Tolley®CPD

June 2018

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Personal tax

Company cars - advisory fuel rates from 1 June 2018

HMRC has published revised advisory fuel rates for company cars, applying from 1 June 2018. The rates are to be used only where employers either reimburse employees for business travel in their company cars, or require employees to repay the cost of fuel used for private travel.

These rates apply from 1 June 2018. You can use the previous rates for up to one month from the date the new rates apply.

Engine size	*Petrol - per mile*	*LPG - per mile*
1400cc or less	11 pence	7 pence
1401cc to 2000cc	14 pence	9 pence
Over 2000cc	22 pence	14 pence

Engine size	*Diesel – per mile*
1600cc or less	10 pence
1601cc to 2000cc	11 pence
Over 2000cc	13 pence

Hybrid cars are treated as either petrol or diesel cars for this purpose.

www.gov.uk/government/publications/advisory-fuel-rates

State Aid approval for EMI options

Last month, we reported that the grant of EMI share options after 6 April 2018 may not be eligible for tax relief. It appeared that state aid approval for the relief was about to expire with the UK was waiting to hear whether the European Commission would extend approval.

In a press release published on 15 May 2018, the European Commission has confirmed its approval for state aid to continue for the UK's Enterprise Management Initiative (EMI) scheme.

In granting state aid approval, the Commission's assessment states:

> "Without prejudice to any provisions of the Withdrawal Agreement, which is under negotiation, this Commission decision only applies until the UK ceases to be a Member State."

http://europa.eu/rapid/press-release_MEX-18-3803_en.htm

Injury to feelings

Summary - Damages awarded for injury to feelings, resulting from the discrimination of an employee, fell within the scope of s406 ITEPA 2003.

In March 2010, Mr Moorthy was made redundant by Jacobs Engineering (UK) Limited and received statutory redundancy pay. Subsequently, Mr Moorthy entered into a compromise agreement in relation to a claim for unfair dismissal and unlawful age discrimination. Under the agreement, Mr Moorthy accepted payment of an ex gratia sum of £200,000 by way of compensation for loss of office and employment, in full and final settlement of his claim.

The issue was whether the payment (or part of it) was subject to income tax under ITEPA 2003 s 401(1)(a) as a payment received 'in consideration or in consequence of, or otherwise in connection with' the termination of his employment; and if so, whether it was taken out of the scope of s 401 by ITEPA 2003 s 406 as a payment 'on account of injury … to an employee'.

Decision

The Court of Appeal found that there was no doubt that the payment had been made in connection with the termination of his employment; the compromise agreement stated that it represented 'compensation for loss of office and employment'.

The question was therefore whether awards of this nature fall within ITEPA 2003 s 406. The court noted that there is no definition of 'injury' in s 406 and that there is nothing to indicate that it should be given its ordinary meaning; in particular, the section does not use the term 'personal injury'. The court construed s 406 as applying to injury to feelings.

The Court of Appeal noted that going forward 'Any attempts to obtain exemption for much larger sums under the guise of a settlement of a discrimination claim would no doubt be rigorously scrutinised by the First Tier Tribunal.'

Krishna Moorthy v HMRC [2018] EWCA Civ 847 (20 April)

Adapted from the case summary in Tax Journal (27 April 2018)

Transfer of tax allowance after death (Lecture P1076 – 9.59 minutes)

In FA 2014, legislation was passed which allows individuals who are married (or in a civil partnership) to transfer 10% of the standard personal allowance (£11,850 for 2018/19) to their other half. The relevant details can be found in Ss55A – 55E ITA 2007.

A wife, for example, who has little or no income can transfer £1,185 in 2018/19 to her husband, subject to the requirement that he must not be liable to income tax at the higher or additional rate (or the dividend equivalent). In other words, the maximum tax benefit for 2018/19 of what is known as the 'marriage allowance' is 20% x £1,185 = £237.

Hitherto, the legislation has been drafted in such a way that the individual giving up part of their personal allowance and the other party who is entitled to the tax reduction must be married to (or in a civil partnership with) one another at the time when the election is made. Therefore, if the spouse who would otherwise have been able to make the election under S55C ITA 2007 to effect the marriage allowance transfer is no longer alive, this facility has not been available and the surviving spouse cannot benefit from the tax reduction under S55B ITA 2007. It is known that this situation has caused particular resentment among bereaved spouses (and civil partners) who were unaware of the election until after the other party's death when someone – probably a professional person who was assisting with the administration of the estate and providing advice – drew their attention to it.

When the Low Income Tax Reform Group first highlighted this anomaly, the Government were immediately sympathetic. Accordingly, Cl 6 F(No2)B 2017 allows an election to be made under S55C ITA 2007 by the personal representatives of a deceased individual and for that election to have effect for the tax year of death and for any earlier year, up to the statutory limit of four years previously.

Elections can be made by personal representatives on this basis on or after 29 November 2017.

Thus, if a wife were to die in February 2018 without having made the requisite election, her personal representatives could elect under S55C ITA 2007 both for the year of death (2017/18) and for any of the previous years during which the transferable marriage allowance rules were in force (2016/17 and 2015/16) and the surviving husband could benefit from a tax reduction for those years.

It should be noted that Cl 6 F(No2)B 2017 will enable those who have previously tried to make an election on behalf of a deceased individual, where that claim has been rejected, to make a fresh election.

Contributed by Robert Jamieson

PAYE for short-term business visitors from overseas branches

HMRC is consulting until 6 August 2018 on possible changes to the current 'EP appendix 4' PAYE arrangements, under which UK employers need not operate PAYE for employees of their overseas subsidiaries on short stays in the UK.

What is a short-term business visitor?

Short-term business visitors are individuals who are not resident in the UK for tax purposes, but who make business trips to the UK.

When a short-term business visitor comes to the UK to work for a UK company, the company must operate PAYE on the individual's earnings in the normal way. The UK company is treated in the UK as the short-term business visitor's employer, even when the short-term business visitors continues to be paid by an overseas entity.

The UK company is responsible for recording and reporting the short-term business visitor’s earnings and making deductions of PAYE.

Short-term business visitors will normally be required to pay tax on their worldwide income in their country of tax residence (the “home country”). An individual’s worldwide income will include the earnings that have been taxed in the UK whilst working here.

Individuals can usually make a claim to DTR if they are taxed on the same income in more than one country. DTR is available where the UK holds a DTA with the individual’s home country.

Short-term business visitor arrangements

HMRC permit UK companies with short-term business visitor’s from overseas subsidiaries to enter into short-term business visitor arrangements (STBVAs). These arrangements, also known as “EP appendix 4”, relax the requirement on the UK company to operate PAYE on the short-term business visitors earnings. This eases the administrative costs and burdens associated with operating PAYE.

These arrangements also relieve the individual of the need to pay UK tax on their earnings or file a Self-Assessment (SA) tax return. Short-term business visitors under these arrangements are not taxed twice and will not need to make a claim to DTR.

At the Summer Budget 2015, the government introduced a PAYE special arrangement to simplify PAYE procedures for UK companies with short-term business visitors who were ineligible for STBVAs.

Under this arrangement, the UK company can operate an annual PAYE scheme for qualifying short term business visitors and does not have to report to HMRC in real time. These arrangements can only be used for short-term business visitors with 30 or less UK workdays in the tax year.

HMRC does not require a short-term business visitor under a PAYE special arrangement to submit a SA return, unless they have a UK tax liability on other income.

Branch employees visiting the UK

STBVAs do not currently apply to visits to the UK for employees from overseas branches of UK companies and it is this area that HMRC are consulting on.

Two broad options are proposed:

1. Extending the UK workday rule from 30 to 60 days; or

2. Introducing a new tax exemption for short-term visitors from overseas branches.

www.gov.uk/government/consultations/tax-and-administrative-treatment-of-short-term-business-visitors-from-overseas-branches

Income tax in Wales

From April 2019, the UK government will reduce the basic, higher and additional rates of income tax by 10 pence for taxpayers in Wales. The Welsh Government will announce the three Welsh rates of income tax in its Budget later this year, which it will add to the reduced UK rates to arrive at the overall rate payable by Welsh taxpayers.

gov.wales/funding/fiscal-reform/welsh-taxes/income-tax/?lang=en

Capital Taxes

Reliance on tax adviser

Raymond Hart lived in Australia. He sold his UK flat but no capital gains tax was due as it was covered by Principal Private Residence relief. He was unaware of the need to file a NRCGT return within 30 days of the sale, submitting it more than a year later, with HMRC imposing penalties.

He appealed, saying that he had always relied on his UK tax adviser to deal with his affairs and that neither this advisor or the solicitor dealing with his sale had mentioned the requirement to file a return within 30 days time limit.

Decision

There have been a few similar cases recently through the Tribunal and the First-tier Tribunal noted 'a divergence of view' on such cases but reminded us that these were not binding on him.

The Tribunal said the conclusion in McGreevy (TC06109) and Saunders (TC06273) that the maxim 'ignorance of the law is no excuse' was confined to criminal rather than civil law was incorrect. The judge in this case preferred Lord Denning's statement in Cenlon Finance Co Ltd v Ellwood 40 TC 276 that 'no one is to be excused from doing his duty by pleading that he did not know the law' that he believed applied in this case. The requirement had been publicised and it was not realistic to expect HMRC to contact all taxpayers who might be affected to tell them about it. However, it was reasonable for Raymond Hart to expect his tax adviser to inform him about the need to file a return. Having told them that he planned to sell the flat, it was difficult to see what more he could have done (FA 2009, Sch 55, para 23)..

The appeal was allowed.

Raymond Hart v HMRC (TC06446)

No cash to pay IHT due

Summary – Personal representatives were responsible for paying the IHT due and the appeal was struck out.

The personal representative of Helena Norma filed an inheritance tax return for the estate of Glyne Harris. HMRC determined tax due of about £341,000.

The personal representative appealed on the grounds that he did not have the funds to pay the IHT tax because all the estate's funds had been released to the deceased's brother, who was also a beneficiary. This had been on the understanding that the brother would pay the inheritance tax. However, he moved abroad and could not be traced.

HMRC applied to have the appeal struck out because it had no reasonable prospect of success.

Decision

The First Tier Tribunal noted that the personal representative had not challenged the amount of tax due and concluded that he was responsible for the inheritance tax due. It was no defence to say the assets had been transferred to a beneficiary on the basis that person would pay the tax.

The appeal was therefore struck out.

Glyne T Harris as personal representative of Helena Norma v HMRC (TC06448)

This was not seasonal goodwill! (Lecture P1077 – 13.19 minutes)

Over the course of the recent Christmas holiday season, the newspapers became more than a little exercised about HMRC's apparent pursuit of wealthy Brexit supporters who had made large donations to the 'Vote Leave' campaign. So now might be an appropriate time to remind ourselves of exactly how the IHT rules work.

IHT is a tax on deceased persons' estates and, in some cases, it can also be a tax on lifetime gifts. It is this latter aspect that is relevant here.

The basic rule is that, if a person's estate is diminished by anything that he does (or deliberately fails to do), he is likely to have made a transfer of value. In this situation, it is then necessary to consider whether the transfer of value can be classified as a 'chargeable transfer', given that IHT is only levied on transfers which fall into this latter category.

Any action taken which is not intended to confer a gratuitous benefit on someone (like purchasing an asset from a friend at what is considered to be a fair market price) is not usually a transfer of value and so falls at the first hurdle. And gifts made to individuals are not treated as chargeable transfers, provided that the donor survives for seven years from the date of the gift.

It is gifts made to 'non-natural persons' such as trusts, companies, organisations and associations that typically can give rise to IHT problems. If, in any seven-year period, such gifts exceed £325,000, tax is payable at 20% on the excess. And it can sometimes be more than this – see below. Gifts (whether or not the £325,000 limit has been reached), where they have been made within seven years of the donor's death, also have a knock-on effect on the IHT payable on the death estate. As a result, the IHT liability on the deceased's estate will usually be greater.

Of course, some categories of gift to 'non-natural persons' are exempt. These include, inter alia, gifts to charities and to political parties. However, gifts to political parties only qualify provided that they managed to have at least two MPs elected at the most recent General Election (or one MP and the party received 150,000 votes or more in total) – thus the Green Party are included, but UKIP are not. Campaigning organisations and pressure groups that are neither charities nor qualifying political parties do not count. The 'Vote Leave' campaign falls under this heading and that is where the problem has arisen.

None of this matters as long as the chargeable transfers over the last seven years do not exceed £325,000 and the donor survives seven years. But it appears that a number of individuals who made substantial donations, particularly to 'Vote Leave' during the EU referendum campaign, may have overlooked the need to make appropriate returns (Forms IHT100 and IHT100a) and have consequently found HMRC coming after them. It should be noted that, although the headline rate of IHT on lifetime gifts is 20%, the tax – where paid by the donor – is calculated on a grossed up basis and so becomes 25% of the sum donated.

Some donors have been crying foul, contrasting HMRC's assiduousness in collecting IHT in respect of 'Vote Leave' donations with their failure to pursue a similar path with the 'Vote Remain' supporters and thereby implying a political agenda.

In fact, wealthy benefactors of the 'Vote Remain' campaign would be in exactly the same tax position as their 'Vote Leave' opponents. The truth of the matter is that much of the money raised by 'Vote Remain' came from public companies rather than well-heeled individuals that involves completely different tax considerations. This is the real reason for HMRC taking the actions that they did.

There was an interesting postscript to this debate when the Daily Telegraph reported in January 2018 that the Chancellor was said to be 'sympathetic to looking carefully' at the dilemma so that, in future, large-scale donations to referendum campaigns by private individuals would not be subject to IHT. However, any change in the law as a result of this rethink will not affect the present tax demands that run into millions of pounds.

Contributed by Robert Jamieson

Legal v beneficial interest in a home

Summary – Mr Wall had failed to prove a sale agreement entitling him to claim the entire property but had established his fall back position giving him a 50% beneficial interest.

Christine Munday and Bryan Wall married in 1969. In June 1972, they bought a leasehold property as joint tenants in Bromley, Kent with the aid of a mortgage. In 1973, Christine Munday left the home and in 1974, they divorced. No formal steps were taken to deal with the ownership of the house, however, Bryan Wall took on full responsibility for maintaining and improving it. In 1978, he purchased the freehold to the property and some time later, in 1990, he redeemed the mortgage. Bryan wall developed motor neurone disease and died in March 2015 intestate.

As joint tenants, on the death of Bryan Wall, Christine Munday became the sole legal owner of the property by the right of survivorship. The personal representative for Bryan Wall's estate claimed that an informal settlement had been reached between both parties at the time of their divorce that included a sale by Christine Munday to the deceased of all her interest in the property and, accordingly, Bryan Wall was the 100% beneficial owner of the property.

At the initial hearing, the judge held that by reason of the mutual dealings between the parties the beneficial joint tenancy had been severed by the end of 1975.There had been no agreement between the parties for Christine Munday to sell her interest in the house to the deceased. The judge held that it was open to the estate to argue that there had been a subsequent common intention of the parties as evidenced by their conduct to vary their respective shares in the property.

With no such evidence, the judge held that there had been no such variation and the parties were each entitled to half of the beneficial interest in the property.

Decision

The High Court held that the judge had been well aware of the redemption of the mortgage by the deceased in 1990, yet had still concluded that no variation of beneficial interests was to be inferred. That had been a matter of fact. The judge had not excluded either the repayment of the mortgage or consideration of the period thereafter as part of the whole course of conduct between the parties in ascertaining whether or not there had been an agreed variation of the beneficial shares in the property.

On the contrary, he had had well in mind what had happened in the whole of that period, and had to have taken it into account in reaching his conclusion. The appeal on the variation of shares was dismissed. The property was beneficially owned 50:50.

On the evidence, the personal representative had failed to prove their primary case and had been left with his fall back position, with entitlement to a 50% beneficial interest.

Wall (as personal representative of the estate of Wall, deceased) v Munday [2018] EWHC 879 (Ch)

Land and building transaction tax reliefs for property investment funds

The Scottish government is consulting on introducing reliefs from land and buildings transaction tax for property authorised investment funds (PAIFs), similar to those introduced for SDLT in FA 2016. The consultation will run until 2 August 2018.

Since LBTT became operational in 2015, the investment management sector, law and accountancy firms have raised concerns about the impact on investment vehicles holding property in Scotland of not having reliefs comparable with SDLT.

Relief from SDLT is available where properties are acquired from other types of investment vehicles into a PAIF or CoACS within a period of up to 18 months.

Trading in units held in CoACS is treated as 'non-transparent' for UK SDLT purposes, meaning that acquisitions into the scheme are taxed, but trading in the units of the scheme is not. The SDLT rules treat the participants as shareholders in a company, rather than as direct owners of the underlying assets of the scheme. In Scotland, this treatment would require changes to the LBTT (Scotland) Act 2013 through secondary legislation.

The consultation considers whether the Scottish government should introduce the 'genuine diversity of ownership' rules used in SDLT to prevent artificial tax avoidance; and 'portfolio tests', which limit the application of the relief to transactions involving a minimum number and value of properties, aimed at preventing the risk of enveloping. It asks whether these tests should use the same thresholds as the SDLT portfolio tests, based on total property assets across the UK, or some other measure for Scotland.

Other questions concern whether LBTT should use the same claw-back provisions as SDLT where funds cease to qualify for relief; and whether seeding relief in Scotland should apply only to non-residential property.

The consultation also seeks to gather information on the size of managed property fund assets in Scotland and their exposure to Scottish property.

Tax Journal (11 May 2018)

Bed and breakfast business and higher rate SDLT

Goode Cuisine Company Ltd bought a property for its bed and breakfast business. The company argued that higher rate stamp duty land tax was not payable as the building would provide a source of income in the course of a qualifying trade'.

HMRC refused the relief, saying this was not within the definition of qualifying trade in Sch 4A para 5B(3) FA 2003 as the company did not satisfy the condition requiring them to offer the public the opportunity to make use of, stay in or otherwise enjoy the dwelling as customers of the trade'. HMRC said this would not be satisfied because the property would no longer be a dwelling after it had been converted for the bed and breakfast business.

The taxpayer appealed.

Decision

The First Tier Tribunal said that as the property was to be used for the purposes of a 'hotel, inn or similar establishment', s116(3) FA 2003 applied. After conversion, the property would no longer be a dwelling. They said that the word dwelling used throughout the legislation was not a synonym for 'property'.

The appeal was dismissed.

Goode Cuisine Company Ltd v HMRC (TC6416)

Care homes and higher rate SDLT

Summary – Unfortunately no relief from the SDLT higher rate applied to the acquisition by a company of a residential property to be used as a care home.

Sequence Care Group Holdings Limited provides specialist residential and care services for adults with learning disabilities, mental health needs, etc.

In February 2015, having obtained planning consent for alterations and change of use to a care home, Sequence Care Group Holdings Limited bought of a five bedroom house for £560,000, filing an electronic SDLT return calculating the amount due as £18,000.

Sequence Care Group Holdings Limited's argued that the higher rate was not aimed at genuine commercial exploitation of dwellings, hence there were reliefs for property letting businesses and trades offering the public the opportunity to make use of dwellings. They believed that its 'care homes' were therefore 'just as worthy of exemption'.

It was accepted by both parties that the higher rate of SDLT was due unless relief provided in para 5B applied whereby the dwelling was made available to the public. HMRC considered that the 15% SDLT rate applied.

Decision

The First Tier Tribunal made specific reference to the following comment by David Gauke (Exchequer secretary to the Treasury):

> 'The hon. Lady also asked why there is no relief from the 15% rate for businesses that wish to purchase a residential property and convert it to non-residential for use in their trade, such as a care home. It is a general feature of the SDLT rules that there is a different rate for property that is residential or non-residential at the time of purchase. The rules are even-handed at present … Additionally, such a relief could open up avoidance opportunities with companies claiming non-residential intentions to take advantage of the lower rate, but then not following through with the conversion.'

So on both a literal and purposive interpretation of para 5B the company's appeal failed. Higher rate SDLT was payable.

Sequence Care Group Holdings Limited v HMRC (TC06475)

Administration

Multiple personal allowances

Summary – Had the taxpayer been made aware in time of the alternative to settle his PAYE underpayment, he could have avoided being served a notice to file a return for 2011/12.

In 2011/12, Marc Capuano had three separate part-time employments and under each employment he received the full personal allowance against his earnings, As a result of the personal allowance having been allocated against his overall taxable earnings more than once, there was a net shortfall in PAYE deducted of £349.

The PAYE underpayment could have been collected by adjusting the coding notice for the following year, or settled as a one-off payment. For whatever reasons that are not on file, HMRC's review letter stated that the PAYE underpayment could not be 'coded out'. Marc Capuano was served a paper return to file for 2011/12 on 30 June 2014 that was due for filing by 7 October 2014.

However, this was not filed until 31 March 2016 with Marc Capuano arguing that he had a reasonable excuse for being late:

- He moved house in 2011/12 and did not receive any letters or else he would have paid the original £349.20. He settled the tax due as soon as he knew about it;
- He worked for an employer and has never been self-employed and has 'never had to deal with paying [his] own tax', as it is deducted by the employer.
- He tried to get information from HMRC on how to 'fix the situation' that he was 'messed about and not told how to rectify the situation'.

After 'countless phone calls', he was informed to fill in a tax return for 2011/12, and appealed the penalties.

Decision

The First Tier Tribunal accepted that Marc Capuano did not receive the correspondence to notify him of the PAYE underpayment at the correct address. Consequently, he was unaware and unable to deal with the PAYE underpayment in a more expedient manner. Without the knowledge and former experience in filing a Self Assessment return, Marc Capuano understandably turned to HMRC for help. The Public Accounts Committee criticised HMRC of 'failing UK taxpayers' in 2015, over two years after the National Audit Office's report of December 2012. Marc Capuano would seem to be one of the taxpayers who had been failed by HMRC in this respect. Viewed in this light, Marc Capuano's delay in filing the return was excusable.

The Tribunal concluded that he was brought into the Self Assessment regime somewhat unnecessarily. Had he been aware of the alternative to settle the underpayment, and had contacted HMRC in time to rectify the situation, he could have avoided being served a notice to file a return for 2011/12.

The appeal was allowed.

Marc Capuano v HMRC (TC06371)

Follower Notices (Lecture P1079 – 7.58 minutes)

Disclosure of tax avoidance schemes (DOTAS)

DOTAS has been around for a while (since 2004 – time flies). Without going into DOTAS in any detail, the regime is designed to help HMRC keep up to date with the types of tax avoidance schemes that are doing the rounds. DOTAS requires the scheme promoter to make a disclosure of a "notifiable arrangement". This in turn gives HMRC the opportunity to review that arrangement and, where they consider the scheme to be on the wrong side of the invisible "tax planning" boundary, to make amendments to the legislation to counter or block the scheme. It's a clever idea. We think up a way of saving tax, tell HMRC about it and they duly stop it.

Arrangements are notifiable if their main purpose is to obtain a tax advantage and the scheme falls within one of a number of descriptions or "hallmarks". The DOTAS rules are long and complex and are constantly changing with new hallmarks seemingly being added every time we turn our backs, so practitioners are advised to seek specialist assistance if unsure about whether an arrangement is or is not notifiable.

DOTAS had limited success to begin with so the government upped the ante in 2013. Consultations called 'Raising the Stakes on Tax Avoidance' (August 2013) and 'Tackling Marketed Tax Avoidance (January 2014) were set out with the stated aims of "changing the economics of entering into tax avoidance schemes" and "changing the behaviour of people and promoters in relation to tax avoidance".

Following that consultation process, the measures on Follower Notices and Accelerated Payments were introduced in Finance Act 2014. HMRC has made no secret about the objective of these rules which is to ensure that the tax in dispute in relation to the use of an avoidance scheme sits in the Government's bank account until such time as the dispute is resolved. So we pay now and argue later. In many cases this is a long time later as these processes tend not to be swift. There is something slightly sinister and Orwellian about it all but there is no doubt that it's a vote winner.

Follower Notices

Follower Notices are part of the Government's "drive to accelerate litigation".

The plan was that once HMRC had taken a representative case to the Courts, obtained a favourable ruling and recovered the requisite tax from the protagonist, other taxpayers using the scheme (their "followers") would dutifully throw in the towel and offer up the tax which they had hoped to avoid.

However, there was little incentive for other taxpayers using essentially similar arrangements to accept the Court's findings and surrender arms. These taxpayers would invariably argue that the decision in the case of HMRC v Mr. A Tax-Avoider (2012) did not apply to them as their arrangement was slightly different.

This in turn meant further litigation, adding years to the time taken to resolve the dispute and meaning that the money needed to fund Hinkley Point, HS2 and other essential government projects was not forthcoming.

A person who is a “follower” will now be given a Follower Notice. The Follower Notice is the equivalent of HMRC “sending the boys round”. What the boys are trying to persuade the taxpayer to do is to take “corrective action”. Corrective action typically means amending the return or claim which is under enquiry or coming to a final agreement with HMRC to determine the appeal, but in essence is an acceptance that the tax arrangements previously entered into do not work. Corrective action is therefore surrender.

A Follower Notice can only be issued if 5 conditions have been met:

1. There is an open enquiry into the taxpayer’s return or claim or the taxpayer has made an appeal that has not yet been determined;

2. The taxpayer made the return, claim or appeal on the basis that a tax advantage (the “asserted advantage”) arises from the particular tax avoidance arrangement (the “chosen arrangement”);

3. HMRC is of the opinion that there is a final judicial ruling that is relevant to the chosen arrangement;

4. HMRC has not previously issued a Follower Notice to the taxpayer for the same arrangement; and

5. The notice is issued within the statutory time limit which is 12 months from the date of the judicial ruling becoming final or 12 months from the day that HMRC received the taxpayer’s return, claim or appeal (whichever is later).

A Follower Notice can only therefore be issued if there is a “final judicial ruling” which, in HMRC’s view, is “relevant to the arrangements entered into” by the recipient of the notice.

A ruling can be final at any stage in the legal appeal process, including the First-tier Tribunal, provided that it is not appealed further. The ruling does not have to set a strict legal precedent in sense that a judgment of a senior court would.

A ruling is “relevant” if it would deny the tax advantage sought by the taxpayer when applied to the taxpayer’s tax arrangements. The definition of “relevant” in this context makes it highly likely that Follower Notices will be issued to users of packaged or marketed avoidance schemes as opposed to cases against one person with a small number of followers.

Follower Notices should not be issued as an automatic response to a tax avoidance scheme being defeated. Before a Follower Notice is given in relation to a relevant judicial ruling, a HMRC governance panel must consider whether it is appropriate to apply the reasoning or principles established by the ruling to that taxpayer’s arrangements. However in most packaged schemes, this will be self-evident. The Follower Notice must identify the judicial ruling in question and explain why that ruling is relevant to the taxpayer’s own arrangements.

What some taxpayers perhaps don’t realise is that the Follower Notice does not strictly require “corrective action” to be taken (it is a suggestion rather than a demand), so taxpayers can pop the notice in their green recycling bin if they feel such action is merited. This depends on how confident the taxpayer feels in the case going his way. So while the notice is HMRC’s subtle way of “leaning” on the appellants in the hope they will give up the ghost, resistance is possible.

However the notice will then go on to explain that, if the necessary corrective action is not taken within the prescribed period of 90 days, the person may be charged a penalty. The maximum penalty is 50% of the 'denied advantage' that is the tax advantage that would have been obtained had the scheme been successful. The penalty is 20% for partnerships (divided between the partners).

The penalty can be mitigated down to 10% (4% for partnerships) based on co-operation, although one imagines that if a taxpayer decides not to take corrective action on receipt of a Follower Notice (typically on the basis that his tax arrangement will work and ultimately the case will be decided in his favour), he is perhaps not minded to be particularly 'co-operative' once the penalty notice comes through. Bear in mind that the penalty is a percentage of the denied advantage. So if HMRC eventually fail to deny the tax advantage, there can be no penalty.

In summary, on receipt of a Follower Notice, a taxpayer can either:

- Comply with the notice, do whatever is required to bring the case to a close and forfeit any tax advantage they had hoped to return. This is an irrevocable decision after which there is no going back. It's an admission of defeat.

- Challenge the notice. There is no formal right of appeal against a Follower Notice although the person can make representations to HMRC if he disagrees with the validity of the notice normally on the basis that one of the conditions described above has not been met (for example, the judicial ruling referred to in the notice is not relevant to the taxpayer's own arrangements). At this point HMRC could, of course, accept that the notice has not been validly issued and duly withdraw it, but bearing in mind that a senior governance panel had to be convened to issue the thing in the first place, one imagines that such instances are rare. If HMRC does not accept the representations made and the Follower Notice is upheld, an application for Judicial Review may then be sought.

- Throw the notice in the bin and take whatever consequences then "follow" (one of which will be a 50% penalty as ignoring the notice is hardly an indication of taxpayer co-operation).

It is important to note that the Follower Notice does not itself crystallise a payment of tax. All the Follower Notice does is try to persuade the taxpayer to take action to help bring their case to a close. There is nothing in the Follower Notice rules that requires the taxpayer to pay any tax. That is the job of the (increasingly infamous) Accelerated Payment Notice….

Contributed by Steve Sanders

Accelerated Payment Notices (P1080 – 8.38 minutes)

In many cases the Follower Notice will be swiftly followed by an Accelerated Payment Notice (APN). The APN is the document that triggers a payment of tax. It is a tax demand. As it says on the tin, it accelerates payment. [Partners are subject to partner payment notices (PPNs) rather than APNs, but these follow the same principles and will not be discussed further.]

Various hoops have to be jumped through before an APN can be validly issued. The legislation calls these Conditions A, B and C, all of which must be satisfied.

- Condition A: A tax enquiry is in progress into a return or claim or the taxpayer has made a tax appeal in relation to a relevant tax, but the appeal has not been finally determined by the Tribunal or Court. In short, the person is well aware that their tax arrangements are being challenged and the enquiry into those arrangements is still open.

- Condition B: The tax enquiry is in relation to "chosen" arrangements (these being the arrangements which were entered into using the relevant avoidance scheme which HMRC is targeting).

- Condition C: The arrangements are either:

    - Notifiable under DOTAS;

    - Subject to a GAAR counteraction notice; or

    - The subject of a Follower Notice.

Therefore a Follower Notice is not always required before an APN can be issued (which makes sense as this caters for instances where there is a disclosable avoidance scheme under enquiry but there are no followers).

The APN must specify the sum to be paid. This is an amount equal to what the HMRC Officer determines to the "best of his information and belief" to be the denied tax advantage. The taxpayer must then pay the tax demanded in the APN within 90 days. Therefore, unlike the Follower Notice, the APN cannot be ignored. So even in cases where the taxpayer refuses to take corrective action and stands firm in the confident belief that his tax arrangement is legal and valid, HMRC can still make demand for the tax that their Officer believes is boing avoided.

Any late paid accelerated payment does not itself attract interest. However the interest clock that is ticking on the disputed tax will stop when the accelerated payment is made.

A late accelerated payment will however be subject to late payment penalties. Penalties start to accrue from the due date for payment. The penalties are as follows:

- 5% of the amount unpaid by the due date; plus

- 5% of any tax still unpaid 5 months after the due date; plus

- 5% of any tax still unpaid 11 months after the due date.

This is in addition to the possible penalty of 50% of the tax that could be charged for the non-compliance with the Follower Notice.

Taxpayers who can provide evidence that complying with an APN would cause hardship can make a claim to HMRC for "interim relief". This will delay enforcement of the APN.

For example, if paying the tax demanded by an APN means that a business is not able to continue to run in its usual manner, interim relief will be granted and collection of the tax will be postponed. However interim relief does not change the due date for the payment of the APN so the normal penalty rules will apply when the APN is eventually paid.

There is no right of appeal against an APN and taxpayers cannot negotiate with HMRC to reduce the amount stipulated in the APN. It is not therefore a tax assessment.

There is however a right to make representations to HMRC on the grounds that either:

- The conditions required for the issue of an APN have not been met; or

- The amount of tax specified in the APN is not correct.

The representation then extends the payment date to 30 days after HMRC has responded.

HMRC has been forced to withdraw over 6,000 APNs so far on the grounds that they were incorrectly issued. This is mainly because the notices were issued in relation to schemes which turned out not to have been notifiable under DOTAS in the first place. It therefore seems that the best defence against an APN is to argue that be that the arrangement was never actually disclosable under the DOTAS regime.

This is perhaps more common than we might think because many practitioners – naturally anxious to be compliant and fearful of the consequences of failing to do so – have taken a belt-and-braces approach and have disclosed planning schemes for which there was no DOTAS hallmark or which did not go far enough to be avoidance arrangements. Even if the disclosed planning scheme turned out not to be successful, any tax due should not have been collected via an APN.

In addition, the linking of APNs to DOTAS disclosures does make one a little sceptical about the Ministerial Statement that "disclosure under DOTAS does not necessarily mean that someone will be affected by the APN regime" as it does appear that one seems follows the other with an unnerving degree of regularity. The fact that 80,000 APNs have so far been issued seems to suggest their usage is perhaps not as selective and targeted as HMRC claimed it would be and that HMRC Officers are pushing the envelope.

Investors in certain packaged or marketed schemes have now been put in a position of having to try and raise funds to meet an APN even where they are confidently advised that they will eventually win once the appeal process has run its course. In such cases the accelerated tax will naturally be repaid if they taxpayer does win, but the cash-flow burden in the meantime could be crippling.

All this has recently been brought to light in various published cases including that involving the Ingenious Media Group. Ingenious Film Partners were involved in the production of a large number of films leading to losses. They claimed that their investors could relieve these losses sideways against their other taxable income. HMRC took the view these losses were artificial, as the partnership was not trading with a view to profit. As such this was not a legitimate investment but was instead a scheme for the avoidance of tax.

This scheme captured the interest of the Press as several of the investors in this scheme were high-earning footballers with large additional rate income tax liabilities who participated in the film scheme on the advice of their financial advisers and agents. Names publicly recorded at Companies House as being investors included David Beckham, Wayne Rooney and Gary Lineker. Other less prominent (and far less wealthy) footballers participated in the scheme "because their mates did".

The Upper Tribunal found in favour of HMRC in 2017 and APNs and PPNs were subsequently issued to collect the tax. HMRC has since won a judicial review with the Court of Appeal deciding that the notices were validly issued. Appeals along the lines that the issue of APNs was a breach of claimants' human rights were also rejected.

Whether the Ingenious (or perhaps not so ingenious…) film scheme works remains to be seen. But tax is now being sought from the investors using APNs meaning that they will be compelled to find the money to meet the APN while their case remains unsettled. And there are many more in a similar position. Many high-profile celebs have been outed as tax avoiders by sources like the Paradise Papers published in the Guardian and are no doubt facing similar issues. For example, most of the cast of Mrs Brown's Boys are alleged to have used offshore companies, overseas trusts and loan arrangements to avoid tax on their UK earnings. Even national treasures like Ant & Dec, Philip Scofield and Joey Barton have been linked with schemes now under investigation by HMRC.

Whilst one probably has little sympathy for those named above, some taxpayers who perhaps misguidedly invested in such schemes on the dubious advice of people close to them, have been issued with APNs which they simply can't afford to pay and will be faced with IVAs or possible bankruptcy. And no doubt these people paid a hefty fee for the advice in the first place, all of which leaves something of a sour taste in one's mouth.

Which brings me back to Orwell. I can't help but feel uneasy about APNs as all this seems…well, just not cricket (although a more appropriate analogy should perhaps be found given that former England cricket captain David Gower was also an investor in Ingenious films).

According to HMRC…. "There is no inherent presumption that tax and/or NICs in dispute should sit with the person, rather than the Exchequer…". Err…. except this is exactly what we had all assumed until APNs came in and HMRC told us otherwise. Normally we send in a tax return and pay the tax due per the return. HMRC takes umbrage with something in the return and opens an enquiry. An argument ensues. After a few rounds of sparring, we bow to the greater wisdom of the Tax Officer and agree to amend the return or withdraw the claim. This triggers extra tax (and a bit of interest as "commercial restitution") which we begrudgingly pay. These are the rules of the game and we're comfortable with them.

What doesn't happen is that HMRC issues a S.9A Notice of Enquiry and then staples to it an unappealable demand for payment of the tax which HMRC think should be paid on the assumption that their enquiry will be successful. We assume the taxpayer is innocent until proven otherwise. So the disputed tax does sit with the taxpayer until such time as it is no longer disputed at which point it is either retained by the taxpayer or released to the nation. And if the tax ends up at the Exchequer later than it should have done, an interest charge at a rate dictated by the government acts as reasonable compensation.

Similarly if we make a claim in a return that is likely to lead to a tax repayment and this is disputed by HMRC, we cannot insist that the tax at stake is repaid to us before the dispute is agreed. So despite the assertion that the accelerated payment is just another form of payment on account, goalposts (bad football pun intended) have been moved.

And I mention Orwell because there is some part of me which thinks that strong-arming a taxpayer to make a payment of tax before the liability has been agreed will by itself lead to taxpayers giving in and letting down their drawbridge rather than standing firm and defending their castle.

There is a whiff of threat about all of this which seems at odds with HMRC’s insistence that “the legislation does not in any way deny the person’s access to their full appeal rights”. Whilst not removing any rights to continue the fight, this legislation has clearly given HMRC the heavier gloves.

Writing a cheque or making a bank transfer is psychologically defeatist. I understand that HMRC has so far collected north of £4 billion from accelerated payments. I am also told that having obtained the money using APNs, HMRC seem to be more ambivalent about bringing enquiries to a close that cannot be helpful.

The introduction of APNs must make tax avoidance schemes less attractive as promoters now have a responsibility to warn potential investors that an APN will mean that tax has to be paid up front and thereafter tied up for several years while the battle with HMRC continues. This is not something a potential investor wants to hear. One could argue that anything that deters tax avoidance is for the greater good and on this basis, the end justifies the means. Politically there is no doubt that APNs look like a strong move in the fight against tax avoidance and for this reason alone it’s hard to see things changing.

Contributed by Steve Sanders

Reasonable excuse for the non-payment of an APN?

Summary – A genuine belief that judicial review proceedings against advance payment notices (APNs) had a good prospect of success, did not amount to a reasonable excuse for their non-payment.

Sheiling entered into arrangements notified under DOTAS, under which it had made payments to two directors in return for those directors incurring obligations to subscribe for partly paid shares in the company.

HMRC issued determinations under The Income Tax (Pay As You Earn) Regulations, SI 2003/2682, reg 80. The company appealed against the determinations and HMRC agreed to postpone the PAYE due in March 2016 but issued APNs in July 2016. The company did not pay the APNs and started judicial review proceedings. HMRC issued penalties.

Sheiling's tax advisers had recommended judicial review and Mr Houchen, the company's director, understood that there was a good prospect that the APNs had been issued unlawfully. In his witness statement, he explained that the likely unlawfulness of the APNs, coupled with the severe financial blow they would represent for the company, had led him to decide not to pay them.

Decision

The First Tier Tribunal said that Parliament had 'legislated specifically to permit HMRC to demand accelerated payment and had done so to combat what it regarded as the “mischief ” of tax avoidance schemes.'

Given this statutory background, a taxpayer would have to demonstrate a high degree of probability that the APNs were invalid. Although the fact that the High Court had given the company permission to bring judicial review proceedings suggested that it had a 'reasonable prospect of success', the company did not seem to have any reason to conclude that its specific APNs were invalid and seemed to rely mainly on generic statements made by the courts in previous judicial review proceedings relating to APNs.

Finally, the insufficiency of funds referred to by Mr Houchen did not seem to result from circumstances outside the company's control and could therefore not constitute a reasonable excuse.

There was no reasonable excuse for the non-payment of the APN.

Sheiling Properties Limited v HMRC (TC06479)

Adapted from case summary in Tax Journal (11 May 2018)

Trust Registration Service and pension scheme trustees

HMRC introduced the Trust Registration Service last year to help trustees meet their obligations under The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations, SI 2017/692.

Some pension scheme trustees have had difficulty using Trust Registration Service and so HMRC has changed their guidance. If a registered pension scheme is a trust, the scheme trustees do not need to register separately on Trust Registration Service. They can update their details by contacting Pension Schemes Services.

Trustees must keep the information required under the Money Laundering legislation in their own written records and provide it to HMRC if they ask for it.

If pension trustees incur a UK tax liability and choose to register on Trust Registration Service, they should not register as a new trust if they already have a unique taxpayer reference as this will create another unique taxpayer reference and will lead to trustees receiving Self Assessment returns to complete for previous tax years.

Trustees who choose to register on the Trust Registration Service and who have told HMRC the value of the trust assets on a 41G paper, SA900 or SA970 tax returns or through another channel, when they register on Trust Registration Service they should complete the ‘Other Asset’ field on Trust Registration Service using the term – ‘Already notified’. They should leave all other asset fields marked as ‘£1’.

www.gov.uk/government/publications/pension-schemes-newsletter-98-may-2018

No enquiry; repayment claim out of time

Summary - The Court of Appeal held that there had been no enquiry and no closure notice, with the result that no appeal to the First Tier Tribunal lay against the rejection of the claim as out of time and that the First Tier Tribunal had been right to strike out the appeal.

In January 2008, Ms Raftopoulou submitted her self-assessment return for the 2006-07 tax year, showing tax owed of about £18,000, which she paid.

In October 2011, believing that her income had been overstated and her deductible expenses understated, she submitted a claim for repayment. HMRC rejected this as out of time.

The First-tier Tribunal agreed with HMRC's application and struck out the appeal. The Upper Tribunal accepted her case that HMRC's letter constituted both notice of an enquiry, under para 5 of Sch 1A TMA 1970 and a closure notice, under para 7. Therefore, she was entitled to appeal to the First Tier Tribunal against the rejection of her claim as made out of time. HMRC appealed.

Decision

The Upper Tribunal had said that it would always be a question of fact whether HMRC had 'enquired into' a claim. The Court of Appeal disagreed. There could be no enquiry into a claim without HMRC giving the notice required by Sch 1A para 5. Whether the letter or other communication in question had given the necessary notice depended on whether it would be read by a reasonable recipient in the position of the taxpayer as doing so. The same was true of any document said to be a closure notice.

HMRC's letter had not demonstrated that HMRC had conducted an enquiry into the taxpayer's claim under Sch 1A or had ever intended to do so. Nowhere did the writer of the letter state or indicate that they intended to enquire into the claim or that they had completed enquiries nor did it state any conclusions resulting from his enquiry or amend the claim. A reasonable person in the position of the taxpayer would not read the letter as stating that her claim had been reduced to zero but that, rather than considering the substance of the claim, it had been rejected as out of time. The Upper Tribunal's decision that the letter could serve as both a notice under Sch 1A para 5 and a closure notice under para 7 could not be accepted.

The appeal was allowed.

HMRC v Raftopoulou [2018] EWCA Civ 818

Another opinion from the GAAR Advisory Panel (Lecture P1078 – 27.23 minutes)

On 11 December 2017, the GAAR Advisory Panel published three further opinions. Two of these cases involved employees receiving rewards as gold bullion – they are very similar to the first case heard last summer and the Panel came to the same conclusion, i.e. that the tax arrangements in question did not represent a reasonable course of action.

However, it is the other case which is of interest and which may prove to be of considerable importance. Two (anonymous) taxpayers are involved: Mr A and his company. Mr A is the sole director of, and shareholder in, the company.

The relevant tax planning arrangements were entered into over the course of 2013 and 2014. At the time, Mr A owed his company £460,000. Had that loan remained in place, the company would have incurred a charge to tax under S455 CTA 2010.

The planning advice was designed to allow Mr A to extract cash from his company with:

- no charge to income tax for Mr A, either on a dividend or on a close company loan write-off under S416 ITTOIA 2005;
- no loan to participator charge on the company under S455 CTA 2010; and
- no participator benefits charge on the company under S464A CTA 2010.

In outline, the tax planning involved the following steps:

- On 16 and 17 July 2013, two trusts were created by an offshore company settlor and funded with £325,000 each. The money was then lent back to the settlor.
- On 26 August 2013, a Cyprus company took over as sole trustee of the trusts.
- On 7 July 2014, the assets of one of the trusts (together with the corresponding loan to the settlor) were reduced by £150,000 and the assets of both trusts (now worth £500,000) were combined under a single deed.
- On 16 July 2014, the settlor assigned to Mr A the settlor's interest in the trust for £500,500, the settlor repaid its £500,000 loan to the trust and the trust made a loan of £500,000 to Mr A. These steps did not involve the incurring of any cost by Mr A other than a £500 trust set-up expense.
- On 31 October 2014, Mr A's company purchased the 'primary interest' in the trust from Mr A for £500,000. The purchase price was paid via a credit to Mr A's loan account with his company, thus eliminating the overdrawn loan account balance of £460,000.
- On 11 November 2014, another company (which was the trustee of a separate family trust of Mr A) acquired the 'secondary interest' in the trust in return for a payment of £100.

The 'primary interest' entitled the holder to income from the trust's assets until 2135.

The 'secondary interest' entitled the holder to the remaining capital after 2135.

The terms of Mr A's loan from the trust were that it would be interest-free for as long as Mr A held the 'primary interest' and thereafter interest would become payable by reference to a rate derived from a formula involving the Bank of England's base rate.

On 25 September 2014, the company's board minutes recorded that the trustee had the power to make an outright distribution of the underlying assets of the trust to the holder of the 'secondary interest', thus effectively ending the holder of the 'primary interest's' right to income.

The result of all this is that:

- Mr A received £500,000 from the company, of which £460,000 was used to discharge his company loan;

- until the loan from the trust to Mr A is repaid on his death (or is otherwise unwound), Mr A funds the annual income which the company receives from the trust;

- the company reflects the right to receive annual income from the trust as a £500,000 asset in its accounts; and

- the trustee has the power to make an outright distribution of trust assets to the holder of the 'secondary interest' (Mr A's family trust).

These arrangements seek to provide Mr A with £500,000 on a tax-free basis, and with no charge arising on the company under either S455 CTA 2010 or S464A CTA 2010. The £500,000 received on the sale of Mr A's 'primary interest' enables him to repay his existing £460,000 company loan, thereby avoiding the loan to participator charge. The Panel summed up the position as follows:

'The arrangements in other words seek to get round the taxing provisions by steering a course away from the distributions legislation (which charges to income tax shareholder extractions of value from a company), away from the loan to participator legislation (which levies tax on a close company providing loans to participators) and away from the other participator benefits legislation (which levies tax on a close company providing, as part of tax avoidance arrangements, an otherwise untaxed or undertaxed benefit).'

The Panel continued:

'The tax position of hypothetical normal transactions is as follows:

(i) A dividend paid by the company to Mr A gives rise to a charge to income tax on the amount of the dividend.

(ii) A loan by the company to Mr A gives rise to a loan to participator charge in the company by reference to the amount of the loan.

(iii) The sale of a valuable asset by Mr A to the company at overvalue gives rise to a charge to income tax under the distributions legislation on the difference between the value received by Mr A and the market value of the asset received by the company (in essence, the charge is on the value extracted from the company).

(iv) The sale of a valuable asset by Mr A to the company has potential capital gains consequences for Mr A.'

The argument of Mr A's tax advisers was that the £500,000 which he received from the company was a market value purchase price for an asset (the 'primary interest' in the trust). Accordingly, as no value was extracted from the company, no charge to income tax under the distributions legislation should arise. In addition, it was asserted that Mr A's CGT base cost was at least £500,000 so that there was no capital gain on the sale of his 'primary interest' to the company. As far as the company is concerned, the £460,000 loan was repaid and was not replaced by another loan. Therefore, there should be no charge under S455 CTA 2010 or S464A CTA 2010.

Unsurprisingly, the Panel found that the tax arrangements described above did not represent a reasonable course of action. There was no commercial non-tax rationale for involving a trust in the desired goal of extracting cash from the company.

One unsatisfactory feature of the opinion given by the Panel is that, in the GAAR Guidance, much is made about the importance of the taxpayer's safeguard – the so-called double reasonableness test ('the arrangements cannot reasonably be regarded as a reasonable course of action') – and the fact that this test exists specifically for the purpose of setting a high threshold. It is a pity that, when it comes to the Panel, they do not have to apply this same high threshold. They merely have to decide whether the arrangements are a reasonable course of action (which places the bar at a much lower level).

In this case, the Panel, having examined the relevant legislation, conclude that the purpose of the rules is to charge tax on benefits received by a participator in a close company. This is perhaps a little too broad. As has already been mentioned, there are three different ways in which the regime imposes a charge to tax on participator benefits (via the distribution legislation, via S455 CTA 2010 and via S464A CTA 2010). It is not illogical to suggest that, if a taxpayer's arrangements do not fall within the scope of these provisions, then they are not intended to be taxed.

However, the GAAR Guidance provides a response to this riposte: a taxpayer is not permitted to exploit shortcomings in the legislation. One of the basic principles of the GAAR is to deter or counteract the deliberate exploitation of statutory defects or lacunae. It is therefore interesting to read the following passage in the Panel's review (see Para 10.1):

> 'We do not consider there to be a shortcoming in any of the three separate sets of rules charging tax on benefits conferred by close companies.'

This sounds like a let-out for the taxpayer, but unfortunately the verdict does not pan out that way. The thrust of the Panel's opinion seems to be that, if Mr A could have received his money differently (e.g. as a dividend) and if this would have given him a liability to tax, he should pay tax on that basis.

Although the legislation and the GAAR Guidance are clear about the meaning of 'exploit' in this context, the Panel seem to have extended the sense of the word so that it includes the circumstance, as one commentator has put it, that 'you have "exploited the fact" that the legislation was not designed to tax your transaction'. In other words, it could potentially cover virtually everything. And that makes one wonder what protection or safeguard now exists for the embattled taxpayer.

An opinion of the Panel is not of course binding, but it will be a brave (or seriously aggrieved) taxpayer who is prepared to challenge such a finding.

Contributed by Robert Jamieson

Deadlines

1 June 2018

- Corporation tax due for periods ended 31 August 2017 for small and medium-sized companies where payment is not required by instalments

7 June 2018

- Electronic filing and payment of VAT liability for quarter ended 5 April 2018

14 June 2018

- Quarterly CT instalment for large companies (depending on accounting year end)
- EC sales list for quarter ended 30 April 2018 due (paper form)

19 June 2018

- PAYE/NIC/CIS/student loan payment liabilities for month to 5 June 2018 if not paying electronically
- File monthly construction industry scheme return

21 June 2018

- File online monthly EC sales list
- Submit supplementary intrastat declarations for May 2018

22 June 2018

- Electronic payment of PAYE/CIS liabilities for month to 5 June 2018

30 June 2018

- Accounts to Companies House by private companies with 30 September 2017 year end
- Accounts to Companies House by PLCs with 31 December 2017 year end
- HMRC should have received CTSA returns for companies with accounting periods ended 30 June 2017
- CT61 — quarterly period ends
- VAT partial exemption annual adjustments for March VAT year end
- Returns by savings institutions made under the European Savings Directive for 2017-18 must be received by HMRC

HMRC News

Off-payroll reform in the public sector

Research

Research conducted by IFF Research and Frontier Economics explored the immediate impacts on public sector bodies of the reform of off-payroll working in the public sector, which took effect in April 2017. The research looked at the key sectors of Public Administration & Defence, Education and Health & Social Work sectors.

The research consisted of a quantitative survey of 117 central bodies and 100 individual sites in the public sector, all of which had recent engagement with off-payroll contractors, and qualitative follow-up interviews with 30 respondents whose responses indicated they had been affected by the reforms.

The results indicated increased levels of compliance, with an estimated £410m raised as a result of the reforms. HMRC's analysis of PAYE data covering the first 10 months of the reform, from April 2017 to February 2018, shows, each month, around 58,000 more individuals than expected paying income tax and NICs when undertaking work for a public authority.

No mass walkouts

In spite of warnings that the new rules would lead to mass walkouts from public bodies, survey results suggest the reforms have had minimal impact on how public bodies recruit. Although there was a fall in the number of off-payroll contractors engaged by public bodies, survey data showed that there was also a fall in employee headcount. ONS public sector employment by industry data shows a general downward trend in public sector employment, mainly driven by a reduction in employee numbers in the Public Administration & Defence sector overall. Qualitative interviews showed that in some cases, off-payroll contractors had left public sector bodies after being declared within the rules, but were replaced with other off-payroll contractors willing to work within the off-payroll working rules, resulting in no overall change to contractor numbers. The research found little evidence of contractors turning to self-employment (i.e. working through an unincorporated structure) to avoid off-payroll working rules.

Filling roles

Roughly one in three central bodies and one in five sites said that it had been more difficult to fill contractor vacancies. Some of those that had reported difficulties in filling vacancies felt there were fewer suitable contractors available in the marketplace since the reforms and that the process of filling contract vacancies had become more time consuming after the reforms came into effect. It was felt by some that difficulties in filling vacancies were more pronounced among roles where there had been pre-existing challenges with recruitment, for example, for doctors and social workers. Interestingly, some public bodies stated that some of the challenges that the off-payroll working reforms presented in filling vacancies were short-term, and that contractors and agencies had become more accepting of the changes after the initial bedding-in period.

Administration

The majority of central bodies found the off-payroll working reforms easy to comply with, frequently that this was because they had suitable systems in place. Where compliance was found to be difficult, this was commonly stated as being due to struggling to use HMRC's online Check Employment Status for Tax (CEST) tool. Qualitative evidence suggested its functionality had improved since being introduced and it was now fit for purpose.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/704931/Off-Payroll_Reform_in_the_Public_Sector.pdf

Compliance with off-payroll working rules in the private sector

In the Autumn Budget 2017, the government announced it would consult on how to tackle non-compliance with the off-payroll working rules in the private sector. This consultation will run until 10 August 2018.

The main option under consideration is the extension to the private sector of reforms similar to those introduced in April 2017 for public sector off-payroll engagements.

The consultation document begins with an evaluation of the effectiveness of the new public sector off-payroll working rule, based on the findings that were discussed in the previous article. It then sets out the government's view of current factors contributing to non-compliance with the 'IR35' rules in the private sector, before putting forward a number of options for changes to improve private sector compliance.

The problems HMRC has in enforcing compliance under the current off-payroll working rules in the private sector are summarised as follows:

- the need for enquiries to deal individually with each PSC, even where there are numerous workers engaged and working in the same way for a single client;
- the perception that there is a very limited chance of HMRC opening enquiries and a low risk of being found non-compliant;
- widespread advertising and selling of so-called 'IR35 proof' contracts, or offers of 'insurance' against being found non-compliant with the legislation;
- long time-lag between the engagement taking place and the date when tax on the income arising from the engagement becomes due;
- fragmentation of responsibilities within the labour supply chain concerning how work is supplied, carried out, and payment of tax; and
- the length of time it can take to recover amounts due from PSCs once a tax liability has been established.

The main options the government puts forward for improving compliance in the private sector are:

- applying new rules to the private sector similar to those introduced in the public sector, involving transferring responsibility to the engager for determining the correct status and deducting the correct tax and NICs; and

- improving on the public sector rules by enabling HMRC to use its recovery powers where agencies (as fee-payers) disregard determinations by their clients (as engagers) about a worker's employment status and decide, incorrectly, not to operate PAYE.

Other options being considered are:

- encouraging, or requiring, clients to undertake specific checks, underpinned by penalties, based on HMRC's guidelines in 'Use of labour providers: advice on due diligence'; and

- additional record-keeping requirements on clients, when making payments to PSCs either directly or through an agency, to retain certain information such as contracts, shift rotas, and line management reporting requirements relating to the engagement.

The government acknowledges that these last two options would create extra administrative burdens, without directly affecting compliance.

www.gov.uk/government/consultations/off-payroll-working-in-the-private-sector

'Manage and Register Pension Schemes' service delayed

HMRC amended its April newsletter on 3 May to advise that launch of the new 'Manage and Register Pension Schemes' service has been delayed until 4 June 2018. Registration via the existing pension schemes online service will be discontinued after 1 June.

This delay is because the full development and testing of the service is slightly behind the planned delivery date.

HMRC will release the service on 4 June 2018 and will launch this in a bespoke newsletter to provide with full details of the features available on the service and where supporting guidance can be found.

Remember, from April 2019, scheme administrators will be able to use the new service for reporting, and practitioner access will become available between 2019 and 2020. The new service is intended to replace the pension schemes online service completely after 2020.

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

Simple assessment and dynamic PAYE coding halted

HMRC have announced that a number of the projects they were undertaking will be paused or stopped because of the extra challenges posed to the tax authority by Brexit. Projects confirmed as paused include the rollout of Simple Assessment for income tax and real time changes to PAYE tax codes (‘dynamic coding’).

Yvette Nunn, Co-chair of ATT’s Technical Steering Group, said:

> “Given the unprecedented changes which will result from Brexit, it is only sensible that HMRC seek to reprioritise their work.
>
> “Two projects which have been paused – Simple Assessment and dynamic coding - have caused problems to date which still need to be addressed.
>
> “There have been reports of inaccuracies in the information which HMRC have used in Simple Assessments to calculate tax bills. As a result, taxpayers are required to check these carefully once received, especially as they only have 60 days to correct any errors.
>
> “Dynamic coding has caused some employees who have been paid a bonus early in the tax year, or who have uneven earnings, to receive an incorrect tax code which can lead to a tax overpayment.4
>
> “While we welcome the pause to these projects, we strongly urge HMRC to use the extra time given to iron out the known problems with Simple Assessment and dynamic coding before they hit play on them again.”

Simple assessment

Under Simple Assessment, the goal is for HMRC to use information that it already holds to produce the income tax calculation for certain groups of taxpayers, rather than require the submission of a self assessment tax return. Simple Assessments have been rolled out gradually, with the first Simple Assessments issued in 2016/17 to:

- Individuals who started to receive a State Pension in 2016/17 where that pension exceeded the personal allowance and;
- Taxpayers who are subject to PAYE, but where the tax due cannot be collected through the tax code, for example if it exceeds £3,000.

There were originally plans to rollout Simple Assessment to further groups of taxpayers, but these have now been delayed indefinitely.

Dynamic coding

In July 2017, HMRC began using monthly Real Time Information (RTI) data provided by employers to automatically adjust PAYE tax codes for employees during the year. This dynamic coding is intended to reduce the number of employees who end up with an under or over payment at the end of the tax year.

Under dynamic coding, HMRC estimate an employee’s income for the tax year by taking details of earnings reported for the period to date and extrapolating these to a whole year.

This can lead to problems if the employee has been paid a bonus in the period as the system does not discriminate between regular payments of salary and irregular bonuses. This leads to the estimated income for the year being too high, resulting in an incorrect tax code and a tax overpayment.

www.att.org.uk/technical/news/press-release-opportunity-rethink-simple-assessment-real-time-changes-paye-tax-codes

Online marketplaces cooperation agreement

This document sets out the commitments between HMRC and the undersigned online marketplaces that have third party businesses (whether UK based or overseas) operating on their marketplace that are liable to pay VAT in the UK. These are separate to the legal obligations placed on such online marketplaces by UK VAT legislation such as sections 77B, 77BA and 77C-77E of the VAT Act 1994.

The commitments made in this paper do not create binding legal obligations.

1) Provision of data

By signing the agreement:

- all online marketplaces commit to providing HMRC with data about the businesses operating on their marketplaces. This data should be provided either voluntarily or in response to the issuing of a legal notice;

- each online marketplace agrees to find a suitable and legally compliant mechanism for providing HMRC with data on a timely basis via one of the above routes.

At a minimum the data provided will be sufficient to allow HMRC to:

- identify individual business sellers;

- calculate the value and volume of UK sales of individual businesses over a prescribed period;

- contact the individual business directly.

The data requested by HMRC could form part of a one off request or be for a regular flow of data over a prescribed period of time.

2) Education for sellers

Online marketplaces agree to ensure that sellers have access to information about sellers' VAT obligations in the UK, including for UK and EU sellers as well as non-EU sellers. Online marketplaces may choose to provide guidance or assistance themselves or to direct sellers to other information, including HMRC's guidance information on GOV.UK.

3) Responding to evidence of non-compliance

Online marketplaces agree to respond expeditiously when notified by HMRC that sellers are using their marketplace in breach of UK VAT legislation obligations.

In addition, each online marketplace will have systems to take appropriate action whenever presented with evidence of potential non-compliance with UK VAT registration obligations.

Online marketplaces agree to inform HMRC when it has restricted a seller from selling on the UK marketplace or removed a particular seller from its marketplace for non-compliance with UK VAT legislation obligations within 30 days of that action. HMRC acknowledges that the 30-day clarification period mentioned above is separate from the statutory periods set out in sections 77BA and 77E of the VAT Act 1994 which carry precedence.

Responsibility of HMRC

Requests for data to online marketplaces by HMRC will be made on a case by case and on a risk basis. In all cases where it receives information about sellers from online marketplaces, HMRC will respect the 'commercial-in-confidence' status of information subject always to any overriding legal obligation.

HMRC acknowledges the need to maintain a level playing field between online marketplaces and will ensure that this agreement is made available to all online marketplaces.

Who has signed up

HMRC will publish the list of all online marketplaces that sign up to this agreement. In the event that a signatory does not comply with this agreement HMRC will remove them from the list. This includes failing to identify a legally compliant way of providing data to HMRC when requested.

www.gov.uk/government/publications/hmrc-and-online-marketplaces-agreement-to-promote-vat-compliance

Business Taxation

Personal service companies (Lecture B1076 – 22.15 minutes)

Much has been written about the recent tax case of Christa Ackroyd Media Ltd v HMRC (2018), with the First-Tier Tribunal's decision, which went in favour of HMRC, certainly being deserving of detailed analysis. Christa Ackroyd Media Ltd is a personal service company which was set up several years ago by Christa Ackroyd (CA). CA is, along with her husband, a shareholder in, and director of, the company.

CA is a television journalist who has been engaged in a variety of media roles since the late 1970s. Between 1990 and 2001, she co-presented a news and current affairs programme called 'Calendar' for Yorkshire Television, initially with Richard Whiteley and later with Mike Morris. 'Calendar' enjoyed ratings well above those of the equivalent BBC programme ('Look North'). In those days, the Yorkshire area was one of the few regions where the BBC were not winning the ratings battle with ITV. The BBC were keen to change the fortunes of 'Look North' and so CA was approached to join the BBC on what was referred to as 'a freelance basis'. She initially turned them down, but, when a second – doubtless more attractive – offer was made, she agreed to jump ship and started working on 'Look North' in September 2001, with Harry Gration as her co-presenter. The new version of 'Look North' was immediately successful.

CA's first contract in this job was between the BBC and Christa Ackroyd Media Ltd. It ran for a period of five years. In 2006, she was offered a new five-year contract, but she declined this offer because she wanted a seven-year agreement. At the same time, there were discussions about CA giving up a regular newspaper column which she wrote for the Sunday Express. The BBC wished CA to terminate her involvement with the newspaper, which she was anyway minded to do on account of the time which she had to devote to the writing of the column. In due course, she did negotiate a seven-year contract with the BBC, together with an ex gratia payment of £40,000 which was presumably linked to CA ceasing her newspaper activities. This contract stated that CA could not provide her services for publications of any kind other than for the BBC without first obtaining the BBC's consent.

This second contract, which provides the subject-matter for the case, gave the BBC 'first call' on CA's services for up to 225 days a year. For this, she was to be paid, starting in 2007, £163,233 per annum in equal monthly instalments regardless of whether or not the BBC had taken up their full entitlement of days. Her fees for subsequent years were to increase in line with inflation (measured by reference to the RPI). CA's company was also eligible for a six-monthly performance-related bonus of £7,500 if the ratings for 'Look North' were 'consistently and significantly' higher than the ratings for 'Calendar' (which they always were).

Another relevant factor is that the vast majority of the income received by CA's company came from the BBC. For example, less than 2% of the company's gross income in 2009 was derived from other sources and, for the following year, the equivalent figure was 3.5%.

Put briefly, HMRC considered that these arrangements fell within the IR35 legislation in Ss48 – 61 ITEPA 2003, with the result that a substantial tax liability arose.

The key issue here is to consider whether, if the services provided by CA to the BBC had been rendered under a contract that was directly between her and the BBC (rather than between her company and the BBC), she would have been regarded as an employee of the BBC under this hypothetical contract. The difficulty is that we have a real contract between two unrelated parties that one might have thought would be the proper basis for the assessment to tax. However, under the IR35 regime, we are forced to disregard the real contract between the real parties and to assume a hypothetical contract (involving different parties) and then establish what the tax outcome would be had those different parties entered into such a contract.

In the event, the First-Tier Tribunal decided that CA would have been an employee under the hypothetical contract with the BBC. The reasons given for this conclusion were that:

1. there was mutuality of obligation;

2. there was a sufficient degree of control over the performance of CA's services; and

3. the other provisions of the hypothetical contract were consistent with it being a contract of service.

With regard to mutuality of obligation, one writer has made the following point:

> 'The mutuality of obligation was said to be (CA's) obligation to perform the work offered and for the BBC to pay her for it. I have never been able to understand this interpretation of a mutuality of obligation. I am clearly wrong in thinking that the relevant mutuality in establishing a master/servant relationship is the obligation for the employer to provide or offer work and the obligation on the employee to accept and perform it. In this case, the BBC was not bound to call on the services of CA – which could be said to exclude the mutuality of obligation.'

The same writer, referring critically to the First-Tier Tribunal's judgment, goes on:

> 'The Tribunal also referred at length to the question of control which will clearly vary from case to case – and here CA has no set hours or set working days or set location. However, they concluded that the hypothetical contract satisfied the relevant condition which is that (CA) was "subject to the other's control in a sufficient degree to make that other master". So how much control is necessary for her to become an employee? Oh, that's easy: it is control to a sufficient degree for her to be an employee. That argument is so circular it is almost a perfect sphere!'

However, it should be noted that, under the terms of the contract, the BBC had the right to 'call on the freelance services of CA (including acting as presenter reporter and reasonable ancillary services normally associated with such a role) as they may require to the output of the BBC'. In other words, the BBC was entitled to use CA's skills in whatever area and type of programme that they saw fit. The BBC was not obliged just to use her services on 'Look North'. This sounds like – to this speaker – enough control to establish an employment relationship.

The surrounding facts suggest that this is a not unreasonable conclusion, with the key ones being the:

- seven-year term for CA's contract;
- BBC's exclusive rights over CA's services; and
- proportion of the turnover of CA's company which derived from the BBC.

It is known that there are a number of other cases in the offing involving BBC 'talent'. It will be interesting to discover whether they are – essentially – on all fours with CA's circumstances or whether (as one suspects) most of these will be about contracts where the BBC's rights over the performer are limited to a specific programme, i.e. unlike CA's arrangements.

Contributed by Robert Jamieson

IT contractor wins IR35 case

Summary – Mr Wells, an IT contractor who worked for the Department of Work and Pensions, did not fall within IR35.

Ian Wells had worked as an IT contractor for many years. In 2012/13, he undertook a series of short contracts for the Department of Work and Pensions through his company Jensal Software Ltd. He provided his services via a recruitment agency, Capita Resourcing Limited.

HMRC argued that these contracts fell within the IR35 rules, raising assessments on Jensal Software Ltd to collect income tax and NIC due of nearly £27,000.

However, Ian Wells believed that he had a strong case:

- Recruitment agency, Capita Resourcing Limited, had advertised for an IT contractor to work at the Department of Work and Pensions. In the contract between Capita Resourcing Limited and Jensal Software Ltd it stated that no mutuality of obligation was intended between the parties;
- Through the period of the contracts, Ian Wells was free to perform work for other clients;
- Managers at the Department of Work and Pensions said that Ian Wells was unsupervised, instructions that he received were limited and check-ups on his work was minimal. His role could only be varied with agreement of Capita Resourcing Limited and himself;
- There was a substitution clause in the contract between the Department of Work and Pensions and Capita Resourcing Limited as well as a right of substitution in the contract between Capita Resourcing Limited and Jensal Software Ltd;
- Ian Wells took on an element of financial risk as he would have been expected to rectify any sub-standard work in his own time. Additionally, he provided some of his own equipment needed to carry out his work.

Decision

The First tier Tribunal considered the hypothetical contract between the Department of Work and Pensions and Ian Wells which actually involved looking at thee contracts: the contract between:

1. the Department of Work and Pensions and Capita Resourcing Limited;

2. Capital Resourcing Limited and Jensal Software Ltd; and

3. Jensal Software Ltd and Ian Wells.

The Tribunal concluded that there was minimal Mutuality of Obligation, as the Department of Work and Pensions was not committed to offer additional contracts and indeed, there had been a period during the short contracts when no work was available.

The judge stated:

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

They also concluded that there was a substitution clause and Ian Wells did have more freedom to carry out his work than the Department of Work and Pensions employees, receiving no benefits or training but rather, was in business on his own account.

The judge commented:

> "this is Mr Wells' second IR35 case, which does raise important questions over HMRC's targeting of contractors.
>
> I can't recall another situation where a contractor has been investigated twice. From this, it could be argued that HMRC has an agenda, and is wrongly going after certain individuals."

Jensal Software Limited v HMRC

CIS - how the scheme works (Lecture B1077 – 13.57 minutes)

Introduction

The Construction Industry Scheme (CIS) is a scheme under which contractors are required to withhold tax on certain payments made to sub-contractors. The CIS was introduced in the 1970s as a reaction to the amount of tax being lost as a result of under-declarations or failures to register by itinerant sub-contractors who came to work in the UK for relatively short periods of time and then left without paying tax on the profits from their UK self-employment.

The CIS ensures that some tax is withheld at the point of payment. However sub-contractors who can prove that they are fully compliant with their UK tax obligations can apply to receive payments gross. These people will thereafter account for the full amount of any tax and NIC due on their profits under self-assessment.

Contractors

The CIS only applies to "contractors". A contractor for the purposes of the CIS is either:

- A person carrying on a business which includes "construction operations" (most commonly builders or building companies);

- A person whose business does not normally involve constructions but whose expenditure on construction operations across a 3 year period exceeds £1 million per annum (for example, supermarkets and certain specified bodies such as housing associations and local authorities).

The CIS does not apply to homeowners engaging the services of subcontractors to work on their own home.

"Construction operations" covers a wide variety of activities including;

- The alteration, repair, extension, demolition or dismantling of buildings (including structures such as road and bridges);

- The installation of heating, lighting, air-conditioning, power supply, drainage or sanitation systems; and

- Cleaning, painting, decorating and other operations integral to the construction process (such as excavation and site-preparation).

The manufacture of components used in the building trade is not within the scheme. Neither is the professional work of individuals involved in the building process such as architects and engineers (or other individuals such as scaffolders, carpet fittings and caterers).

The CIS is restricted to construction operations carried on in the UK. This does however mean that:

- A non-resident contractor who pays sub-contractors for construction work carried out in the UK; or

- A non-resident sub-contractor who is being paid for construction work carried out in the UK

will both be within the CIS.

All contractors must register with HMRC for the CIS. Registration is made online. HMRC will then set up a Contractor Scheme. HMRC has a New Employer Helpline which also deals with CIS registration. The number is 0300 200 3211.

Sub-contractors

A person is a sub-contractor if he is under a duty to the contractor to carry out the construction operations or to furnish his own labour or the labour of others in carrying out the construction operations.

Sub-contractors can be sole traders, partnerships or companies.

If a sole-trader subcontractor carries out work exclusively for one contractor, it is highly likely that he should be treated as an employee of the contractor with any payments subject to deduction of tax and NIC at source under PAYE. Individuals sub-contractors are therefore only within the CIS if there is a genuine case for them to be treated as self-employed traders.

Employment status

The CIS only applies to self-employed sub-contractors.

Contractors have to make a monthly declaration, via their monthly CIS return, that they have considered the employment status of each sub-contractor and they are satisfied that the sub-contractors are self-employed. A penalty of up to £3,000 can be charged if the wrong employment status for a sub-contractor is declared on the monthly return.

Status has always been a very hot topic in the construction industry and HMRC has been making a concerted effort to categorise sub-contractors as employees wherever an opportunity presents itself.

There is no legislation on employment status for tax purposes, but case law suggests that the following three factors are always key in any status discussion:

- Mutual obligation – is the contractor obliged to offer work and is the sub-contractor similarly under an obligation to accept?

- Control – does the contractor exercise control over how the work is done? [Note here that detailed instructions given to the sub-contractor with regard to the nature and extent of the work which is required to be done are not the same as exercising control.]

- Substitution - is sub-contractor obliged to carry out the work personally rather than hiring an assistant or sending along a substitute?

If the above three points are missing then case law strongly suggests that an employment relationship cannot exist so the sub-contractor will be self-employed.

It is vitally important that contractors pay proper attention to the status of a worker engaged to do a job as the risks of failing to do so are with the contractors who are normally held liable for any unpaid PAYE.

Tax treatment of payments

Payments by a contractor to a self-employed sub-contractor can either be made:

- Gross; or

- Under deduction of income tax at 20%; or

- Under deduction of income tax at 30%.

Gross payment

Sub-contractors can only receive payment without deduction of tax if they are "registered for gross payment". Indeed many construction companies do not engage labour nowadays unless they see evidence of the sub-contractor's gross payment status as they do not want the additional compliance burdens of monthly CIS returns and tax deduction.

Sub-contractor registration can be made online (normally by logging in with a Government Gateway ID) or via the CIS Helpline on 0300 200 3210.

For limited companies there is an online registration form CIS305 (form CIS304 for partnerships).

Registration for gross payment will be granted by HMRC if the sub-contractor satisfies three tests:

1. The business test;

2. The compliance test; and

3. The turnover test

The business test requires the sub-contractor to be in business carrying out construction operations or supplying labour for construction operations. The business must be substantially carried on through a bank account. Cash trades will not qualify. Proper business records must be maintained.

The compliance test requires the sub-contractor to be up to date with his tax affairs, including paying all tax liabilities, throughout the 12 months up to the application. Minor compliance failures in this period can be overlooked. HMRC seem to be relatively generous here in their interpretation of the word 'minor' as up to 3 late monthly return submissions in a year or 3 late payments of PAYE, or a late SA return or a late year-end PAYE return are all considered minor infringements which would not jeopardise the compliance test.

The turnover test is the most complex test. Sole traders must have a construction turnover of at least £30,000 in the 12 months prior to the application. For partnerships, the turnover is £30,000 multiplied by the number of partners or £100,000 (whichever is lower).

The standard turnover test for companies is also £30,000, but for close companies this is multiplied by the number of individuals who are shareholders and/or directors of the company. Again this is capped at £100,000.

"Turnover" is net of any materials used to generate the income (such that the turnover test is effectively measured in relation to the supply of labour).

Before a contractor makes a payment to a sub-contractor, the contractor will use HMRC's online verification system to check his status. This is mandatory and tells the contractor whether payments can be made gross or whether tax needs to be deducted (and if so at what rate).

Verification is only required in relation to sub-contractors who have not received a payment from the contractor in the previous 2 years. Contractors do not therefore need to use the verification service every time they make a payment to a sub-contractor. HMRC will notify contractors of any changes in the status of a sub-contractor to whom payments have been made in the previous 2 years.

Where a sub-contractor is registered for gross payment, HMRC will undertake an annual review of his compliance record to ensure that gross payments status can continue. This is an automatic check that all tax returns have been submitted and all tax has been paid on time and any information requested has been provided. Minor failures can be overlooked.

The 20% deduction rate

Sub-contractors who are registered with HMRC but are not registered for gross payment – for example due to not meeting the turnover test or because of outstanding tax returns etc - will be subject to tax deduction at 20%. Contractors will be notified of this via the online verification system. There are no bars to registration so all self-employed sub-contractors can register.

The 20% rate is deigned to equate (approximately) to the average tax and NIC rate suffered by a typical sub-contractor taking into account expenses and personal allowances etc. Extra tax or NIC will be paid (or repaid) via the self-assessment system.

The 20% rate is applied to the VAT-exclusive part of the payment that does not represent the cost of materials incurred by the sub-contractor.

Example:

John is a self-employed central heating engineer. He is registered with HMRC but is not registered for gross payment. He is VAT registered. John submits the following invoice to a contractor for work carried out:

	£
Supply of labour	4,000
Travelling & subsistence expenses	600
Materials supplied (excluding VAT)	400
	5,000
VAT @ 20%	1,000
Total payable	6,000

The tax to be withheld by the contractor is as follows:

	£
Re: Labour	4,000
Re: Travelling & subsistence expenses	600
Amount liable to 20% deduction	4,600

Withholding tax @ 20% 920

The contractor will therefore pay John £(6,000 – 920) = £5,080.

Note here that John must account for the VAT of £1,000 via his normally quarterly VAT returns. The £920 tax deduction will be a credit against any tax and NIC due on submission of his SA return.

Where materials as well as labour are supplied (‘supply and fix’ contracts), if the sub-contractor is registered for VAT (as with John above), any input VAT paid on materials should be excluded. This is because the sub-contractor will recover this VAT via his monthly returns. However where the sub-contractor is not registered for VAT, any VAT paid on materials should be included within the amount invoiced.

The 30% deduction rate

Subcontractors who are not registered with HMRC will be subject to tax deduction at 30%. The higher deduction acts both as an incentive for sub-contractors to register and as a safety-net for HMRC in the event of a sub-contractor default. The deduction is applied as above.

CIS - compliance rules, penalties & recent tax cases (Lecture B1078 – 10.29 minutes)

Paying the tax

The contractor must pay-over any tax deducted to HMRC on a monthly basis. Payment is due by the 19th (22nd if made electronically). Contractors will typically tie this in with their other payroll obligations.

The tax can be paid quarterly where monthly payments to HMRC (including PAYE deductions) are less than £1,500 on average.

The contractor must provide a statement to the subcontractor showing the tax deducted. Statements are normally issued electronically. The statement is due 14 days after the tax month to which the invoice relates (ie, by the 19th of the following month). Penalties can be charged if a statement is not provided.

[As a word of warning, advice for contractors is not to include inflammatory words like “employment” or “payslip” on the statements issued to sub-contractors for obvious reasons…]

If HMRC discover that a contractor had an obligation to make CIS deductions but failed to do so, HMRC can make a determination under the Construction Industry Scheme Regulations 2005 on a contractor to collect them.

However the Regulations (Reg 9) state that HMRC can relieve a contractor of any liability either:

- If the failure was as a result of an "error made in good faith" or a "genuine belief" that the payment was not within the scope of the scheme; or

- The subcontractor's income (including the payment in question) has been declared and the sub-contractor has paid the tax due in respect of this income.

Setting-off deductions

Sole traders (including partners in partnerships) will set-off any CIS deductions against their income tax and NIC liabilities under self-assessment.

Companies acting as a subcontractor may have CIS deductions taken from their income.

These deductions will first be set-off against their monthly PAYE payments. Where the company's own CIS deductions are greater than the PAYE, the excess is set against future PAYE payments in the same tax year. If an excess still remains at the end of the tax year – which is often the case for "one-man-band" companies where the director draws dividends rather than a salary - this can be either refunded to the company or set against corporation tax.

Online returns

A monthly online return (form CIS300) is required by the 19th of the month detailing all payments made to sub-contractors in the previous month (ending on the 5th). The return must also include details of the tax deducted (if any) and any materials provided by the sub-contractor.

Contractors who choose to pay tax quarterly will still be required to submit an online return every month.

Returns do not need to be submitted where no payments have been made in the previous month although contractors are asked to notify HMRC that no return is due in order to prevent an automatic fixed penalty notice being issued. Any penalty notices issued for nil returns will be cancelled.

No annual return is due under the CIS.

Contractors have to make a declaration each month, on the return, that they have considered the employment status of each sub-contractor and they regard them as self-employed. A penalty of up to £3,000 can be charged if the wrong employment status for a sub-contractor is declared on the monthly return.

Penalties

Like many of its counterparts, the penalty regime attaching to the CIS is potentially expensive for those contractors who do not get to grips with it. For busy contractors (and their staff) who have better things to do with their time, outsourcing the CIS compliance function is therefore an attractive option.

The penalties for a late CIS return are as follows:

- £100 if the return is late;
- An additional £200 if the return is 2 months late;
- The higher of £300 or 5% of the tax due if the return is 6 months late;
- An additional £300 or 5% of the tax due if the return is 12 months late; and
- Further tax related penalties if the failure continues and information necessary for HMRC to assess the penalties is withheld.

Capping of CIS fixed penalties has applied since October 2011. Capping only applies to "new" contractors being those who until 29 October 2011 had never filed an online form CIS 300.

Capping means that the total of all the fixed CIS penalties applying during the "capping period" are subject to a maximum of £3,000. The capping period starts on the date that the contractor first had an obligation to file a CIS monthly return and ends at the 5th of the month following the date the contractor filed their first CIS 300. Capping will not therefore apply to a contractor for any periods once a CIS 300 has been filed.

Capping applies only to the fixed CIS penalties – ie, the £100 and £200 penalties. The tax geared penalties are not capped and, if applicable, will be issued in addition to the capped fixed penalties. In practice this means that while capping appears generous on the surface, in reality it is normally of limited help.

The penalties for the late payment of CIS deductions are the same as for PAYE and are based on the number of defaults in the tax year.

The first late payment in the tax year does not count as a default. Thereafter the penalty is 1% of the tax paid late for the 1st, 2nd or 3rd default rising to 2% for the 4th, 5th and 6th default, 3% for the 7th, 8th and 9th default and finally 4% for the 10th and subsequent default.

If the tax is outstanding for more than 6 months, a penalty of 5% is charged with a further 5% penalty after 12 months.

Interest is also charged on any tax paid late.

The penalty for an incorrect return is up to £3,000. As each monthly return can be eligible for a penalty, the same error repeated for a year could cost up to £36,000. However these penalties are mitigable depending on the degree of culpability and the nature of any disclosure. Errors on CIS returns can normally be corrected online (or via the CIS Helpline) and in many cases the prompt disclosure and correction of an error will avoid any penalty charge.

Contractors and their authorised agents can make an electronic appeal against CIS late-filing penalties by using HMRC's Online Penalty Appeal Service (PAS). The PAS will display the penalty details. Contractors and agents can access PAS using options in PAYE/CIS Online.

Once the appeal has been processed, a Generic Notice will be issued giving result of the appeal. This can be accessed online through the 'Generic Notices' option. Only if the appeal is rejected will it be referred to the HMRC Reviewing Officer.

Finally here are 3 (relatively) recent tax cases involving CIS compliance issues to share with you:

Barrett v HMRC (2015)

Mr. Barrett was (and probably still is for all we know) a self-employed jobbing builder. On jobs which required more than his own two hands he engaged the services of sub-contractors. He had previously worked as a sub-contractor himself for a large building contractor and had received his payments net of CIS deductions, so he had knowledge of the scheme. However he assumed (wrongly) that the CIS did not apply to small businesses like his own which mainly worked on private homes. His accountant was also blissfully unaware of this fact. Payments by Mr. Barrett to his sub-contractors were duly made gross and no CIS returns were filed and no tax deductions made.

For the 4-year period under review, the deductions which ought to have been made under CIS amounted to only £2,000. The tax at stake was not therefore a national catastrophe.

However for the period under review, nil returns were required (HMRC only agreed to not charge penalties for nil returns from April 2015). Therefore the total penalty liability for the period – bearing in mind the tax at stake was a little under £2,000 – was an eye-watering £128,000. This consisted mainly of penalties for the non-filing of monthly CIS returns plus a few penalties for the non-payment of CIS deductions.

Mr. Barrett (not surprisingly) appealed the penalties on the grounds that:

(a) The penalties were disproportionate (this was dismissed by the FTT on the grounds that they did not have the jurisdiction to consider arguments of proportionality in the context of direct tax penalties);

(b) HMRC should waive CIS payments of £1,800 in relation to a sub-contractor whose tax affairs had been (belatedly) brought up to date (this was also dismissed as the sub-contractor was so late in filing his own returns that the original determination to require Mr. Barrett to pay the CIS deductions could not be revisited); and finally

(c) He had a reasonable excuse, that being his reliance on his accountant.

The case therefore rested on point c).

The Tribunal held that it was reasonable for Mr. Barrett to rely on his accountant in this case. Mr. Barrett's awareness of the CIS had arisen in a different context and did not mean that he ought therefore to have understood its wider impact.

The accountant on the other hand was a professional engaged by Mr. Barrett to deal with his accounts and his tax obligations including PAYE and related matters. The accountant was fully aware that Mr. Barrett was engaging sub-contractors. Mr. Barrett had supplied all relevant information and would have been entitled to rely on his accountant to draw his attention to any relevant filing obligations.

As the Judge said…

"It would also have been reasonable for such a taxpayer to have concluded, from his accountant's silence, that there were no such obligations outstanding."

For this reason, Mr. Barrett's appeal against the penalties was allowed.

Schotten & Hansen (UK) Ltd v HMRC (2017)

Schotten & Hansen (UK) Ltd ('S&H') is a UK company that supplies and fits high-end wooden flooring. The directors (Mr. & Mrs. Hansen) had come to the UK from Denmark in 2002.

Some of the flooring is imported from Germany and is of such a high specification that S&H – on the occasions that this flooring was ordered by a customer - engage the services of a German company to carry out the installation work. On such occasions, the German company sent a fitter from Germany to the UK and S&H paid the fitter's labour and travel expenses. The German company supplying the fitters was S&H's only sub-contractor (all other jobs were carried out by its UK employees).

HMRC carried out a CIS compliance check and discovered that S&H had not deducted 30% tax from payments made to the German sub-contractor (the German company had not registered as a subcontractor in the UK so the 30% deduction technically applied). The tax which should have been deducted in the period under review came to £395,000. Penalty notices for the late filing of CIS returns and non-payment of tax were subsequently issued in the amount of £28,000.

S&H explained that it had taken advice on their UK tax obligations (including the CIS) from a "major international firm of accountants" which it knew and trusted (having previously used their Danish counterparts at home). S&H registered for the CIS in 2005 but no returns had been filed as no UK sub-contractors were used. S&H had no reason to believe that a German sub-contractor would fall within the CIS and this had not been pointed out to them by their accountants who were also unaware that the CIS applied to foreign sub-contractors. This was therefore a single error which was repeated year-on-year. S&H therefore had a "reasonable excuse" for failing to submit CIS returns.

The Tribunal decided that it was not unreasonable for S&H to assume that their UK accountants would properly and fully advise them of their UK compliance obligations. The taxpayers had come to the UK and had engaged the services of an accountancy firm in the UK which they trusted. It was unreasonable to expect the company to check whether tax should be deducted from payments to a foreign sub-contractor.

The Tribunal therefore concluded the taxpayer had a reasonable excuse and set aside the penalties.

This is not the first time that we have seen the Tribunal give a sympathetic hearing to taxpayers who argued that the failings of their accountant or tax adviser is a reasonable excuse when considering liability to penalties. It seems that the world is cottoning-on to the common sense viewpoint that if you pay someone to do a job and they don't do it properly, then what happens after that is not your fault.

JP Whitter (Waterwell Engineers) Ltd v HMRC (2017)

Finally here, the First Tier Tribunal case of JP Whitter (Waterwell Engineers) Ltd v HMRC (2017) which concerned HMRC's decision to withdraw gross payment status from the sub-contractor company on the basis of a number of PAYE failings in the preceding 12 months.

The company accepted that 7 of the previous 12 PAYE payments had been late and did not put forward any reasonable excuse for the late payment. However, the company argued that the withdrawal of gross payment status would inevitably lead to a loss of some (if not all) of its major contracts, and that this would in turn lead to job losses.

The company's appeal was on the grounds that in a 2011 FTT case (Scofield v HMRC), the Tribunal had said that HMRC has a power but not an obligation to remove gross payments status. Gross payment status should not therefore be removed automatically and HMRC should instead exercise its discretion before so-doing. The company argued that when exercising their discretion, HMRC was obliged to consider the wider impact of any decision to remove the company's gross payment status.

The FTT agreed that taxpayers within the CIS have various safeguards against the removal of gross payment status and that HMRC has discretionary powers to allow a taxpayer to retain that status despite minor compliance failings.

However the consideration of what the Judge called "matters extraneous to the CIS regime" was not one of the safeguards within the CIS code and HMRC's discretion should be limited to the matters set out in that code. The CIS rules protect taxpayers from penalty sanction if the taxpayer has a reasonable excuse for non-compliance. The company had no such excuse. The CIS code makes no reference to the financial impact on a business of removing its gross payment status so this should not be a matter HMRC is obliged to consider. The appeal was denied.

This seems a little harsh as gross payments status is – if you think about it – just a question of cash flow and cash-flow is far more important to small businesses than it is the Government (the UK is already £1.8 trillion in debt so waiting a few extra months to collect JP Whitter's tax wouldn't have been life-changing). And it was not as if the appellant company here had not already been punished for its PAYE failures (interest having been charged on the PAYE paid late). Denial of gross payments status was therefore something of a double-whammy.

In reality the appellant company was probably already on a yellow-card with HMRC (more accurately on several yellow cards) having previously been given some leeway with regard to its previous misdemeanors, so its consistent inability to comply with its PAYE responsibilities seems to have pushed HMRC right to the end of its tether. One would hope that businesses in a similar position who had not incurred the wrath of HMRC to the same extent as JP Whitter Ltd might get a more sympathetic hearing.

And I've just clicked on JP Whitter's website and it seems they are alive and well and have not been driven out of business by this setback which is good to see. So if you live in East Lancashire and need a submersible pump to be installed in your borehole, give them a go. [In the interests of balance, other Lancastrian submersible borehole pump installers are available.]

Losses on financial instruments

Summary – The taxpayer was trading on a commercial basis with a view to making profits.

Mr Gill started buying and selling shares in 1995. He viewed the initial period of trading, whilst a student, as a learning experience. After completing his education initially Mr Gill established a routine whereby he would work not only whilst the market was open (8am to 4.30pm) but also 30 additional hours to be able to conduct research.

Over the years he expanded the range of what he traded in as well as where he traded. His typical working day ran from 7.30 am to 11pm. He had a "virtual office" consisting of several laptops, that he used when he was abroad, and he would follow the same working day pattern even when he was on holiday. The only "real break" that he had from trading would be during Christmas when the markets were closed

He had specific strategies that he followed and for many years was profitable. However, a number of global economic events led to great uncertainty and volatility in the markets in the appeal year and this made it difficult for Mr Gill to use his normal trading strategies profitably. He had not experienced such volatile market conditions previously. The factors resulting in volatility and uncertainty included the repercussions of the 2008 financial crash and the Greek debt crisis.

This was an appeal against a decision of HMRC, contained in a closure notice that Mr Gill was not trading, or alternatively if he was trading then he was not doing so "on a commercial basis" or "with a view to the realisation of profits" as required by s.66 Income Tax Act 2007 for relief to be available for the several million pounds of losses that he had generated.

Decision

The First Tier Tribunal considered the Badges of Trade concluding that four of the badges of trade (length of the period of ownership, frequency of similar transactions, circumstances that were responsible for the realisation, and motive), are highly indicative of trading. The question of the subject matter of realisation is more mixed. Some of the assets in which Mr Gill dealt were conventional stocks and shares, and were therefore capable of producing income, and might be regarded as a characteristic of an investment, but many were derivative instruments that do not, in the judge's view, have the character of investments. They are primarily short term assets from which a dealer might expect to make profits by regular buying and selling. 'Supplementary work' was not considered relevant. They concluded that, based on the size and frequency, and the rapid and continuous turnover of Mr Gill's transactions, and the fact that he did have a deliberate and organised scheme of profit-making, Mr Gill's was carrying on a trade for tax purposes.

Mr Gill changed strategies when he realised that his initial strategies were not working, and indeed, he probably changed those strategies more quickly than larger organisations, whose very nature makes them less able to change direction rapidly. The Tribunal said that Mr Gill's change in strategy was not whimsical or haphazard but rather he had a clear commercial motivation for what he did. He carried out an evaluation of his trades in order to ascertain what had gone wrong and in fact came to the conclusion that his stop loss policies had been set too close to his entry price and had therefore stopped him out from trades which would have been profitable had he held them for longer. If anything therefore this showed that his risk management strategies were over-cautious rather than reckless.

It did take some months before he realised this and he adapted his trading accordingly, but I do not regard this delay as a sign of haphazardness or casualness.

The Tribunal believed that Mr Gill had a serious interest in profits and a serious interest in making a success of his trade. It was the sole means of supporting his family, and had been for some time. In addition his eventual aim was to set up a hedge fund to which third party investors would be attracted. He therefore had a very serious interest in making a success of this trade.

Until the appeal year, Mr Gill had been a very successful trader utilising many of the strategies used in the appeal year. On this basis alone the Tribunal found that there was indeed a reasonable prospect of making profits from his trading activities.

The Tribunal concluded that Mr Gill was indeed trading with a view to making profits.

Rajesh Gill v HMRC (TC06477)

Partnership units were not intangible fixed assets

Summary - The acquisition of partnership units by the UK permanent establishments of US entities did not constitute the acquisition of intangible fixed assets.

Bloomberg Inc was a US resident company, and BLP Acquisition Holding LLC was a US LLC.

Both entities had increased their holding of units in BLP, a Delaware registered limited partnership. They considered that under the UK/US double tax treaty Art 7, their UK permanent establishments should be treated as separate and distinct from them. They also believed that the UK permanent establishments should be regarded as having acquired intangible fixed assets when they acquired the units. They had therefore made elections under FA 2002 Sch 29, which allows a debit to be brought into account for corporation tax purposes in relation to the writing down of the capitalised cost of an intangible fixed assets on a fixed rate basis.

HMRC had refused these elections arguing that the relevant trade in the UK was carried out at the partnership's level, so that the relevant accounts were those of the partnership and the partnership had not acquired intangible fixed assets.

Decision

The First Tier Tribunal held that the entities should be treated as trading in the UK through the permanent establishments through which the partnership business was carried on. It was therefore necessary to determine the profits of that trade and attribute that to the UK permanent establishments.

The issue was whether the fact that the UK/US double tax treaty treated the PEs as separate and distinct entities meant that the transaction had been a transfer of assets to them. Referring to the OECD 2000 commentary, the First Tier Tribunal thought that there was 'ample support' for HMRC's submission that the function of the treaty is the allocation of taxing rights. The First Tier Tribunal accepted that both the treaty and the supporting material supported a factual or functional analysis, as a legal one 'would not work', since a permanent establishment does not have legal personality.

However, this did not mean that the transaction was a transfer of assets. The fact that the partnership was fiscally transparent did not mean that the permanent establishments were the economic owners of its underlying assets.

The tribunal also rejected the appellants' contention that HMRC's analysis meant that the acquisition of the units had no tax implications, which could not have been intended. Agreeing with HMRC, the First Tier Tribunal thought that this was not an anomaly, as nothing had happened at the level of the partnership.

Bloomberg Inc and BLP Acquisition Holdings LLC v HMRC (TC06449)

Adapted from case summary in Tax Journal (4 May 2018)

Meaning of trade

Summary - The taxpayer's activity, although relating to his other business activities, did not amount to a trade.

Jerome Anderson had claimed losses of around £3m. He had invested the amounts claimed in a South African soccer academy, Bafana, having borrowed the amount from a Jersey based entity, Maddox.

HMRC considered that these losses from activities undertaken to develop and bring young South African footballing talent to the European football market, were not allowable.

There were two issues:

1. Was HMRC's discovery assessment was valid?

2. Had Jerome Anderson been carrying on a trade on a commercial basis with a view profit?

Decision

The Upper Tribunal observed that: 'The officer must believe that the information available to him points in the direction of there being an insufficiency of tax' and added that 'The discovery must be something more than suspicion of an insufficiency of tax and it need not go so far as a conclusion that an insufficiency of tax is more probable than not.' They added that there was an objective test as well, which is that the belief of the officer must be reasonable. They accepted the First tier Tribunal’s finding that the officer had the appropriate belief, noting that her belief went beyond a 'mere suspicion' and that this belief was reasonable, given all the information available to her. It concluded that the discovery assessment was valid.

The Upper Tribunal agreed with the First Tier Tribunal’s decision that, as a matter of fact, Jerome Anderson's activities were more akin to those of an investor in a market comprising young African footballers, but with no substantial active day-to-day involvement in the activity. Finally, agreeing with the First Tier Tribunal, the Upper Tribunal found that the fact that Jerome Anderson was not an amateur or dilettante was not sufficient to establish his serious interest in profit. It accepted the First Tier Tribunal’s finding that Jerome Anderson had not taken sufficient steps to indicate that his purpose met the statutory requirements.

Jerome Anderson v HMRC [2018] UKUT 159

Adapted from case summary in Tax Journal (25 May 2018)

Eradication of aggressive corporate tax planning!

Just 330 businesses told HMRC they were using corporation tax planning schemes in 2016-17, down 42% from 2015-16 and 88% from a peak of 2,860 four years ago, according to figures obtained from UHY Hacker Young. The firm says the statistics show that a series of government crackdowns in recent years have almost eradicated aggressive corporation tax planning.

Partner Clive Gawthorpe said:

> 'The corporation tax planning scheme is now virtually dead — HMRC can claim to have won the war on aggressive tax planning by businesses. Once-commonplace schemes like employee benefit trusts have almost completely died out, with only a small number remaining. Many of those businesses are likely to be in the process of settling or litigating with HMRC over them.'

The Revenue's recent powers to tackle tax avoidance include accelerated payment notices, new criminal penalties for enablers of tax avoidance and the general anti-abuse rule. However, given the falling participation in schemes, Mr Gawthorpe questioned the need to add to its weaponry: 'These figures really raise the question of why that is necessary.'

Taxation magazine (10 May 2018)

Valid claim for capital allowances?

Summary - Claims for capital allowances had been submitted late but, as a result of HMRC's enquiries, had become valid.

Dundas Heritable Limited operated a number of public houses and bars.

For the years to 31 March 2012 and 31 March 2013, the company claimed capital allowances that should have been claimed by 31 March 2014 and 31 March 2015 respectively. However the relevant company's returns were not received by HMRC until February 2015 and November 2015. At this point both capital allowance claims were late.

However, HMRC had opened enquiries in relation to capital allowances. Did this extend the time limit for the capital allowances claims?

- Dundas Heritable Limited argued that para 82 provided that one of the applicable time limits was 30 days after the closing of an enquiry.

- HMRC argued that whether a claim is valid should be decided at the time it is made by reference to the time limit applicable at that time; and that there were no enquiries at the time the claims were made.

Decision

The First Tier Tribunal believed that Parliament wished a taxpayer who was subject to an enquiry to have the benefit of any reliefs. There were four possible deadlines in para 82 and a claim was in time if lodged 'at any time' before the last of them.

Dundas Heritable Limited v HMRC (TC06476)

Acquisition of trading losses

Summary - The company that had acquired a business with substantial trading losses, was not entitled to set off that business' losses against the future profits of the enlarged business for the purposes of corporation tax.

The taxpayer department store acquired and rebranded a second department store which had accumulated losses. The company claimed relief for the losses against post acquisition trading income. However, HMRC disallowed the claim

The company appealed to the First-tier Tribunal who found in favour of Leekes Ltd but on appeal, the Upper Tribunal overturned the decision.

The issue to be decided by the Court of Appeal was where a company succeeded to a trade where losses had been incurred and that trade formed part of a larger trade carried on by the successor including its existing trade, could these losses be carried forward and set against profits of the enlarged trade?

Decision

The Court concluded that a successor was entitled to relief if the predecessor had itself continued to carry on the trade. The words 'the trade' could only refer to the trade previously carried on by the second company. They could not refer to the enlarged trade carried on by the company, because that trade had never been carried on by the second company, and the second company could not therefore be deemed to have continued to carry it on.

Leekes Ltd v HMRC [2018] EWCA Civ 1185

Corporation tax loss relief –from 1 April 2017 (Lecture B1079 – 20.27 minutes)

More flexible use of brought forward losses

Certain corporation tax loss amounts incurred from 1 April 2017 can be carried forward against all income and gains and those of 75% group companies in future. Group relief of brought forward losses is only after the company that incurred the loss has reduced its relevant profits by the maximum amount in that period.

A company that does not have a period to 31 March 2018 will need to apportion any profit or loss on a just and reasonable basis, though there are special rules in some situations.

This flexible use of brought forward losses covers:

- trading losses;
- non-trading loan relationship deficits;
- management expenses of investment companies;
- UK property losses; and
- non-trading losses on intangible fixed assets

If the trade falls to a negligible level after1 April 2017, trade losses from then can only be carried forward against future profit of same trade.

Separate records of Pre-1 April and post 1- April 2017 will need to be kept as will post- 1 April 2017 losses that can only be used against profits of the same trade to ensure the correct set-off is made.

Restriction on the amount of losses brought forward that can be set off in a period

The set off of losses brought forward in a particular period is limited to £5m plus 50% of profits above £5m. This is a group wide limit and for a period of 12 months – in a short accounting period the £5m will need to be time-apportioned.

A group can choose how to allocate the £5m allowance to each company.

This restriction does not just apply to losses from 1 April 2017, but older losses brought forward as well.

Capital losses can still only be offset against gains, but without any £5m restriction.

Loss pro-forma approach

Calculate the company's taxable profits after all reliefs (including in-year losses and group relief), but exclude:

- carried forward losses;
- carried back reliefs; and
- post-31 March 2017 carried forward losses to be claimed from other group companies;
- Allow up to £5,000,000 of these profits to be relieved in full by carried forward losses;
- Allow up to 50% of the remaining profits to be relieved by the remaining carried forward losses (with pre-1 April 2017 losses to be used in priority to later ones); and
- If there are still profits which can be relieved within the 50% limit, allow them to be relieved by post-31 March 2017 carried forward losses which have been claimed from other group companies.

Other points

Losses carried back from a later year are not deducted in arriving at the 50% of profit above £5m figure for current year loss set-off.

If the profit for the current period is both trading and non-trading, allocate in-year losses and group relief pro-rata. This may then affect the ability to utilise pre-1 April 2017 brought forward losses.

Groups can allocate their £5m allowance to group companies in any proportion they choose.

Pre 1 April 2017 losses can only be carried forward against profits of the same trade. They are however subject to the 50% restriction and £5m allowance.

Principles not affected by the new rules

Loss carry back – still attractive as there is no £5m cap on the amount of losses carried back, so they are fully deductible.

Cessation rules for trading and property businesses will not change. E.g. terminal loss relief of losses made in final accounting period – still carry back against trading profits of the previous 3 years (LIFO basis)

Any losses brought forward for periods before the period when the trade ceases can be carried back three years against all income and gains without the £5m restriction applying

The set off of capital losses is unaffected as seen earlier.

Anti-avoidance rules

There have been some changes to the loss anti-avoidance rules to cater for the possible abuse of the flexible set off of post 1-April 2017 loss amounts. If a company with post 1-April 2017 losses brought forward is acquired, the new group it has joined cannot use those losses for a period of 5 years by means of group relief. There are also rules to prevent the use of the acquired company's brought forward losses by allocating gains to it from other group companies.

Major change in nature of conduct of trade ("MCINOCOT")

If there is a MCINICOT and within 3 years the ownership of the company changes, any remaining trade losses are forfeited (as before).

If there is change in ownership of the company, followed by a MCINICOT in the following 5 years, any remaining losses are forfeited (an increase from 3 years).

Winners

- Small groups unlikely to have more than £5m of losses or for which this is a high proportion of the total - £5m exclusion from the 50% rule will then benefit them (but unless the £5m is index-linked, its value will erode over time).
- Groups with post-2017 losses which would have become trapped losses (more flexible offset will outweigh impact of the 50% restriction).

Losers

- Large groups with bad trading year post April 2017 (in past relief in full against the next available trading profits but where relief now spread forward).
- Capital intensive businesses or high risk start-up businesses with deep initial losses
- Groups with unpredictable income patterns e.g. split between trading and non-trading income may be difficult to judge most efficient use of tax losses within election time limits
- Groups and entities where there is a variable split between trading and non-trading income (can lead to distortion).

Contributed by Malcolm Greenbaum

Withholding tax on manufactured overseas dividends

Summary - The imposition of withholding tax on manufactured overseas dividends (MODs) was contrary to EU law.

Coal Staff Superannuation Scheme Trustees had responsibility for managing the UK Coal Staff Superannuation Scheme. It had claimed repayment of withholding tax in connection with stock lending transactions. Typical stock lending arrangements involve institutional investors transferring legal and beneficial ownership of shares to a borrower on terms that, at the end of the stock loan, the shares or an equivalent number of shares will be transferred back to the lender. The contractual terms of a stock lending transaction involve an obligation on the borrower to provide the lender with a payment of equivalent value to any dividends paid during the term of the loan. These payments are known as manufactured dividends (MDs); and, when they relate to dividends derived from overseas shares, as MODs.

In the relevant tax years, the UK imposed no charge to UK income tax or corporation tax on MDs paid in respect of shares in UK companies; however, it imposed a withholding tax on MODs where a withholding tax would have been imposed by the country of origin had the MOD been an actual dividend (ICTA 1988 Sch 23A). Furthermore, the trustees were exempt from tax on their investment income (FA 2004 s 186), so that no double taxation relief or credit was available for this deemed overseas tax (ICTA 1988 s 796). The issue was whether EU law permitted the UK to charge withholding tax on MODs when it did not charge any tax or equivalent tax on MDs in relation to UK shares.

Decision

The Upper Tribunal concluded that the First Tier Tribunal had been right to find that the acquisition of overseas shares by the trustee was a movement of capital within TFEU article 63. The question was therefore whether the relevant UK provisions were capable of restricting the exercise of the freedom of movement of capital. The UT noted that the tax imposed on MODs by the UK amounted to a cost, as it was not recoverable; and no such cost arose in the case of stock lending using UK shares. This difference amounted to a restriction on the movement of capital which was predicated entirely on whether the shares employed in a stock lending transaction were overseas shares or UK shares, and an investment in overseas shares used for stock lending was directly and objectively comparable to an investment in UK shares used for the same purpose.

Coal Staff Superannuation Scheme Trustees v HMRC [2018] UKUT 152

Adapted from case summary in Tax Journal (24 May 2018)

VAT

Zero rated construction costs

Summary – Building D qualified for zero rating as a separate building and if wrong, it would still qualify for zero-rating as a qualifying annexe.

A new block, Building D, was constructed at St Brendan's Sixth Form College, which provided additional teaching space, a café, a staff room and socialisation space for the students. The issue was whether this new building qualified for zero-rating under Item 2, Group 5, Sch 8, VATA 1994.

Building D was built 7.1m away from the existing Building C. It was built some years after Building C and was noticeably different from it in terms of its design and materials. The building consists of two floors with its own entrance at ground level. It has its own utility supplies and toilets. The two buildings are linked by a covered bridge/walkway at first floor level. This bridge is fully enclosed but it is not heated and has double doors at both ends, into Building C and Building D.

Building D does not have a lift for access to its first floor. There is a lift in Building C but this is not suitable for use by wheelchair users and is key operated, and is for the sole use of premises staff. It is not available for use by either students or teachers. The only access to the first floor of Building D for wheelchair users therefore is via a lift in the main college building, Building B, and then via a bridge/walkway that connects Building B to Building C, and then via the link bridge that connects Building C to Building D. The college organised the timetable such that all lessons in which wheelchair users participated took place on the ground floor of the building. The doors into classrooms and the doors at either end of the link walkway are not automatic and only open one-way. Wheelchair users therefore require assistance to use these doors. The entrance door on the ground floor of Building D however is automatic, and is therefore suitable for wheelchair users.

HMRC argued that the Building D was not a separate building because of the link bridge, which physically connected all the buildings on the site such that they could function as a single entity. The activities carried on in the new building were similar to those carried on elsewhere within the college, and so the building was merely an extension of the existing buildings.

Decision

The Tribunal did not consider that the existence of the link bridge, on its own, was sufficient connection with the main building to mean that Building D was not a separate building. In their view it was a separate building.

They concluded that if this interpretation was correct then the construction works in question fell to be treated as zero-rated under Item 2 of Group 5 of Schedule 8 without any further consideration. However, for completeness, they also considered that if they were wrong on this point, whether or not the building still qualified for zero-rating as an annexe, in accordance with Note 17 to Group 5

The Tribunal concluded that the main access to Building D was via its own ground floor entrance door and that this is not the main access to Building C. This fulfilled the condition set out in Note 17 condition (b).

Condition (a) was the condition being challenged by HMRC who argued that as the building on its own does not provide access to the first floor for wheelchair users then Building D cannot function independently from the existing building. They said that in the absence of the link bridge Building D does not fulfil the requirements of the Disability Discrimination legislation.

The Tribunal concluded that the Equality Act 2010 does not impose obligations on the building as such, as might be the case with Fire Regulations. It imposes obligations on the college, who have explained how they organise lessons to cater for the fact that the building does not have its own access to the first floor for wheelchair users. They did not therefore consider that the inability of wheelchair users to access the first floor of Building D in the absence of the link bridge disqualifies it from being able to function independently.

They held that even if they were wrong as to whether or not the new building was a separate building, it would still qualify for zero-rating in accordance with Note 17 to Group 5 of Schedule 8 VATA 1994 as a qualifying annexe.

St Brendan's Sixth Form College v HMRC (TC06384)

Is the provision of courses for subsidised fees an economic activity?

Summary – Wakefield College was providing education in the course of an economic activity, so that the supplies of construction services it had received were not zero-rated under Schedule 8 Group 5 VATA 1994.

Both parties agreed that the college was a charity and that following the construction of the building, the college intended to make use of it for the provision of further and higher education, and that this was capable of amounting to a relevant charitable purpose.

A new college building had been constructed but HMRC had refused to authorise Wakefield to issue a zero-rating certificate to the builders.

The issue was whether the provision of further education courses to students paying a fixed but publicly subsidised fee amounted to the carrying out of an economic activity (VATA 1994 Sch 8 implementing the Principal VAT Directive art 9).

Decision

The Court of Appeal observed that whether there is a supply for consideration and whether that supply constitutes an economic activity are separate questions; a supply for consideration is a necessary but not sufficient condition for an economic activity.

- The first condition requires a legal relationship with reciprocal performance between the supplier and the recipient, the 'direct link' referred to in Borsele (Case C-520/14). It was accepted that this condition was satisfied; the fee paid was consideration for the supply of education.

- The economic activity condition means that the supply must be made for the purpose of obtaining an income; this is an objective test. The court found that the economic activity condition was also satisfied. The college's main activity was the supply of education and the subsidised fees represented a significant part of its undertaking, both in value and in relation to the cost of providing the relevant courses. Furthermore, the fees paid by the students were calculated by reference to the cost of providing the courses and not to the means of the relevant students.

Wakefield College v HMRC [2018] EWCA Civ 952

Adapted from case summary in Tax Journal (11 May 2018)

Marriott loyalty scheme

Summary – Payments by redeemer hotels to Marriott Rewards LLC, the reward scheme operator, were not third party consideration but were for supplies made to the operator. However, the claims failed on other issues.

Marriott Rewards LLC is a US based company that is a wholly-owned indirect subsidiary of Marriott International Inc. It operated a customer loyalty scheme (the program), in connection with hotels operated by the Marriott group (the group).

Whitbread Group plc, a UK company that owned hotels operated under a franchise agreement with the group, took part in the program. Whenever a customer who was a member of the program (the member) purchased a qualifying stay at a participating hotel, or a non-hotel participant in the program (in that capacity, a 'sponsor'), Marriott Rewards LLC issued reward points to the member, calculated on the basis of the amount paid by the member to the sponsor. Every time a member stayed at a participating hotel and earned points, that hotel was obliged to pay a fee to another group company (G), a company incorporated in Luxembourg. Marriott Rewards LLC did not contract directly with hotels that participated in the program.

When a member had earned enough reward points, they could use those points to obtain a a ‘reward’ stay at a participating hotel. Redeemers, including Whitbread Group plc, were the hotels, or other participants, who provided goods or services on redemptions of points. When points were used to obtain rewards, Marriott Rewards LLC made a payment to the relevant redeemers.

The First Tier Tribunal had held that HMRC were wrong finding that payments to Redeemers were consideration for services that Redeemers were providing to Marriott Rewards and not third party consideration (issue 1).

However, they held that the relevant supplies were neither services connected with immovable property, as argued by Marriott Rewards LLC or advertising services, as argued by Whitbread Group plc (issue 2).

Both parties and HMRC appealed to the Upper Tribunal.

Decision

On issue 1 the Upper Tribunal held that the agreements between Marriott Rewards and the participating hotels was for the hotels to provide 'free' accommodation to customers redeeming points. This was not third party consideration for the customer's stay but rather a 'redemption' service to Marriott Rewards.

On issue 2, The Upper Tribunal disagreed with both Marriott Rewards and Whitbread. The supply was a redemption service, the place of supply for which was the UK prior to 1 January 2010 and the USA after that date. Neither Marriott Rewards nor Whitbread's claims would be paid.

The appeals were dismissed

Marriott Rewards LLC and Whitbread Group PLC v The Commissioners for HM Revenue and Customs: [2018] UKUT 0129 (TCC)

Flat rate scheme – where are we now? (Lecture B 1080 – 13.04 minutes)

Introduction

It is one year since the most important date in the history of the flat rate scheme (FRS), when a new category was introduced for a 'limited cost business' on 1 April 2017. In a nutshell, this new 16.5% rate applies to users that spend either less than 2% of their gross sales on goods or £250 in a VAT quarter. The excessively high rate has wiped out the financial gains previously enjoyed by thousands of businesses across the UK, particularly those involved in selling standard rated services, with not much input tax to claim. In many cases, these businesses qualified for a favourable rate of 12% for 'business services not listed elsewhere'. So the key question is as follows: does the FRS still serve a purpose for some SMEs? And in this age of easy to use accounting software and apps, are the scheme's time saving benefits that HMRC promote with such enthusiasm really worthwhile?

Background

The main principles of the FRS are as follows:

- A business chooses its relevant category from a list of 54 activities published via Notice 733, section 4 and applies this percentage to its VAT inclusive business income for the period in question. This calculation includes income from zero-rated and exempt sales but not those that are outside the scope of VAT, e.g. most sales of services to B2B customers based outside the UK are excluded.

- A business can claim input tax on capital expenditure goods where the cost of the item exceeds £2,000 including VAT. All other input tax is lost.

The scheme can only be adopted by a business that expects its taxable sales excluding VAT to be less than £150,000 in the next 12 months.

So what has been the outcome of the new limited cost trader category? See Increased VAT bill.

Increased VAT bill

John is a health and safety consultant with annual sales of £150,000 excluding VAT. His annual input tax is only £500. He does not purchase goods where the total cost exceeds £250 in a VAT quarter or 2% of his gross sales.

John's annual VAT bill until 31 March 2017 would have been £21,600 i.e. gross income of £180,000 x 12%. This is because his relevant FRS category would have been 'business services not listed elsewhere'.

After 1 April 2017, his annual FRS liability increased to £29,700 because he is now a 'limited cost business' with a rate of 16.5%.

John's 'annual windfall' of £7,900 compared to normal VAT accounting (£30,000 less £500 input tax compared to £21,600) has been eliminated and he would be £200 better off using normal accounting from 1 April 2017 rather than the FRS i.e. the usual output tax less input tax calculation (£29,700 compared to £29,500).

The time saving benefit

HMRC would argue that the extra VAT paid by John is a worthwhile cost because he is still saving time by using the scheme (he has no need to worry about input tax) and there is less risk of making errors on his returns. However, my counter argument is that there are so many quirks with the FRS that the risk of errors is higher than with normal VAT accounting. See Flat rate scheme quirks.

Flat rate scheme quirks

The sale of a business car is subject to FRS tax, even when no output tax is charged on the sale or input tax claimed on the original purchase of the vehicle.

The opportunity to claim input tax on capital expenditure costing more than £2,000 including VAT is only relevant to 'goods' and not 'services'. So a hairdresser fitting out a new salon or building an extension would not be able to claim input tax on these costs.

If a legal entity has income from buy to let residential property, the income is captured by the scheme.

A builder joining the scheme might come within three different categories, depending on how much he spends on building materials.

The rules on 'relevant goods' for limited cost traders are very complicated with a lot of exclusions from the figures e.g. you exclude spending on food and drink consumed by business owners or staff and only include food or drink for resale (Notice 733, para 4.6).

Many clients get confused about the difference between exempt, zero-rated and outside the scope sales and sometimes forget that the FRS calculations are based on VAT inclusive income.

Some clients find it tricky to identify their correct category – for example, HMRC rightly issued an assessment to a farming contractor for choosing the 6.5% rate for 'Farming or agriculture not listed elsewhere' when he should have chosen the 11% rate for 'Agricultural services'.

Potential tax savings?

Having dismissed the time saving benefits in most cases, the key question is whether there are categories where the rate is quite generous and we should therefore encourage our clients to adopt it and possibly save tax. Here are my 'top five' selections that might be worth considering:

- Advertising 11% - if an advertising business has enough spending on goods to keep out of the limited cost trader category and does not have a lot of input tax on its other spending, 11% is potentially a good rate for any service business;

- Computer repair services 10.5% - the same logic as above;

- Entertainment or journalism 12.5% - the trick here might be for journalists to buy hard copy books rather than online publications for their research. The books are zero-rated (so no loss of input tax) and the spending will also help them reach the £250/2% limit for spending on goods to avoid the limited cost trader category;

- Hotel or accommodation 10.5% - the FRS might be good for a small B&B business but proceed with caution. As soon as a big repair bill hits the fan, or building improvements are carried out, the scheme gains could be instantly wiped out;

- Repairing vehicles 8.5% - an accountant I know decided the scheme would be a winner for a car repair business he acted for but didn't realise that the rent for his garage was standard rated rather than exempt because the landlord had opted to tax the building. This extra input tax made the scheme a non-starter despite the favourable percentage.

Options

In the lead up to the introduction of the limited cost trader category, I took two key measures with my private clients and still apply the same thinking one year on:

1. For those entities registered for VAT on a voluntary basis (annual taxable sales are less than £85,000), and that did not have much input tax to claim, we deregistered the business. I knew at the time that I was also taking them out of the potential problem of having to become MTD compliant from April 2019.

2. For clients where VAT registration was compulsory, or those voluntarily registered with worthwhile amounts of input tax to claim, I withdrew them from the FRS and reverted to normal VAT accounting. Don't forget to notify HMRC of the withdrawal (Notice 733, para 12.1). This proved to be a good decision in the case of one of my clients who does public relations work because she started to use the services of a VAT registered subcontractor on a big project and was able to fully claim input tax on these expenses.

So overall, it is fair to conclude that the tax bonanzas enjoyed my many SMEs between 2003 and 2017 are now in the past. As the old saying goes 'all good things come to an end!'

Contributed by Neil Warren

Recovery of VAT on investment management fees

Summary - In a claim for deduction of input tax, where the management fees were incurred in relation to a non-taxable investment activity, there remained a lack of clarity as to whether it was nonetheless possible to make the necessary link between those costs and the economic activities that were subsidised with the investment income which was produced.

The university provided goods and services that fell under both taxed and exempt transactions with residual input VAT apportioned between both types of transactions using a special method agreed with HMRC, known as the Committee of Vice Chancellors and Principals Agreement (the CVCP agreement).

In 2009, KPMG LLP made a claim on behalf of the university for a repayment of input tax of £182,501 incurred on the investment of management fees paid to the managers of a fund. The basis of the claim was that the input tax incurred on fund management charges should be treated as residual input tax and deductible in accordance with the CVCP agreement as the income generated from the investment activities was only used to provide funds to support the normal activities (taxable and exempt) and non-business activities of the university.

Even if the expenditure could not, by its nature, be said to be part of the general expenses of running the business, an argument has sometimes arisen as to which of a number of output supplies (some taxable, some exempt or non-taxable) it was objectively connected. Some of that reasoning was highly abstract.

The university contended that the management of the fund was not an end in itself and would not have been carried out but for the purpose of generating income for use in the subsidy of the whole range of the university's economic (and non-economic) activities which included the making of taxable supplies. The fees involved should therefore be treated as part of its overheads and dealt with as residual input tax under the PESM.

HMRC contended that the fees were directly and immediately linked to the non-taxable transactions carried out by F&CM and could not therefore be an overhead for VAT purposes. Putting the argument in that way meant that the issue went beyond a mere question of classification and involved a consideration of the proper interaction or operation of the two lines of reasoning which the Court of Justice of the European Union (CJEU) had developed to deal with the deductibility of input tax in such circumstances. The issue in all these cases was one of attribution.

Decision

The approach to be taken to the issue of attribution in the present case was not acte clair. The matter would accordingly be referred for guidance to the CJEU under art 267 Treaty on the Functioning of the European Union.

In particular, there remained a lack of clarity as to whether in such a case where the management fees had been incurred in relation (and only in relation) to a non-taxable investment activity, it was nonetheless possible to make the necessary link between those costs and the economic activities which were subsidised with the investment income which had been produced.

As part of the same issue, confirmation was also needed on the decision of Sveda UAB v Valstybine[2015] All ER (D) 31 (Nov) and whether it had been correct to say that no distinction was to be made between exempt and non-taxable transactions for the purpose of deciding whether input tax was deductible.

HMRC v Chancellor, Master and Scholars of the University of Cambridge [2018] EWCA Civ 568

Adapted from Tolleys Tax Guidance