpose for entering into the loans, and that the entirety of the debits should be attributed to the unallowable purpose, pointing out that the determination of a just and reasonable apportionment was an objective exercise.

On the facts, there was no principled basis to identify any particular amount or proportion of the debits as being attributable to the commercial purpose. Here, the purpose for which LLC5 had been created could not be divorced from its purpose in entering the loans and the commercial advantage was more in the nature of a by-product.

Accordingly, the taxpayer's appeal on the unallowable purpose issue was dismissed and the interest deductions disallowed.

BlackRock HoldCo 5, LLC v HMRC [2024] EWCA Civ 330

Adapted from the case summary in Tax Journal (19 April 2024)

CFC rules: exemption for certain financing income

Summary - Advocate General Medina has opined that the CJEU should set aside the General Court's judgment and annul the Commission's decision regarding tax breaks granted by the UK to certain multinational groups between 2013 and 2018.

According to the Commission, the UK's Controlled Foreign Company (CFC) rules were aimed at preventing the UK companies from using a subsidiary, based on a low or no tax jurisdiction, to avoid taxation in the UK. They allowed the UK authorities to reallocate all profits artificially diverted to an offshore subsidiary back to the UK parent company, where it could be taxed accordingly.

However, between 2013 and 2018, the CFC rules included an exemption for certain financing income (i.e. interest payments received from loans) of multinational groups active in the UK. The Commission considered part of this Group Financing Exemption as unlawful tax advantage. It ordered the UK to recover it from its beneficiaries.

The UK and ITV brought an action against the Commission's 2019 decision.

On 8 June 2022, the General Court dismissed the actions in their entirety (the General Court's 2022 judgment). In particular, the General Court held (among other things) that the Commission did not make an error of assessment in considering that the rules applicable to UK CFCs constituted a separate body of tax rules within the general UK corporation tax system. Furthermore, the General Court held that the Commission did not commit any errors of assessment when it concluded that there was an advantage and that it was *a priori* selective, since the exemptions at issue derogated from the UK rules applicable to CFCs, in that they introduced a difference in treatment between taxable companies in a comparable situation, in the light of the objective of those rules.

Decision

AG Medina has now recommended that both the Commission and the General Court erred in law when considering the CFC rules.

In her opinion, the CFC rules can only be fully understood when considering the UK corporate system as a whole.

In the context of determining the reference framework, the Commission and General Court failed to carry out an objective examination of the content, structure and actual effects of the applicable rules under the national law concerned.

Therefore, the error made in the determination of the reference framework necessarily vitiates the whole selectivity analysis.

Adapted from the case summary in Tax Journal (19 April 2024)

United Kingdom of Great Britain and Northern Ireland (Case T-363/19) and ITV plc (Case T-456/19) v European Commission

Pillar 2 taxes - Part 5 (Lecture B1440 – 23.25 minutes)

The effective rate of tax must be calculated for each jurisdiction in the which the group operates. This is generally the tax expense divided by the profit before tax.

Tax expense in Pillar 2 terms is called the ‘covered tax balance’. This session covers the contents of the covered tax balance.

Covered taxes (s.173)

Covered taxes are:

1. taxes on profits of that member (including, where it has direct or indirect ownership interests in another member of the group, taxes on its share of the income or profits of that other member);

2. taxes imposed under an eligible distribution tax system;

3. taxes imposed as a substitute for a tax on profits that generally applies in the territory of the member; and

4. taxes charged by reference to the capital of a company, or by reference to its capital and profits.

None of the following are covered taxes:

- multinational top-up tax, or any tax equivalent to multinational top-up tax
- a qualifying domestic top-up tax
- a qualifying undertaxed profits tax
- A disqualified refundable imputation tax
- where the member carries on a life assurance business, taxes in respect of which amounts were charged to the member's policyholders

Covered tax balance (s.174)

1. Start with the qualifying current tax expense for the period

2. Exclude amounts in s.175 below

3. Included amounts in s.176 below

4. Include any covered taxes allocated to the member and exclude amounts allocate from the member to other members

5. Adjust for any amount of covered taxes that is taken into account more than once to ensure there is no double-counting

6. If there is a net tax credit, it is referred to as a 'negative covered tax balance'

7. If there is a net expense (or nil) it is referred to as a 'positive covered tax balance'

Exclusions from covered tax balance (s.175)

- Amounts relating to income or gains not included in adjusted profits
- Amounts relating to an uncertain tax position (IAS 12)
- Credits or refunds related to qualifying refundable tax credits recorded as a reduction of qualifying current tax expense

- Amounts not expected to be paid before the end of 3 years and 1 day after the end of the accounting period
- Amounts allocated to another member of the MNG
- Amounts excluded under a blended CFC regime

Amounts included in the covered tax balance (s.176)

- Covered taxes reflected in underlying profits but not currently reflected in current tax expense (unlikely)
- The 'total deferred tax adjustment amount' (see next session)
- Covered taxes paid/ refunded in the current period relating to an uncertain tax position excluded in an earlier period (see above)
- Credit/refund relating to a tax credit that is not a qualifying refundable tax credit and has not been reflected in qualifying current tax expense of the current or a prior period
- Covered taxes refunded/credited other than a qualifying refundable tax credit
- 'Special loss' deferred tax assets used in the current period (see below)
- Covered taxes recorded in OCI relating to amounts included in the adjusted profits which are subject to covered taxes
- Covered taxes relating to changes in accounting policy/prior period errors included in this period's adjusted profits
- Amounts allocated to the member from another MNG member

Tax relating to a permanent establishment (s.177)

Any amount of qualifying current tax expense included in the underlying profits accounts of a member that is in respect of profits of a PE must be allocated to the PE.

Where the PE profits are treated as income of the main entity, covered taxes on the profits are allocated to the main entity up to a maximum of the profits allocated x the highest corporate tax rate on ordinary income in the territory where the main entity is located

A deferred tax asset related to a PE loss treated as an expense of the main entity is ignored in both the PE and the main entity when computing the covered tax balance, to avoid double counting.

Tax expense reallocation (s.178)

Where profits are allocated to a member of an MNG and the member from whom it was allocated has qualifying current tax expense, the qualifying current tax expense is allocated to the member to whom the profit was allocated.

The tax allocated cannot exceed the ‘mobile income’ reallocated x (15% minus the effective tax rate of members in the territory where the member is located, ignoring the qualifying current tax expense)

Mobile income means:

- Dividends
- Interest
- Rent
- Royalties
- Annuities or gains from assets producing these forms of income
- in respect of which a member of a MNG is subject to tax under a CFC tax regime or as a result of an ownership interest regarded as tax transparent where the member is located but not where the entity is located

Example

UPCo Ltd is the ultimate parent of a qualifying MNG. One of its subsidiaries, O Inc. is located in a low-tax jurisdiction, Ruritania. UPCo has 4 other members located in Ruritania, including M Inc.

O Inc. has an ownership interest in M Inc. of 40%.

M Inc. has adjusted mobile profits for the year ended 31 December 2024 of £4.8 million and for Pillar 2 purposes, its profits are allocated to its owners, including O Inc.

M Inc. has a qualifying current tax expense of £384,000 on its profits

The effective tax rate of all the members resident in Ruritania for the accounting period is 7.4%.

Calculate the tax expense of M to be allocated to O.

Analysis

O Inc. must add (40% x £4.8m) £1.92 million to its adjusted profits for the year ended 31 December 2024.

The amount of qualifying current tax expense allocated to O Inc. is ordinarily (40% x £384,000) £153,600.

This is restricted to (£1.92m x [15% - 7.4%]), i.e. £145,920.

This will reduce O Inc.'s overall effective rate of tax, compared to if it was permitted to just include its share of M Inc.'s current tax expense of £153,600.

CFC tax regimes (s.179)

If a member is subject to a CFC regime and has an ownership interest in another member that is a CFC entity, any qualifying current tax expense in its accounts relating to its share of the profit of the CFC is allocated to the CFC.

A CFC entity is a CFC of a member of the MNG, a PE of the CFC or an entity whose profits are treated as the profits of the CFC.

This does not apply to a 'blended CFC regime' in accounting periods commencing on or before 31 December 2025 and ending on or before 30 June 2027, i.e. broadly the first 2 years of the income inclusion rule.

The amount of qualifying current tax expense for mobile income is restricted in the same way as set out in s.178 above and the amount not allocated to the other member remains with the CFC but is excluded from the CFC's covered tax balance if it relates to income or gains excluded from the CFC's adjusted profits.

Blended CFC regimes (s.180)

The provision is designed to cover the US GILTI rules (Global Intangible Low-Taxed Income of US CFCs, typically taxed at 10.5% - 13.125%).

A blended CFC regime is (broadly), a CFC regime where income, losses and creditable taxes of all an entity's CFCs are aggregated to calculate the CFC tax liability. It does not take into account income of group members arising in the entity's location and which operates by reference to a rate reflecting a threshold for low taxation.

The amount allocated cannot exceed the 'mobile income' reallocated multiplied by (15% minus the effective tax rate of members in the territory where the CFC is located), ignoring the qualifying current tax expense.

The appropriate proportion is allocated to the CFC if it is a member of the MNG, otherwise it is allocated to the member who has an ownership interest in the CFC.

Intra-group distributions taxed on recipient (s.181)

Where qualifying current tax expense relates to a distribution received from another member of the group in which it has a direct ownership interest, that expense is allocated to the member that made the distribution.

Distributions received includes deemed distributions taken account of for the purposes of taxes on a shareholder of an entity in respect of undistributed earnings or capital of the entity.

Contributed by Malcolm Greenbaum

VAT and other indirect taxes

Mega marshmallows (Lecture B1436 – 13.02 minutes)

Summary - Mega Marshmallows were zero rated as they did not fall with Excepted item 2 of Group 1 Schedule 8 VATA 1994.

Innovative Bites Limited supplied ‘mega marshmallows’ which they argued were zero rated food (Group 1 Schedule 8 VATA 1994).

HMRC disagreed, believing the product to be standard rated confectionery (Excepted Item 2). Assessments were issued to collect nearly £473,000 of VAT for supplies of the product between June 2015 and June 2019.

The First Tier Tribunal found in the company’s favour. Having considered the marketing, packaging, size of the product, location in supermarkets and the seasonal fluctuation in sales, the Tribunal concluded that the marshmallows were sold and purchased as a product specifically for roasting and therefore qualified as a zero-rated cooking product.

HMRC appealed to the Upper Tribunal arguing the First Tier Tribunal had been incorrect by adopting its multi-factorial approach. It claimed that the marshmallows clearly fell within Note 5 which is a deeming provision and reads: "...'confectionery' includes chocolates, sweets and biscuits ..... and any item of sweetened prepared food which is normally eaten with the fingers".

Decision

The Upper Tribunal confirmed that Note 5 is not a deeming provision. Note 5 simply states that confectionery ‘includes’ followed by a list of items/descriptions.

Indeed, the Upper Tribunal noted that Note 5 has been amended over the years to include the term ‘sweetened prepared food normally eaten with the fingers’ to ensure that cereal bars that were not wholly or partly covered in chocolate were captured as well as other products that could be so described.

The Upper Tribunal considered if a multi-factorial assessment was required and concluded that it would depend on the situation. If a product clearly fell within Note 5, then such an assessment would not be needed. For example, a box of chocolates was confectionery.

However, a product could fall within Note 5 but there could be other relevant factors such as was the product used for other purposes. Alternatively, a product might not fall within the Note 5 description but might still fall within Item 2. In both cases, a multi-factorial assessment should be undertaken to determine whether the product is confectionery.

In this case, the Upper Tribunal concluded that the First Tier Tribunal were correct to adopt a multi-factorial assessment in reaching its decision. The Upper Tribunal upheld the First Tier Tribunal’s decision. This product was found in supermarket barbecue aisles and was marketed as an item for roasting.

The First Tier Tribunal’s conclusion was valid and HMRC's appeal was dismissed.

HMRC v Innovative Bites Limited [2024] UKUT 00095 (TCC)

Adequate invoice narrative (Lecture B1436 – 13.02 minutes)

Summary – Supplier invoices for 'building works' supporting input tax claims met the statutory requirements of the Value Added Tax Regulations, meaning the claims were allowed.

Fount Construction Limited sought to recover input VAT relating to three invoices from Landcore Limited.

Each invoice:

- contained the description "Building Works at the above";
- provided a box entitled "Job address" containing the building site address;
- stated that VAT was calculated at the standard rate;
- included a VAT-exclusive subtotal, the VAT amount, and the overall total.

HMRC denied the input tax claim stating that they did not meet the requirements set out in Value Added Tax Regulations, SI 1995/2518, reg 14(1)(g) and (h).

- reg 14(1)(g) requires 'a description sufficient to identify the goods or services supplied';
- reg 14(1)(h) requires 'for each description, the quantity of the goods or the extent of the services, and the rate of VAT and the amount payable, excluding VAT, expressed in any currency'.

HMRC believed that the invoice details were insufficient as it was not possible to tell from the narrative whether the work should be standard rated, or alternatively zero or reduced rated.

The company appealed that decision.

Decision

The First Tier Tribunal stated the purpose of the description required by reg 14 was twofold:

1. To enable both the recipient and supplier of the supply to have a common understanding of which services the invoices relates to, so that they can complete their respective VAT returns accurately.
2. To provide HMRC with a means of understanding the essential nature of the supply and a means of identifying the supply in correspondence with the recipient or the supplier in order to seek more information as needed.

The Tribunal stated that HMRC has 'wide-ranging powers to seek further information in relation to the supply, and to refuse recovery of input tax if such information is not supplied.'

The Tribunal found that the supplier's description was adequate and enabled HMRC to have 'a means of understanding the essential nature of the supply'.

The company's appeal was upheld.

Fount Construction Limited v HMRC (TC09144)

Revenue and Customs Brief 5/2024 (Lecture B1436 – 13.02 minutes)

This brief sets out a technical change to the VAT treatment of business to business (B2B) wholesale supplies in relation to the Tour Operators' Margin scheme (TOMS).

The TOMS is a VAT accounting scheme for businesses which buy in and sell certain travel services, including passenger transport, hotel accommodation and car hire.

- It is mandatory for supplies to final consumers and under the TOMS, tour operators only account for VAT on their profit margin.
- Services supplied to another business for onward sale ('wholesale' supplies) have a choice as to whether they wish to fall within TOMS.

Previously 'wholesale' supplies were subject to normal VAT rules, but by concession these supplies could be included in the TOMS (see R&C Brief 5/2014)

HMRC has now concluded that B2B wholesale supplies are within the scope of the TOMS and by concession tour operators may opt B2B wholesale supplies out of the TOMS.

This is a technical change to the legal interpretation and will not affect tour operators' ability to choose whether to apply the TOMS or not to B2B wholesale supplies.

https://www.gov.uk/government/publications/revenue-and-customs-brief-5-2024-tour-operators-margin-scheme-for-business-to-business-b2b-wholesale-supplies