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Personal tax

Is it a van or is it a car? (Lecture P1136 – 19.10 minutes)

Summary – Two similar looking vehicles provided by Coca-Cola to their employees were treated differently for benefit in kind purposes: one was a van and the other a car.

At relevant times, Coca-Cola European Partners Great Britain Limited ("Coca- Cola") employed Mr Payne and Mr Garbett as technicians. In connection with that employment, in the tax year 2016/17, Coca-Cola provided them with the use of a second generation VW Transporter T5 Kombi van ("Kombi 2"). In addition, in the tax year 2011/12, Coca-Cola provided other employees with the use of first generation VW Kombi Transporter T5 vans ("Kombi 1") and Vauxhall Vivaro vans ("Vivaro").

- Both Kombi vans were acquired with a second row of seats already fitted but which were removable without tools and were removed during working hours.
- The Vivaro was a van that was subsequently modified to add a second row of two extra removable seats, with some storage space to the side. These extra seats needed tools to remove them

The issue in this case was whether these vehicles were cars or vans for benefit in kind purposes. While a car is not a goods vehicle, a van is defined as a goods vehicle with a laden weight of up to 3.5 tonnes. The vehicle must be <u>constructed primarily for the conveyance of goods</u> and not people. Modified vehicles were the issue in this case.

Decision

The Upper Tribunal accepted the First Tier Tribunal's ruling that the decision as to whether a vehicle was a car or van should be made <u>after</u> any adaptations that are made before it was supplied to the employee. Removable items, including seats, should be considered to be part of the construction

When considering whether it was primarily suited for the conveyance of goods, the Tribunal stated that we should consider the position as a whole. If a vehicle is equally suitable for both goods and passengers, then it has no primary suitability and cannot be a van.

The Upper Tribunal agreed with the First Tier Tribunal that the:

- Kombi vehicle was a car as it could be equally used to move passengers or goods;
- Vivaro was slightly more suited for goods given the storage to the side of its second row of seats, making it a van.

So the morale of the story is that you cannot just look at the outside of the vehicle and make a judgment call; we need to know what goes on inside.

HMRC v Coca-Cola European Partners Great Britain Limited and others [2019] UKUT 0090 (TCC)

Class 1 and the intermediaries legislation (Lecture P1136 – 19.10 minutes)

Summary - The Social Security Contributions (Intermediaries) Regulations, SI 2000/727, apply where a hypothetical contract is one of deemed employment. There was no reason to give entertainers, lecturers and teachers special privileges.

Robert Glenister, a well-known actor, owned a personal service company, Big Bad Wolff Ltd, with his wife. Through this company, he provided services to clients but this is not a standard IR35 appeal.

In February 2016, HMRC raised an assessment to collect some £147,000 of Class 1 NICs covering the period from 6 April 2004 to 5 April 2014. Prior to 6 April 2014, special rules applied to entertainers, whereby they would be categorised as employed earners for NIC purposes, even in circumstances where they would be deemed self-employed for income tax purposes. The NIC Categorisation regs were repealed in 2014, so from 6 April 2014 the normal rules apply. So this case considered the interaction between the NIC Categorisation and the IR35 regulations.

Under general principals, it was agreed between the parties that Robert Glenister would have been treated as a self-employed earner and so not liable to Class 1 NICs. However, under the NIC categorisation regulations, as there was a payment of salary as part of the money paid for Robert Glenister's services, it resulted in Robert Glenister being treated as an employed earner. Consequently, he was liable for the Employee's NIC, and his producer was liable for the secondary NICs due.

However, all monies were paid to his personal service company, Big Bad Wolff Ltd, and so no NIC had been paid over.

- With the introduction of IR35, HMRC believed that they could look through the company, treat Robert Glenister as being in deemed employment and so raise an assessment for the NIC due.
- Robert Glenister and Big Bad Wolff Ltd argued that IR35 should not be considered and also that was not fair as under the Categorisation regs, the class 1 secondary contributor would have been the producer, and not the Big Bad Wolff Ltd.

Decision

The Upper Tribunal stated that Parliament did not intend the provisions to be limited to actual employment situations. The term 'employed earner' used in SSCBA 1992 s 4A(which permits the regulations) embraced both 'actual' employees and those who were treated as such by virtue of SSCBA s 2(3). The Tribunal did not think that the legislation was written so that entertainers, teachers and lecturers should enjoy the special privilege of being able to avoid NIC by contracting through personal service companies rather than directly. The aim of the tax provisions was to ensure that NICs were payable in the same way whether or not the services were provided through an intermediary or not.

The Upper Tribunal concluded that if Parliament had intended that reg 6(1)(c) should only apply to hypothetical direct contracts of actual employment, it would have said so expressly.

The appeal was dismissed.

Big Bad Wolff Ltd v HMRC ([2019] UKUT 121 TCC)

Managed service company (Lecture P1136 – 19.10 minutes)

Summary – Costelloe Business Services Ltd was undoubtedly a managed service company provider and the companies were undoubtedly managed service companies.

Costelloe Business Services Ltd set up Christanuyi Ltd, as well as other companies. Costelloe Business Services Ltd provided these companies with a number of services in return for a fee: provided the companies with a registered office; invoiced their clients for the fees charged for individual's services; paid salaries including PAYE; filed annual company accounts and returns; and submitted their tax returns and paid any corporation tax that was due. The individual companies negotiated their own contracts with their clients.

HMRC argued that Costelloe Business Services Ltd was a managed service company provider (S61B ITEPA 2003). The Upper Tribunal had confirmed that the personal service companies were managed service companies.

Christianuyi Ltd and others appealed against assessments of tax and NIC for their personal service companies. If liabilities to tax and NIC did arise, liability fell initially on the managed service companies, with facility for HMRC to transfer liability to the managed service companies provider, Costelloe Business Services Ltd.

Decision

The Court of Appeal needed to consider the definition in section 61B(1)(d) ITEPA 2003 of a managed service company provider.

HMRC argued that for a company to be treated as a managed service company provider, their business must be of promoting or facilitating the use of companies by individuals through which the individuals provide their services to clients; the provider does not need also to promote of facilitate the services themselves.

The Court of Appeal confirmed that Costelloe Business Services Ltd was the kind of business that the government was aiming to catch under the definition of managed service company. Its business is in promoting a situation in which the workers provide their services through a company instead of directly to an end client and it thereby promotes the use of companies to provide those services.

The appeal was dismissed.

Christianuyi Ltd and others v CRC, Court of Appeal, 19 March 2019

Share options 'by reason of employment'? **(Lecture P1136 – 19.10 minutes)**

Summary –Share options granted by an employer to an employee had not been granted by reason of employment and was not caught by the employment related securities legislation.

Vermilion Software Limited was incorporated in 2003 with its office based in London. The company was involved in the marketing and implementation of its principal product known as 'VRS': an end-to-end client reporting solution for the fund management sector. Apart from software development, the Company's business included the sale, support, and servicing of its software product to the global asset management industry.

In 2006, an exercise to raise equity funding for the Company took place. It was understood that Quest, as corporate advisers, and Dickson Minto, legal advisers, would not be paid a fee for their services rendered in connection with the 2006 financing exercise. In return, the parties were agreed on an option package of 2.5% each of the equity in Vermilion after the financing exercise. As part of this exercise, Mr Noble, who owned Quest, was granted share options that were 'effectively payment for services which had been provided in the process of the fundraising exercise'. At this time he was not a director of Vermillion.

After the 2006 equity raising exercise, the Company's performance was monitored by the new investors against the business plan which had been agreed. By December 2006, it became clear that Vermilion was in financial difficulty, and the Company was significantly under-performing. A rescue plan was implemented and as part of this plan, Mr Noble was appointed as Chairman of Vermillion to drive and oversee the performance and report regularly to the investors. A second option plan was implemented in July 2007.

The issue was whether the 2007 options granted to Mr Noble were employment-related securities within the meaning of s 471(3). The key question was whether the opportunity to acquire the new options was made available by Mr Noble's employer by reason of his employment. HMRC argued that the deeming effect of s 471(3) was that the 2007 option was to be regarded as having been made available to Mr Noble by reason of his directorship.

Decision

The First Tier Tribunal stated that the 2007 Option was made available to Mr Noble only because he already had the 2006 Option, and that he was willing to give up 40% of his 2006 Option. The Tribunal believed that if Mr Noble was asked why he received the 2007 option, he would have said: 'Because I got the 2006 option which had to been diluted to become the 2007 option.' The Tribunal concluded that Mr Noble's directorship was not the reason for the 2007 option; his right under the 2007 option emanated from the 2006 option. The 2007 Option was not 'made available' by the appellant, Vermillion.

Having reviewed the case law on deeming provisions, the Tribunal concluded that legislation was not designed with the intention to create an injustice or absurdity. The application of the employment related rules under S471(3) ITEPA 2003 should be limited in the present case, 'where the artificial assumption from deeming is at variance with the factual reason that gave rise to the right to acquire the option'.

The 2007 Option was not an employment-related securities option for the purposes of S 471 ITEPA 2003 and the appeal was allowed.

Vermilion Holdings Limited v HMRC (TC07077)

Treatment of interest and pension (Lecture P1136 – 19.10 minutes)

Summary – Having proved that he held money on behalf of his father in a single bank account, the taxpayer was not taxable on the interest received. His pension income was fully assessable on him and should not be split with his ex-wife.

Sean Kirby had earned interest from bank accounts held in his name. However, he argued that this interest was not taxable on him as he was holding the money for his father's money. Thus the first issue to decide in this case was whether the funds were held on a resulting trust basis for the benefit of his father and if so, what was the tax treatment of the interest that followed therefrom.

In 2012, Sean Kirby and his wife had divorced and had informally agreed that she would be entitled to receive half of his private pension income. From the date of divorce he had filed his tax returns on this basis, declaring only half of the pension income as taxable on him. As there was no pension sharing order, HMRC sought to amend the returns to include 100% of the pension income arguing that the payments were not qualifying maintenance payments. Thus the second issue in this case was whether the pensions receivable by Sean Kirby were fully assessable on him.

Decision

The First Tier Tribunal stated that normally, the named account holder was the legal and beneficial owner of the underlying capital as well as any interest that was earned. However, this could be overridden where there was 'substantive proof to the contrary'. In this case, Sean Kirby was able to meet this burden of proof relating to one of the accounts but not for the others. The appeal was allowed in part in respect of the interest and the tax relating to this one account was reduced.

Under s579C ITEPA2003 the liability for tax charged on pension income is the person receiving or entitled to the pension under the registered pension scheme. As far as the pension providers were concerned, Sean Kirby was the only person entitled to the pension income and he was assessable on the full amount. The appeal relating to the pension income was dismissed.

Sean Kirby v HMRC (TC07054)

Exemption for expenses related to travel (Lecture P1137 – 14.02 minutes)

Where an employee provides receipts for subsistence expenditure that he has incurred on a work trip, that cost can be reimbursed on a tax-free basis as long as the employer is confident that it represents a business expense incurred wholly, exclusively and necessarily in the performance of the employee's duties.

FA 2015 made various amendments to ITEPA 2003 with a view to simplifying the way in which benefits and expenses provided to employees are taxed. For 2016/17 onwards, FA 2015 inserted new Ss289A – 289E ITEPA 2003 which exempt certain amounts paid or reimbursed to employees in respect of expenses where an allowable income tax deduction would previously have been available. A specific exemption applies where the relevant amounts have been calculated and paid or reimbursed in an 'approved way'.

SI 2015/1948 specifies an approved way of calculating and paying or reimbursing subsistence costs for the purposes of S289A ITEPA 2003. Employers can pay or reimburse such expenses using what are known as HMRC's 'benchmark rates' without seeking explicit approval from the tax authorities. Such payments are tax-free. These arrangements are particularly useful where employees are unable to provide receipts (or fail to do so). The benchmark scale rates for meals purchased by an employee in the course of qualifying travel are currently:

- £5 where the employee is away from his workplace for a minimum duration of five hours, but there is an additional £10 payable if he is still away at 8pm (i.e. a total of £15 in that case);

- £10 where the employee is away from his workplace for a minimum duration of 10 hours, but there is an additional £10 payable if he is still away at 8pm (i.e. a total of £20 in that case); and

- £25 where the employee is away from his workplace for a minimum duration of 15 hours and is still away at 8pm.

These rates cover food and drink, but do not include just a drink in, say, a pub.

In order to qualify for these benchmark rates, the employee's travel must be carried out in the performance of his duties or when travelling to a temporary workplace on a journey which is not ordinary commuting. The employee must be absent from his normal place of work for a continuous period of at least five hours and he must have incurred the cost of a meal of food and drink after starting his journey.

If employers want to pay rates that are more generous than the standard HMRC amounts, they need to seek specific approval by providing relevant samples in order to demonstrate to HMRC that higher rates are appropriate. If they do not obtain HMRC approval but still pay higher rates, the excess over HMRC's published figures will be liable to tax (and NICs).

A further requirement of S289A ITEPA 2003 is that Conditions A and B must be met. Condition A is that the employer (or a third party) must have a system in place to check that the employees are actually incurring the correct type of expenses and that they would otherwise be allowable - S289A(3). Condition B stops the exemption from applying if the person operating the checking system knows or suspects that the employee is not incurring the expense or that the expense is not tax-deductible – S289A(4).

For 2019/20 onwards, S10 FA 2019 introduces an alternative Condition C that contains a lower checking stipulation. It simply requires employers or others to operate a system for checking that employees were engaged in qualifying travel in relation to the amount paid or reimbursed – see new S289A(4A) ITEPA 2003. In other words, employers will not have to check amounts spent in order to make such payments free from tax.

Contributed by Robert Jamieson

Capital Taxes

Personal company for entrepreneurs' relief (Lecture B1136 – 17.18 minutes)

Summary - when deciding whether a company is a personal company for entrepreneur's relief, the 5% ordinary share capital test means 5% of the nominal value of the issued shares.

Philip Hunt is a Chartered Accountant. In early 2007 he was approached by the Chairman of Foviance Group Ltd, a specialist web usability and analytics business. At that time, Foviance Group Ltd's issued share capital was divided into shares with a £1 nominal value.

Philip Hunt agreed to take over as Chairman, and to invest £50,000 in the company in exchange for shares. Foviance Group Ltd's lawyers advised that he subscribe for shares with a 10p nominal value, as this would be more straightforward than obtaining the permission of existing shareholders to issue new £1 shares. Over the following years his shareholding increased as the result of further investments. Share buybacks, share options and a merger also changed his position in relation to the other shareholders.

In 2014, Foviance Group Ltd decided to seek a buyer, and on 13 August 2015 all the shares were sold to Ernst & Young. On that date Philip Hunt owned:

- 5.94% of the total shares issued;
- 4.16% of the nominal value of those issued shares; and
- 6.21% of the total number of votes attributable to the issued shares.

In the course of the sale negotiations, EY had pointed out to Philip Hunt that his shareholding might not qualify for entrepreneurs' relief, because he did not hold at least 5% of Foviance Group Ltd's nominal share capital. They suggested he might wish to "recapitalise" his 10p shares so that they became £1 shares, and then wait for a year so that the ER minimum holding period was met. However, he decided that a prompt sale was in Foviance Group Ltd's best interest, and did not delay the transaction.

In due course he completed his SA return claiming entrepreneurs' relief on his share sale.

HMRC opened an enquiry, having decided that Philip Hunt was not entitled to entrepreneurs' relief, and increased the tax due by £225,451.96; this figure was subsequently reduced to £199,751.

Philip Hunt appealed to the First Tier Tribunal.

Decision

The dispute turned on the whether the shares that Philip Hunt held were in a "personal company" as defined at TCGA s 169S(3) which states that he needed to hold: –

> "(a) at least 5% of the ordinary share capital of which is held by the individual, and
>
> (b) at least 5% of the voting rights in which are exercisable by the individual by virtue of that holding."

Since he held more than 5% of the voting rights, the issue was with the phrase “5% of the ordinary share capital”. HMRC’s view was that this meant 5% of the nominal value of the shares in issue but what did the First tier Tribunal find?

The First Tier Tribunal stated Canada Safeway [1972] established the meaning of ordinary share capital which was simple and workable; the statutory phrase was 'issued share capital' not 'issued shares'. In both TCGA 1992 and the Companies Act 2006, share capital is divided into shares where each has a fixed nominal value meaning that the 5% test for entrepreneurs’ relief refers to 5% of the total nominal value of a company's share capital.

The appeal was dismissed.

Philip Hunt v HMRC (TC07057)

Preference shares and entrepreneurs’ relief (Lecture B1136 – 17.18 minutes)

Summary – Cumulative preference shares represented part of a shareholder's ordinary share capital for the purpose of entrepreneurs' relief.

Stephen Warshaw was chairman of Cambridge Education Group Limited. Prior to 12 March 2012, he held 44,183 ordinary shares and 396,000 preference shares in Cambridge Education Group Limited.

Following a group reorganisation in March 2012, Stephen Warshaw exchanged these old shares for new shares in a new company, Cambridge Education Holdings (Jersey) Limited. As a result of these changes, Mr Warshaw’s shareholding in the new company replicated his original shareholding

On 26 March 2012, he subscribed for 24,660 B ordinary shares in the new company and became a director on 26 October 2012.

On 4 December 2013, he disposed of his entire shareholding for cash and ceased to be a director from that date.

On 28 January 2015, he submitted his 2013/14 self-assessment tax return, including a capital gains computation for the disposal of the shares totalling £6,438,419, and a claim for entrepreneurs’ relief in respect of the disposal.

On 5 October 2015, HMRC opened an enquiry into the return and later, in August 2017, issued a closure notice denying the entrepreneurs’ relief claim.

The rights attaching to the various classes of shares in the new company were set out in its Articles of Association. The preference shares were cumulative; if there were insufficient reserves to pay the dividends in respect of those shares in a particular year, payment was deferred to a subsequent year. This meant that the rate at which the dividend would be paid, 10%, would be calculated as the aggregate of the subscription price and the total unpaid dividends. The issue came down to how the preference shares were to be treated. In summary, if the preference shares were 'ordinary share capital' (as defined in ITA 2007 s 989), Mr Warshaw held 5.777%. However, if the preference shares were not 'ordinary share capital', he held only 3.5%.

- HMRC argued that as the rate at which the dividend was paid on the preference shares was fixed at 10%, there was 'a right to a dividend at a fixed rate' and so the shares were should not be treated as ordinary share capital.
- Stephen Warshaw appealed arguing that because the rate of dividend is calculated by reference to any previous unpaid dividends, the preference shares did not have a right to a dividend at a fixed rate.

Decision
The First Tier Tribunal agreed with the taxpayer that the decision of Vinelott J in Tilcon v Holland offered some support. In reaching their decision they must take into account both the percentage element and the amount to which that percentage is applied.

In this case, under the Articles of Association, only the percentage element was fixed. The amount to which that fixed percentage was to be applied could vary.

Consequently, the preference shares could not be regarded as having a right to a dividend at a fixed rate and were therefore ordinary share capital as defined by s 989 ITA.

The appeal was allowed.

Stephen Warshaw v HMRC (TC07107)

Sale of goodwill **(Lecture B1139 – 17.07 minutes)**

The recently released judgment of the First-Tier Tribunal in Villar v HMRC (2018) considered the tax implications of a sale of goodwill by a professional individual and is very helpful in clarifying some of the perceived difficulties about the law in this area.

The taxpayer (V) had a successful medical practice as an orthopaedic surgeon, specialising in hip arthroscopic procedures. On 31 March 2010, he entered into an agreement with a company called Spire Healthcare Diagnostics Ltd (Spire) for the sale and purchase of 'The Richard Villar Practice', for which he received a payment of £1,000,000 upon completion on 1 July 2010.

The taxpayer argued that his sale gave rise to a capital gain, whereas HMRC's contention was that the receipt of £1,000,000 was subject to income tax.

A key part of HMRC's reasoning was that the payment was essentially attributable to goodwill which they maintained could not be transferred to Spire, given that it was personal to V. They also said that there was effectively no business to dispose of and that the money was really an advance payment for the exploitation of V's professional skills in return for a future flow of income. In other words, the transaction represented an arrangement for V to obtain money in a capital form (taxed at 10%, having regard to entrepreneurs' relief) rather than as income that would have generated a much higher tax liability.

It is fair to say that, when anyone buys a business, they are buying an income flow. They buy the business because the business makes profits and that is what provides the capital value. The purchaser may be able to exploit synergies with his own business or he may feel that he has something to add to it that will increase the profitability of the business, making it additionally attractive.

When a business is sold, the vendor gives up his right to the future profits which are subsequently received by the purchaser, but that does not of course mean that every sale is therefore a sale of future income chargeable to income tax on the vendor. The sale of a business typically gives rise to a capital receipt chargeable to CGT.

HMRC's line that the taxpayer did not have a business to sell is a tough argument to support. V certainly felt that he owned a business capable of being sold – and he sold it. The expert valuers who valued the business before the deal went through (Bruce Sutherland & Co) thought so too. And Spire obviously believed that V had a business able to be sold because they paid £1,000,000 for it.

The first question for the tribunal to determine was therefore whether the £1,000,000 received by V was capital or income in nature.

The key points made by V's barrister on his behalf are summarised in the case report as follows:

> 'V had developed a loyal worldwide following through his private orthopaedic practice, carried on under the name of "The Richard Villar Practice". He ran this practice under what was then a unique business model within the UK private medical sphere, in which patients would come to the practice, of which V was the figurehead, rather than to a specific named practitioner. This made the practice a business in contrast to the way consultant surgeons more usually worked.
>
> That the practice did constitute a business capable of sale was demonstrated by the valuation which was carried out independently when V began to contemplate retirement. The fact that the business had to date been so dependent on V and his name and reputation and the risk (which) that represented to a purchaser were taken into account by the valuer and, to reflect these factors, (the valuer) applied a conservative multiplier of two in calculating the value on the earnings basis.
>
> The sale of the business involved, inter alia, the disposal by V of his right to earn any income from the practice and the transfer of all intellectual property, including the database of former patients, website domain name and the business name (all of which belonged to V), in return for the sum of £1,000,000.
>
> That right to earn any income from the practice was transferred from V to Spire and V was precluded from carrying out any paid work in the UK as a consultant surgeon, except through Spire, which engaged him on an ad hoc basis through his private services company, Vineyard Press Ltd (Vineyard). Spire had no right to require V to provide any services, through Vineyard or otherwise. Indeed, Spire were aware that V wished to continue volunteering (for special overseas work) and that this meant there was a real prospect of him not being in a position to provide surgical services after the sale. Neither V nor Vineyard had any right to require Spire to engage V's services. So the sale of the business led to Spire controlling the extent to which V was able to practise in the UK.'

As a matter of fact, V did continue to work in the practice for Spire, for which he was remunerated, via Vineyard, at what was agreed to be a commercial rate. But his role with Spire was substantially different from what he had previously been doing. He no longer ran the practice nor took any decisions concerning its administration and management.

Contributed by Robert Jamieson

There is surprisingly little authority on the capital nature of the sale of a business. However, in John Lewis Properties plc v CIR (2003), the Court of Appeal set out five indicia of a capital payment:

1. the duration of what is disposed of;
2. the value of what is disposed of;
3. the fact that the payment causes a diminution in the value of the vendor's interest;
4. the payment of a single lump sum; and
5. the transfer of risk.

Given that, in this case, all five of these indicators were satisfied by V, his barrister's argument was that the £1,000,000 was unquestionably a capital payment.

In response, HMRC suggested that the payment of £1,000,000 had not been made to purchase the business but rather represented consideration for V changing the way in which he carried on that business. A payment for making such a change is, HMRC stated, essentially income in nature, whether or not it is paid by way of a single lump sum. Therefore, it should be chargeable as part of V's professional profits under S5 ITTOIA 2005. They cited a number of cases in support of this contention, including two Court of Appeal decisions:

1. British Dyestuffs Corporation (Blackley) Ltd v CIR (1924); and
2. John and E Sturge Ltd v Hessel (1975).

V's barrister countered by saying that HMRC's arguments denied the commercial reality of the situation, namely that Spire had bought the practice. The fact that the greater part of the value of the business consisted of goodwill rather than tangible assets did not alter this fact. Goodwill was an asset that could be disposed of in the same way as any other property. Undoubtedly, the involvement of V was part of the attraction and it was entirely rational for Spire to seek to protect its investment by preventing V from practising elsewhere in competition to themselves.

The question of whether or not personal goodwill can be transferred was then discussed, with V's barrister adducing the findings in:

1. Allied Dunbar Ltd v Weisinger (1988); and
2. Balloon Promotions Ltd v Wilson (2006).

In the event, the First-Tier Tribunal did not take long to conclude that, as a matter of fact, the sale by V was a sale of his business and that the amount received represented a capital sum.

However, that was not the end of the story because HMRC raised a second argument that, even if the payment was capital, it should be taxed as income under Ss773 – 789 ITA 2007 (sales of occupation income). S773 ITA 2007 brings into charge as income a capital sum which is received to exploit the earning capacity of an individual in an occupation (which includes a profession or vocation).

The First-Tier Tribunal observed that there was no fixed intention or obligation on V's part to continue to work in this way. On that basis, it was difficult to conclude that the purchaser was exploiting V's earning capacity. In reality, Spire were exploiting the practice and goodwill which V had sold to them.

Another requirement in order for S773 ITA 2007 to apply is that one of the main objects of the arrangements has to be the avoidance of a liability to income tax. HMRC maintained that, if V had continued to receive the profits of his practice, they would have been chargeable to income tax, whereas, having sold the practice, he received £1,000,000 which was chargeable to CGT and was eligible for an entrepreneurs' relief claim. Without doubt, that is a substantial advantage – indeed, a saving of the whole of the income tax. However, the First-Tier Tribunal found that there was no intention or desire to avoid or reduce income tax and they said that they saw no evidence that income tax was a matter which had been considered at all. As a result, the judges decided that S773 ITA 2007 had no application in this situation.

Villar v HMRC (2018) is an important case, given that it clarifies the tax position of goodwill in a professional practice which has certainly been the subject of controversy in the past. Unless there is an appeal (and the indications are that there will not be one), this is obviously a very helpful decision, despite the fact that it has no precedential value.

Matalan discovery **(Lecture P1136 – 19.10 minutes)**

Summary – The discovery leading to an £84 million tax assessment was made in 2004,and since at least three years had passed since that date, the discovery had become stale and was invalid.

John Hargreaves was born in England and was until May 1998 the majority shareholder in Matalan plc.

In May 1998, shares in Matalan plc became listed on the London Stock Exchange. John Hargreaves retained his own shareholding at that time.

On 15 March 2000, he submitted Form P85 to HMRC stating that he had left the UK on 11 March 2000 and that he intended to live outside the UK permanently. He disclosed that he would have accommodation in the UK while he was away as well as the following sources of income in the UK after he had left: Remuneration, Dividends and Bank/building society interest.

On 16 May 2000, John Hargreaves disposed of part of his shareholding in Matalan plc receiving proceeds of approximately £231 million.

John Hargreaves filed his tax return for 2000/01 on 31 January 2002 claiming to be "not resident in the UK" and "not ordinarily resident in the UK". He gave additional information in the return in boxes 9.7 to 9.36. HMRC did not open an enquiry into this return but on 9 January 2007, issued a notice of assessment for that year charging tax of £84 million.

He filed his tax return for 2001/02 on 31 January 2003 on the same basis as being not resident and not ordinarily resident in the United Kingdom. HMRC claim to have become interested in Mr Hargreaves when an article was published, on 23 March 2003, in The Sunday Times where Mr Hargreaves was said to have "made £230m when he sold some of his shareholding in Matalan in May 2000", and was now a "Monaco tax exile who spends three days a week at Matalan's headquarters in Skelmersdale". HMRC opened an enquiry into this return in January 2004 and the original HMRC officer was replaced by Mr West in November 2004. The 2001/02 enquiry was closed by closure notice dated 8 March 2012 concluding that John Hargreaves was "resident and ordinarily resident in the UK during 2001/02" and amended his self- assessment to charge additional tax of just over £6 million. During this period PwC had been asked for reams of detailed information concerning Mr Hargreaves residency status.

Mr Hargreaves initially appealed the 2000/01 assessment on two grounds:

1. He was not in fact resident or ordinarily resident in the UK;

2. The discovery assessment had become stale.

However, in September 2018 he amended his grounds of appeal, accepting that he was resident and ordinarily resident during the relevant period but maintaining his appeal against the validity of the discovery assessment.

This was not unsurprising for a number of reasons including the fact that he had retained his "home" in the UK, his role as CEO of Matalan meant he could show only "occasional residence" abroad and his personal interests meant that he continued to attend various dinners and balls, Wimbledon tennis finals and concerts in the UK.

Decision

Referring to Beagles v HMRC, the First Tier Tribunal stated that Mr West, the HMRC officer in this case, could not argue that he had made a discovery following the receipt of the information received by PwC

The Tribunal stated that if it was Mr West who had made the discovery, he had done so when he had taken personal responsibility for the case in 2004. Indeed, it was likely that his predecessor had made the discovery, and that Mr West had simply found out something that was new to him. This is not a discovery.

The First Tier Tribunal concluded that at least three years had passed between the discovery and the issue of the assessment in January 2007. The discovery was therefore stale and the assessment could not stand.

Hargreaves v HMRC, TC07090.

Using family trust for gifts of property (Lecture P1138 – 11.57 minutes)

Consider a couple with a residential buy-2-let property portfolio who are looking for CGT and/or IHT mitigation strategies.

Placing some of their properties into a trust removes those assets from their estates while still allowing them to have a say in how the assets are used and, ultimately, who they pass to.

Using a trust as a vehicle to hold assets is particularly valuable in circumstances where the clients would like minor children to be able to benefit from the assets without giving them full control over the asset(s) gifted.

The simplest and most common type of trust is a discretionary trust under which the Trustees have full discretion over how the assets of the trust (and any income generated by those assets) are used.

The settlors will appoint the Trustees and nominate persons (or a group or persons) to be the beneficiaries. The Trustees will manage and control the Trust. The beneficiaries are the only persons allowed to benefit from it. Eventually when the Trustees see fit, the trust will be wound up and the assets will be distributed to the beneficiaries.

In a typical “grandparent” trust, the settlor would nominate his children to be Trustees and the children and their descendants to be the beneficiaries. This then gives scope for any additional grandchildren to automatically become beneficiaries of the trust as they are born.

The settlors can act as Trustees should they so wish. However, the settlors should be excluded from being able to benefit from the trust as this has negative tax implications.

If the settlor does not wish to be a Trustee, the settlor(s) can still influence the decisions of the Trustees by a non-binding Letter of Wishes which sets-out the settlors’ hopes and desires as to how the trust fund should be managed and allocated.

A trust is created by a Deed that needs to be drawn up by a solicitor. These are standard documents and are relatively inexpensive. The solicitor would also help draft a Letter of Wishes.

Inheritance Tax issues

A gift to a trust is immediately chargeable to IHT. However, IHT is only charged where the value of the transfer - being the value of the assets gifted – exceeds the IHT nil band. The IHT nil band is currently £325,000. For a trust with joint settlors, this means that up to £650,000 of value can be transferred to the trust without creating a liability. Such trusts are called “nil band” trusts.

A transfer in excess of the nil band will suffer an immediate IHT charge at 25% so it is advisable to restrict the value of the gifted assets to £650,000.

The creation of a nil band trust immediately removes £650,000 of value (£325,000 per person) from their respective estates.

If both clients' survive seven years from creating the trust, this saves £260,000 in IHT. If only one of them survives seven years, the IHT saving is £130,000. If both clients were to die within seven years, the position is IHT neutral - i.e. the value moves back into their estate as it is now.

If the trust is a route the client wants to pursue, it would be advisable for the arrangement to be put in place as soon as possible so as to start the seven-year clock.

There will be no effect for the tenants of the properties being transferred into trust as the trust would simply agree to take over the tenancy responsibilities.

The assets in the trust are not in the estate of any of the beneficiaries. Therefore, to prevent trust assets falling outside the IHT regime completely, trusts are subject to a tax charge on their value every 10 years (a "10-year charge").

This charge is 6% of the value of the trust assets in excess of the then nil band. For example, if the trust was formed by a transfer of properties with a combined value of £650,000, and those properties increased in value by 3% pa over 10 years, using the current nil band of £325,000, the 10-year charge would be in the region of £13,000. Many Trustees provide for this charge by retaining some income each year to meet the liability. If the annual capital growth was 3%, the tax liability is likely to be less than this as the nil rate band should increase in this timeframe.

This charge can be avoided by winding up the trust after 9 years and 11 months. Whether this is appropriate will depend on the situation of the beneficiaries at the point. Some of the grandchildren might be adults at that point and ready to accept a share of the fund outright at that point. This would reduce the 10-year charge. Alternatively, part of the fund could be appointed onto separate bare trusts for each beneficiary to then take outright at 18 (which again avoids a 10-year charge). These are options to be discussed with the Trustees nearer the time.

Capital Gains Tax issues

A transfer of an asset is a disposal for CGT purposes. The donor is treated as having sold the asset at its current market value and, in the absence of any reliefs, would pay CGT in the gain arising.

No CGT would be payable on a gift to trust as a claim can be made for the gains to be deferred.

The CGT deferral is the main reason why advisors recommend the use of a nil band trust as opposed to a direct gift of properties to children or grandchildren. No CGT deferral relief is available on direct gifts, so removing assets from the clients' estate by outright gift will come at a 28% CGT cost. The trust route avoids the 28% CGT.

It should be noted that gift relief is effectively deferring the CGT from the clients' hands into that of the next generation. If the properties are ever sold by the trust there will have a low base cost as a result of the gift relief claim. If the intention is for the properties to remain in the Trust in the long term then the CGT will not be realized for a very long time – if at all.

Stamp Duty Land Tax issues

SDLT is paid by the purchaser of an acquisition of property. However, where property is transferred at nil consideration – for example on a gift to trust – the SDLT is zero.

'Consideration' for SDLT includes the transfer of debt. Therefore, where a property is transferred to a trust and the Trustees assume responsibility for the mortgage attached to the property, the amount of the mortgage transferred is liable to SDLT. As the purchaser would be a trust, the additional 3% SDLT surcharge will apply.

Consequently, if a property (or properties) are to be transferred to a nil band trust as part of an IHT planning exercise, the properties should ideally be mortgage-free.

Income Tax issues

The income from the transferred properties would no longer be taxed in the settlor's hands. Instead the Trustees will pay income tax on their annual trust income. This is disclosed under self-assessment in the same way as for individuals.

The tax rates are 20% on the first £1,000 of annual income and 45% thereafter. This sounds expensive but in reality it is not.

Tax relief is available for the annual expenses of managing the trust (such as any Trustee expenses or accounting / tax return preparation fees).

If we assume a net 5% rental return, annual trust income would be around £32,500.

If we assume trust management expenses of £1,000 (which is reasonable for a nil band trust holding property), the income tax would be around £13,800 leaving net income of £17,700 available to either accumulate within the trust or pay to the beneficiaries.

Each grandchild could receive an income distribution of £1,650 (say). This would carry a 45% tax credit of £1,350, equating to gross income of £3,000 each.

As the gross income would be covered by the beneficiaries' personal allowances, the tax credit of £1,350 could then be reclaimed (giving a total annual tax refund of £12,150). Managed in this way, the actual income tax paid by the trust is very small.

Income distributions do not have to be made annually to achieve this result. For example, income could be retained in the trust and then distributed in (say) year 3. Each beneficiary would then receive £9,000 of gross income covered by personal allowances with the tax credits then repaid.

Similarly, beneficiaries do not have to receive the same amount (although care should be taken to ensure that gross income distributions fall within personal allowances to maximise the tax refund).

However, I would support the idea of annual distributions as this enables the parents to then divert these sums (and the subsequent tax repayments) into products such as Junior ISAs which can then build up tax-free for the grandchild to access at 18 (in time for going to college or university, or for help in acquiring a home).

Conclusion

The IHT effectiveness of the trust option relies on the clients surviving for another seven years. The younger clients start thinking about IHT planning the better!

And if they do survive seven years then they can do it all again!!

Using related settlements (Lecture P1139 – 20.32 minutes)

Following the anti-pilot trust legislation in F(No2)A 2015, it may sometimes be appropriate to consider the possibility of using related settlements, i.e. settlements made on the same day by the same settlor (S62(1) IHTA 1984). As an anti-avoidance measure, S62 IHTA 1984 prescribes that, when measuring the chargeable value of any relevant property trust transaction, the initial value of any related settlement must also be taken into account (Ss66(4)(c) and 68(5)(b) IHTA 1984). Therefore, it is often argued that the deliberate creation of related settlements should be avoided. However, if the value of the intended trust property is likely to escalate over the next few years, there can be an advantage in deliberately creating, say, two discretionary settlements rather than just one.

Example 1

Mark, whose cumulative total stands at nil, wishes to settle property currently worth £200,000 on discretionary trusts.

Let it be assumed that, in 10 years' time, this property is worth £760,000 and that no distributions of capital have been made.

Using 2019/20 lifetime rates, the IHT payable in connection with the principal charge will be:

If only one trust is created the effective rate will be:

87,000/760,000 x 100 = 11.447%

The actual IHT liability is therefore:

11.447% x 30% = 3.434% x 760,000 = £26,098

If two equal trusts are created the chargeable 10-year anniversary amount in each case is:

		£
Value of discretionary trust property		380,000
Add:	Initial value of related settlement	100,000
		£480,000

The effective rate will be:

31,000/480,000 x 100 = 6.458%

The actual IHT liability for each trust is therefore:

6.458% x 30% = 1.937% x 380,000 = £7,361

This makes a total sum payable of £7,361 + £7,361 = £14,722 compared with £26,098.

Consecutive trusts

A variant on this situation might be to create the two trusts on consecutive days. In these circumstances, the related settlement rules would not apply, but, when the trust created second was being taxed, the settlor's previous cumulative total of chargeable transfers would be higher by the amount charged on the occasion of the first trust's creation.

Example 2

Applying this to Mark's situation, the 10-year anniversary charge for the first trust (now worth £380,000) would be computed as follows:

The effective rate will be:

11,000/380,000 x 100 = 2.895%

This gives an actual IHT liability of:

2.895% x 30% = 0.869% x 380,000 = £3,302

The 10-year anniversary charge for the second trust would have to take into account Mark's cumulative total of £100,000 (it is assumed that no exemptions were available) following the creation of the first trust. Thus:

		£
Settlor's chargeable transfers prior to second trust		100,000
Add:	Value of property on 10-year anniversary date	380,000
		£480,000

Using 2019/20 lifetime rates, the IHT on £380,000 is:

				£
On 100,000	– 325,000 =	225,000 @	0%	–
On 325,000	– 480,000 =	155,000 @	20%	31,000
				£31,000

The effective rate is:

31,000/380,000 x 100 = 8.158%

The actual IHT liability is:

8.158% x 30% = 2.447% x 380,000 = £9,299

This makes a total sum payable of £3,302 + £9,299 = £12,601 (which is even lower than the tax liability in the previous illustration).

Contributed by Robert Jamieson

Meaning of 'dwelling' for SDLT (Lecture P1140 – 13.44 minutes)

The recent case of PN Bewley Ltd v HMRC (2019) concerned an appeal by a company against the amendment of an SDLT return that resulted in a fivefold increase in the tax payable by the purchaser in connection with a freehold residential property acquired on 24 January 2017.

The property was a dilapidated bungalow in Weston-Super-Mare which cost £200,000. The SDLT paid at the time of the purchase was calculated as:

	£
On first £125,000 @ 0%	–
On next £75,000 @ 2%	1,500
	£1,500

Towards the end of 2017, following an enquiry into the SDLT return, this charge was amended to:

	£
On first £125,000 @ 3%	3,750
On next £75,000 @ 5%	3,750
	£7,500

on the ground that the acquisition met all the conditions in Para 4 Sch 4ZA FA 2003 which made it subject to the higher rates of SDLT payable (i.e. the 3% surcharge). As a result, additional SDLT of £6,000 was due.

The following are the conditions referred to above:

(i) the purchaser was not an individual;

(ii) the subject-matter of the transaction consisted of a major interest in a single dwelling;

(iii) the chargeable consideration for the purchase came to £40,000 or more; and

(iv) the purchased property was not subject to a lease.

Clearly, (i), (iii) and (iv) were satisfied, but the dispute was whether the property was a 'dwelling'.

Para 18 Sch 4ZA FA 2003 describes what counts as a dwelling. A building is considered to be a dwelling if it is:

- used or suitable for use as a single dwelling; or
- in the process of being constructed or adapted for such use.

These words (apart from the reference to a single dwelling) are found elsewhere in the tax code – for example, see Sch 1B TCGA 1992 (as inserted by Para 15 Sch 1 FA 2019), which deals with the non-UK resident CGT charge, and the IHT rules for enveloped UK residential property interests in Para 8 Sch 10 F(No2)A 2017 – and so the decision in this case may well have a wider than expected significance.

The key issue here was whether the property in Weston-Super-Mare was suitable for use as a dwelling. This is obviously a matter where judgments can differ, which is a neat way of saying that cases will arise where the taxpayer argues that the property is not suitable for use as a dwelling and HMRC assert that it is.

The First-Tier Tribunal took the view that a building may be capable of being a dwelling, but may be unsuitable for this purpose at a particular point in time. The property in the PN Bewley Ltd case was in a very poor state of repair, with radiators and pipework removed (and the presence of what sounds like significant amounts of asbestos). The judges therefore concluded that the bungalow was not suitable for use as a dwelling. It was treated as a non-residential property and, as a result, the SDLT liability was reduced to 2% of the excess over £150,000, i.e. to £1,000.

The discussion contained in this judgment about the various factors to be taken into account (or not to be taken into account) when deciding whether a building is a dwelling will undoubtedly prove helpful in a number of different situations and for a variety of taxes.

Contributed by Robert Jamieson

Administration

Inaccurate P60 (Lecture P1136 – 19.10 minutes)

Summary – Although an honest mistake, the taxpayer should have known that his P60 was substantially understated and submitted his true earnings when filing his self-assessment return.

During 2016/17, Ringo Scheithauer was employed by Dunhill Pontefract PLC and received taxable pay of £306,722.

However, HMRC established that the figure shown on his tax return showed taxable pay of £167,605.48 and tax paid of £71,679.17. He had omitted £139,116.92 of employment income from Dunhill. He had also received employment benefits of £5,411 (car benefit) and £1,288 that had not been included with the rest of his employment benefits on his tax return.

On 16 November 2017 Ringo Scheithauer confirmed HMRC's figures but stated that he had only repeated the figures shown on his P60 and that he could not understand why the employer did not include all of his pay on the P60.

The reason that his P60 did not include his earnings from April to August 2016 is because in September 2016 payroll arrangements were moved in-house, whereas previously the arrangements had been outsourced to external accountants. In consequence his PAYE reference changed from 567/VZ 53163 to 567/A6283. The P45 which his employer's received from the accountants had Ringo Scheithauer on a month one basis tax code throughout the April to August 2016 period and therefore his earlier earnings were not included.

On 22 January 2018 Ringo Scheithauer spoke to the HMRC and was asked whether he was aware that he had earned more than £300,000 instead of £167,605.48. He told HMRC that when he had received his 2016/17 P60 he noticed that the stated pay was low compared to the stated pay in his P60 for 2015/16. When he queried this with his employer he was told it was correct and so he completed his return using this figure.

Ringo Scheithauer argued that he should not be charged a penalty for this error as it was an honest mistake brought about by his employer's mistake. He appealed.

Decision

The First Tier Tribunal believed that Ringo Scheithauer had made an honest mistake, possibly caused by erroneous assurances given to him by his employer.

However, he knew or should have known that his P60 employment income figure for 2016/17 was incorrect and was substantially understated. He knew his income was significantly lower than in 2015/16 and if he had simply added up the figures contained on his pay slips, he would have identified the problem. Sadly, as the Tribunal stated 'the law does not provide shelter for honest mistakes'.

The disclosure was prompted because Ringo Scheithauer did not inform HMRC about the inaccuracy before he had reason to believe HMRC either had discovered it or were about to discover it.

HMRC were therefore correct in applying a penalty calculated by reference to the potential lost revenue on the basis of a prompted disclosure of a careless inaccuracy. This had been calculated using the minimum penalty being 15% of the potential lost revenue.

The penalty was confirmed and the appeal dismissed.

Ringo Scheithauer v HMRC (TC07091)

Reasonable excuse for late payment

Summary – The taxpayer had made every attempt to pay his VAT on time and the surcharge was cancelled.

Peter Farrell ran a VAT registered firm of solicitors based in Glasgow. The business had been in the VAT default surcharge regime from period 03/16 when a non-financial Surcharge Liability Notice (SLN) was issued.

- No penalty was issued on the first default but a (SLN) was issued;
- No financial penalty was issued on the second default because the penalty fell below the £400 de minimis level;
- The penalty under appeal is the third default for Period 03/17.

If payment is by direct debit, HMRC will automatically collect payment from the businesses bank account three bank working days after the extra seven calendar days, following the standard due date. On this occasion the return and payment were received on 16 May 2017, so clearly later than 7 May.

The question was whether Peter Farrell could establish that he had a reasonable excuse for the late payment that gave rise to the default surcharge.

He had attempted to pay his VAT on time on Friday 5 May 2017 but was prevented from doing so because the system did not recognise either his ID number or password. He was puzzled as these numbers were saved on his machine and had been recognised previously.

He contacted HMRC and following a webchat and telephone discussion with HMRC's technical support team, a new ID number was issued, although this turned out to be his original number from when he first registered for VAT. Bizarrely, when he entered this number it recognised it as saved, as well as the original password. At no time was he ever informed that HMRC had reverted to his original ID number.

Decision

It was not clear to the First Tier Tribunal why HMRC did not have the facility when Peter Farrell spoke to them, to assist him in identifying his correct ID number or at least allowing him to change it before the following day, 6 May 2017, which was effectively the last opportunity for him to log on and pay the VAT due before a penalty was imposed.

The appeal was allowed and the surcharge was cancelled.

Peter Gerard Farrell v HMRC (TC07042)

Shares and assets valuations

HMRC has published a revised guide explaining the role of their specialist shares and assets valuations team. This team values assets for other parts of HMRC as well as Post Transaction Valuation Checks and requests for other share scheme valuations

Post Transaction Valuation Checks

The team may be able to help once assets have been disposed of if the taxpayer is an individual working out a Capital Gain liability or a company working out their Corporation Tax liability.

Individuals can only request a Post Transaction Valuation Check:

- after disposals relevant to Capital Gains Tax
- before the date you must file your Self Assessment tax return

The taxpayer must submit a completed form CG34 and HMRC may ask for further information once they have reviewed the form.

Where a valuation has not been agreed before a tax return must be filed, that return must be submitted with the amount of gain or loss expected.

How to disagree with a valuation

Where a valuation cannot be agreed, the issue can be heard by the tax tribunal but only once tax return has been filed.

The team cannot give a valuation for a number of assets including:

- quoted and unquoted shares
- chattels (such as antiques, art and jewellery);
- foreign residential property and shares;
- intangible assets (such as intellectual property, trademarks, patents and goodwill);
- negligible value claim assets;
- informal health checks for PAYE purposes;
- UK land or buildings valuations for tax – contact the Valuation Office Agency.

www.gov.uk/guidance/shares-and-assets-valuations-for-tax

In a separate guide, HMRC explain how it values company share option plans, SAYE schemes, enterprise management incentives schemes and share incentive plans.

Taxpayers can ask the HMRC Shares and Assets Valuation team to agree the value of:

- shares in an Enterprise Management Incentives scheme by filling in a VAL231 form. Valuations are valid for 90 days from the date of the agreement.
- shares in a Share Incentive Plan by filling in a VAL230 form. SIP valuations can last up to 6 months but will end early if a significant event happens which is likely to impact the share value. Significant events include (but are not limited to)
    - any change (completed or actively contemplated) in the share or loan capital of the company
    - any arm's length transaction (completed or actively contemplated) involving shares of the company
    - negotiations or preparations for a flotation or takeover
    - any declaration of a dividend on any class of shares in the company
    - the publication by the company of any new financial information, for example, the annual accounts or interim results or announcement
- a Company Share Option Plan or Save As You Earn scheme by writing to the Savings and Valuation team and including details of:
    - a proposed value for your shares;
    - 3 years of accounts before the valuation date, or if the company is newly trading, any accounts available at the valuation date;
    - any other information that might be relevant.

www.gov.uk/guidance/get-a-share-scheme-valuation-from-hmrc

Deadlines

1 June 2019

- Payment of corporation tax liabilities for accounting periods ended 31 August 2018 for small and medium-sized companies where payment is not required by instalments

7 June 2019

- Electronic filing and payment of VAT liability for quarter ended 5 April 2019

14 June 2019

- Quarterly corporation tax instalment for relevant large companies
- EC sales list for quarter ended 30 April 2019 due (paper form)

19 June 2019

- Payment of PAYE /NICs /CIS /student loan repayments for month ended 5 June 2019 if not paying electronically
- File monthly construction industry scheme return

21 June 2019

- File online monthly EC sales list
- Submit supplementary intrastat declarations for May 2019

22 June 2019

Electronic payment of PAYE /NIC /CIS liabilities for month ended 5 June 2019 should have cleared HMRC's bank account

30 June 2019

- Private company accounts with 30 September 2018 year ends to Companies House
- Public company accounts with 31 December 2018 year ends to Companies House
- Corporation tax returns for companies with periods ended 30 June 2018
- VAT partial exemption annual adjustments for March VAT year end
- Returns by savings institutions made under European Savings Directive for 2018/19

HMRC News

MTD pilot for income tax (Lecture B1136 – 17.18 minutes)

As part of the Making Tax Digital pilot, certain taxpayers can voluntarily use MTD compliant software to keep their business records digitally and send Income Tax updates to HMRC, instead of filing a Self Assessment tax return. This pilot is now open to landlords with income from furnished holiday lettings, together with other UK-resident landlords and sole-trader businesses. Does this mean that landlords with furnished holiday lets will be among the first businesses that will be required to submit tax details through MTD when it goes live?

By taking part in the trial, taxpayers will become familiar with what is required under the MTD system at a time when HMRC are hopefully able to offer greater support.

To take part in the pilot, taxpayers must be UK resident and be up-to-date with both Self Assessment returns and tax payments. They can sign up using their Self Assessment online service Government Gateway user ID and password.

Once their MTD compliant software is functional, HMRC will remind them to send their Income Tax updates every quarter as well as a final report. The deadline for this report will depend on the tax year that the accounting period ends in.

Example 1 - Accounting period is 6 April 2019 to 5 April 2020

Assuming a taxpayer signed up for the pilot on 6 April 2019 they will send their:

- 2018/19 Self Assessment tax return as usual so by no later than 31 January 2020
- Four Income Tax updates under MTD, the last one by 5 May 2020;
- Final report will be due by 31 January 2021.

Example 2 - your accounting period is 1 May 2019 to 30 April 2020

Assuming a taxpayer signed up for the pilot by 1 May 2019,they will send their:

- 2018/19 Self Assessment tax return as usual so by no later than 31 January 2020;
- 2019/20 Self Assessment tax return as usual so by no later than 31 January 2021;
- Four Income Tax updates under MTD, the last one by 31 May 2020;
- Final report by 31 January 2022.

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

Voice data deletion

The Information Commissioner's Office has ordered HMRC to delete voice data collected from around 5million taxpayers who enrolled for its Voice ID service before October 2018.

Following changes to its enrolment process, HMRC will continue to use Voice ID for taxpayers who have given their explicit consent, in compliance with GDPR.

www.gov.uk/government/publications/letter-from-sir-jonathan-thompson-to-hmrcs-data-protection-officer

Welsh pay Scottish tax

HMRC has reported that, due to a mix up in using Scottish tax codes, a number of workers in Wales have paid the wrong amount of tax.

HMRC deputy chief executive, Jim Harra, has written to the chair of the Welsh Assembly's finance committee, describing it as:

> 'disappointing that despite the engagement we had with employers, some have not applied codes correctly. In some cases, individuals have had the wrong amount of tax deducted. I understand that this was due to issues with the payroll software used by some employers and that employers affected in this way are correcting their systems and explaining the error to their employees.'

HMRC has stated that the error was due to employers using an S code for Scotland, rather than a C code for Cymru. HMRC said that the errors would be corrected through PAYE in time for May payroll.

Due to differences in tax rates:

- People earning £12,501 to £14,549 would have underpaid tax (19% v 20%);
- Income in the £24,945 to £43,430 band would have been over-taxed by 1%;
- People earning between £43,431 to £50,000 were overtaxed by 21% ; and
- Anyone with income over £50,000 would have been overtaxed by 1%.

Simplifying tax for smaller businesses

The Office of Tax Simplification (OTS) has published its latest report, 'Simplifying everyday tax for smaller businesses', which concentrates on day-to-day administrative matters facing businesses with fewer than 10 employees and annual turnover below £2m.

This report considers starting up a business, registering for tax, and taking on a first member of staff as the points at which tax and regulatory challenges are most acute for small businesses.

The OTS's recommendations fall into five main themes:

1. Better guidance and support at start-up;
2. Improving the operation of PAYE;
3. The role of agents, including implementation of HMRC's 2014 agent strategy;
4. Improving the corporation tax return process; and
5. Ensuring tax administration is built on an understanding of business processes.

The ten core recommendations developed under these themes are:

1. The government should develop a package of start-up guidance taking small businesses step-by-step through the things they need to do at key stages in the business and focussed principally, but not exclusively, on tax;
2. HMRC should make a strategic focus on the PAYE system a priority to ensure effective implementation of improvements and system changes;
3. The government should carry out a fresh review of areas where the PAYE/RTI system should be improved, possibly through the OTS;
4. HMRC should appoint a senior official to oversee and prioritise implementation of the agent strategy;
5. HMRC should routinely factor agents into system design and improvement, produce a roadmap of implementation dates for key improvements such as the ability of agents to see data relating to their clients, and ensure agents are copied into key exchanges;
6. HMRC should work with partners such as Companies House to develop digital options to help small companies prepare accounts and tax returns, including use of an optional accounts template incorporating standard iXBRL tags;
7. HMRC should simplify the corporation tax online return process as part of any future extension of Making Tax Digital to corporation tax, showing taxpayers only the relevant information, with pop-up information and help screens at key points;
8. HMRC should explore ways to reduce the number of companies having to file two tax returns to cover first accounting periods that are very slightly longer than 12 months;
9. HMRC should develop a programme of change to align the small business experience across the different taxes; and
10. HMRC should explore alignment and streamlining of tax payment processes across core taxes and regimes.

In addition, the OTS suggests exploring an optional PAYE-like experience for self-employed people.

www.gov.uk/government/publications/simplifying-everyday-tax-for-smaller-businesses

Spotlight 51

HMRC is aware of a tax avoidance scheme being marketed as a wealth management strategy that attempts to disguise income and other taxable profits as loans or fiduciary receipts. This scheme claims to provide remuneration or profits free of tax.

Under the scheme, the user scheme user (self-employed individual, partner in a partnership, company or a company director) contributes to a remuneration trust, with trustees based offshore. The scheme user could be a:

The remuneration trust is set up in a contrived manner and is claimed to provide benefits to individuals (beneficiaries), other than the scheme user. The alleged beneficiaries are individuals employed in the trade or profession of lending money.

The trustees take no action to identify or reward the alleged beneficiaries, because the trust contributions are always intended to be used by the scheme user.

As part of the scheme arrangements a personal management company is set up and controlled either by the scheme user or connected party supporting the scheme.

The money contributed to the remuneration trust is actually paid – often minus the 10% scheme fee – to the personal management company. This allows the scheme user full access to the funds.

The scheme user accesses the contribution to the remuneration trust through unsecured loans or fiduciary receipts from the personal management company. It is claimed to be tax free and on terms not available from high street lenders.

Interest and capital repayments on the loans are rarely made. Money from the personal management company is often used to pay living expenses. In some cases, the scheme user decides how the money is invested by the personal management company.

HMRC's view

HMRC's view is that the claims made by scheme promoters about the tax savings are not credible or genuine and taxpayers using such a scheme may find that:

- Corporation Tax, PAYE tax, National Insurance contributions and Inheritance Tax are all chargeable for company and company director users
- Deductions claimed by self-employed individuals and partnerships are not allowable expenses, and Inheritance Tax is chargeable
- Interest will be charged on any tax paid after the statutory due date and penalties may be raised.

What this means for promoters

HMRC will pursue anyone who promotes or enables tax avoidance. This includes using the enabler's penalty regime for anyone who designs, sells or enables the use of abusive tax avoidance arrangements which are later defeated by HMRC.

HMRC will also use its powers under the Promoters of Tax Avoidance Schemes regime against those who continue to promote tax avoidance schemes.

www.gov.uk/guidance/remuneration-trust-tax-avoidance-using-loans-or-fiduciary-receipts-spotlight-51

Spotlight 52

Following their success in the First Tier Tribunal in two cases, Hyrax Resourcing Limited (TC07025) and Curzon Capital Limited (TC06949), HMRC has published Spotlight 52.

In both cases, the arrangements were designed to disguise income for which tax and National Insurance contributions would be due.

How the arrangements work

The arrangements involve individuals receiving their earnings through a small taxable element and the remainder in the form of a loan. They are contrived arrangements that pay scheme users their income in the form of loans, normally routed through an offshore trust in a low or no tax jurisdiction, with the only purpose being to avoid Income Tax and National Insurance contributions.

The loans are provided on terms that mean they are not repaid in practice, and the amounts paid by way of a loan are no different to normal income and are - and have always been - taxable.

These arrangements claimed to offer a much lower tax charge than if the scheme user had been paid all of their income as a salary.

These decisions confirm HMRC’s view that contrived arrangements involving employment income related loans are notifiable under DOTAS.

www.gov.uk/guidance/disclosure-of-tax-avoidance-schemes-tax-avoidance-using-offshore-trusts-spotlight-52

Business Taxation

HMRC tried to go against the grain (Lecture B1138 – 21.00 minutes)

There have been many changes to the capital allowances legislation and case law since it was confirmed by the Court of Appeal in Schofield v R & H Hall Ltd (1975) that grain silos were plant for the purposes of capital allowances.

In that case, the Court reiterated the principle that something which was a building or structure could simultaneously be plant or machinery. Legislation was later introduced in FA 1994 in an attempt to draw a line between something being both:

- a building or structure; and
- plant or machinery.

This legislation now appears as Ss21 and 22 CAA 2001.

S21 CAA 2001 restricts expenditure on the provision of plant or machinery from including expenditure on the provision of a building. By the same token, S22 CAA 2001 restricts such expenditure from including expenditure on the provision of a structure or a similar asset. However, in order to preserve the integrity of the case law that existed in 1994, a list of exceptions to those restrictions was produced – see S23 CAA 2001 (List C).

List C includes, at item 28(a), the provision of silos for temporary storage. However, even if an item falls within List C, it must still qualify as plant or machinery in accordance with S11(4)(a) CAA 2001 which means that it has to satisfy the case law criteria for meeting the key requirement.

Some 44 years after the Court of Appeal handed down their verdict in the Schofield case, the First-Tier Tribunal had to decide in May v HMRC (2019) whether or not, in the light of present day legislation and case law, a modern facility for holding grain qualified as plant for capital allowances purposes.

In May v HMRC (2019), the taxpayer (M) incurred expenditure on the construction of a purpose-built facility for drying, conditioning and storing the grain that he grew and harvested on his 900-acre farm in Devon until such time as that grain was sold to local farms and feed mills.

M's facility consisted of a large steel-framed barn with a concrete floor and three-metre high walls. Piles of grain (being wheat, barley and oats) lay on the floor, separated by a permanent wall down the middle of the structure as well as a moveable barrier further to sub-divide the storage space. The ventilation equipment to dry the grain included an air inlet vent on one side of the building with an extractor fan opposite to draw air across and out of the space. Sitting on the floor and protruding through the levelled piles of grain were moveable vertical tubes (described by M as 'pedestals') with fans on the top. When the outside air was drier than the grain, a central control switched on the pedestal blowers and the drawn-up air then removed moisture from the grain.

Grain was held for up to 10 months in this silo before the facility was emptied and cleaned so that it could be made ready for the following year's harvest.

M claimed capital allowances on his expenditure in respect of the tax years 2011/12, 2012/13 and 2013/14. HMRC rejected the bulk of his claims and only accepted that certain items within the facility itself, equating to 20% of the expenditure, constituted plant. HMRC's conclusion was that most of the expenditure incurred on the construction of the facility for the purposes of drying, conditioning and storing grain did not attract plant or machinery allowances.

It was accepted by M and his advisers that the silo was a building under S21 CAA 2001. Therefore, when M could not reach an accommodation with HMRC, the First-Tier Tribunal judges had to decide two issues:

1. whether the facility was a silo 'provided for temporary storage' within the meaning of List C in S23 CAA 2001; and

2. whether the facility was 'plant or machinery' within the meaning of S11(4)(a) CAA 2001.

Para CA22050 of the Capital Allowances Manual states:

> 'Treat a grain silo as plant where, together with its attendant machinery, it performs a function in distributing the grain so that it acts as a transit silo rather than a warehouse.
>
> The cases where a structure was held to be plant show that a building or structure can be plant if and only if it is apparatus for carrying on the business or employed in the business rather than being the premises in which the business is being carried on.'

It is well known that HMRC manuals do not have the force of law, but most people, when reading the above quotation from the Capital Allowances Manual, would probably assume that the expenditure on M's silo was not a contentious matter. However, one intriguing aspect of this case is that evidence was given before the First-Tier Tribunal in support of M's argument by a Mr Doodney who had worked for HMRC as a capital allowances specialist until 2015. While within HMRC, Mr Doodney was asked to provide technical guidance on M's claim for his silo costs and he advised that the farmer's case had merit. He was then told that HMRC's policy was to 'hold the line' that such structures were not eligible. As a result, he produced a report for his employers, stating that the expenditure did not qualify!

The word 'silo' is not defined in the capital allowances legislation and so the parties agreed that it should take the dictionary meaning. They settled on a definition that a silo needed to have no purpose other than storage and it could include any structure built above ground (ie. the term was not confined to pits or underground chambers).

The First-Tier Tribunal found that M's building was specifically designed, built and used to store, condition and maintain grain through a continuous process of aeration. The cost was much greater than that of a general-purpose agricultural building and its features made it unsuitable for other agricultural uses. The judges were therefore satisfied that the building was a silo.

The case then turned on the question of 'temporary storage'. In Schofield (the only other reported capital allowances dispute about a silo), the grain was stored for up to seven days while it was in transit and so HMRC argued that, while this very short period was clearly 'temporary', holding the grain for up to 10 months (as M did) was much closer to being 'permanent'. The First-Tier Tribunal were unconvinced by this line. The judges noted that silos could be used to store all sorts of commodities, some of which might be retained indefinitely. Here, however, the grain could not be kept for longer than 10 months without deteriorating and was anyway only held until it could be sold. Given that M's business was growing and selling grain, holding his stock for the time being was simply part of that operation. The First-Tier Tribunal were happy that the storage was indeed 'temporary'.

Finally, the judges had to decide whether the silo qualified as 'plant' under general tax law. In other words, did the silo function as apparatus with which the farmer carried on his trade or did it represent non-qualifying business premises in which that trade was conducted? Their conclusion was that M's facility dried and conditioned grain and so all the components, including the structure, were integral to this and constituted business apparatus. The expenditure on the facility was eligible for capital allowances in full, even though it was regarded as a building.

It will be interesting to see whether HMRC appeal this case, in view of the fact that the tribunal's finding went so strongly in the taxpayer's favour.

Contributed by Robert Jamieson

Corporate intangible fixed assets **(Lecture B1137 – 6.39 minutes)**

The law in relation to the taxation of intangible fixed assets held by companies is found in Part 8 of CTA 2009 (Ss711 – 906 CTA 2009). These rules allow, inter alia, groups of companies to transfer intangible fixed assets between members of a 75% group without incurring a tax charge or realising a tax deduction (in other words, on what might be termed a 'tax-neutral' basis).

However, the legislation contains a special anti-avoidance provision (see S780 CTA 2009) which crystallises a tax charge or a tax deduction if a company which has previously received an intangible fixed asset on a tax-neutral basis leaves the 75% group within a period of six years from the date of that transfer. This is known as 'degrouping' treatment.

With effect from 7 November 2018, S26 FA 2019 amends CTA 2009 so that a degrouping adjustment will no longer be made in situations where a company leaves a 75% group as a result of a share disposal which qualifies for the SSE.

The new section has removed an obstacle to commercially-motivated merger and acquisition activity and aligns the degrouping regime in Part 8 of CTA 2009 with the equivalent legislation in the corporate chargeable gains code.

Contributed by Robert Jamieson

Full version of UK CFC state aid decision

On 25 April, the Commission released the full public version of its state aid decision on the finance company exemptions within the UK's CFC regime, having announced on 2 April that the exemptions were partially justified under state aid rules.

Within two months the UK must submit the following information to the Commission:

- a list of beneficiaries that have received aid under the scheme, together with evidence of how the UK has calculated the relevant profits falling within TIOPA 2010, s371EB (UK activities);

- a list of taxpayers that have applied the exemption in a way the Commission accepts did not constitute state aid, i.e. to profits falling within TIOPA 2010, s371EC (capital investments from the UK), together with supporting evidence;

- for each beneficiary, the CFC charge actually charged in determining the beneficiary's liability under the corporate income tax return, for each tax year that he has applied the group financing exemption, as well as the relevant corporate income tax return forms;

- for each beneficiary, the CFC charge that would have been charged if he had not applied the group financing exemption, including underlying calculations, for each tax year that the beneficiary has applied the group financing exemption;

- the total aid amount and its detailed calculation (principal aid amount and recovery interest) to be recovered from each beneficiary, and

- documents demonstrating that the beneficiaries have been ordered to repay the aid.

The decision also requires the UK to effect full recovery within four months, HMRC have already started contacting groups which may be possible effected in this respect.

http://ec.europa.eu/competition/elojade/isef/case_details.cfm?proc_code=3_SA_44896

Loan relationship and unallowable purpose

HMRC had issued a closure notice to the effect that Oxford Instruments UK (OI UK) was not entitled to any relief for the interest that had accrued in respect of a promissory note with a principal amount of $140m that it had issued to its US resident immediate parent company.

This was on the basis that OI UK had an 'unallowable purpose' (CTA 2009 s 442) in entering into, and remaining party to, the $140m promissory note; and that all of the interest which had accrued under the $140m promissory note in respect of the relevant accounting period was attributable to that unallowable purpose. It was therefore not deductible.

The FTT found that the promissory note had been issued at step 8 of a single scheme. It noted that the US objectives of the scheme (partly refinancing and partly simplification of the debt structure) would have been achieved if the scheme had not implemented step 8 (and had comprised only steps 1 to 7).

However, if step 8 had not been implemented, the scheme would have given rise to net taxable income in the UK in an amount that was equal and opposite to the net deductible interest in the US. The FTT added that a Deloitte presentation suggested that the commercial profit included in the planned scheme was the means to justify the existence of the transactions that OI UK needed to implement in order to achieve its purpose. The sole purpose of the incorporation of OI UK, and its role in the scheme as a whole, was therefore to secure the UK deductions.

Finally, the FTT accepted that the purpose of the group as a whole was to achieve the US objectives. However, this did not alter the fact that the purpose of OI UK in issuing the promissory note was to secure the UK tax deduction.

Relevance of the decision

The financing structure used by OI (UK) is now not a viable financing structure but at the time was used to give a US tax deduction with little or no UK taxable income. It was essentially replaced by groups taking advantage of the CFC finance company exemption (see item above). However, any groups that have used the structure described in the case may expect HMRC to review their financing arrangements.

Many anti-avoidance provisions include the 'main purpose' test and so this case is also relevant for a review of this phrase. The transaction step 8 in the financing arrangement had no wider purpose other than to generate UK tax relief and minimise the UK tax liability.

Oxford Instruments UK 2013 Limited v HMRC [2019] UK FTT 254

Tax Journal 1 May 2019 and adapted by Joanne Houghton

Annual tax on enveloped dwellings (ATED): tax relief case

ATED background

The ATED regime applies to high-value UK residential property owned on, or acquired after, 1 April 2013, by what are known as non-natural persons (NNPs), which are:

- companies;
- partnerships with at least one company member;
- collective investment schemes (including unit trusts);
- NNPs can be UK or non-UK resident or established.

Those within the ATED rules are subject to an annual property tax based on the value of the property held, although certain reliefs and exemptions are available. ATED also brings with it additional filing requirements for those within the scope of the provisions, even in cases where no tax charge is actually payable. ATED essentially applies to UK residential dwellings which have a taxable value of more than £500K.

There are also reliefs from ATED that are aimed at genuine commercial businesses, they are as follows:

- property rental businesses;
- property developers;
- property traders;
- financial institutions acquiring dwellings in the course of lending;
- dwellings open to the public;
- occupation by certain employees or partners of a qualifying trade or a qualifying property rental business;
- farmhouses;
- social housing.

Relief as being a development

In Hopscotch, the FTT found that a property first held as an investment, and then redeveloped and sold, had not been owned for the purpose of being developed and sold, so that it did not qualify for relief from ATED.

Hopscotch had purchased a residential property in 1993. It was originally occupied by members of staff until its use declined and Hopscotch decided to sell it. However, unable to find a buyer and following the advice of its estate agent, Hopscotch had undertaken a vast redevelopment programme in the hope of making the property both more valuable and marketable.

When the ATED regime was introduced by FA 2013, Hopscotch submitted ATED returns for the first three ATED chargeable periods on the value of the property (£13.5m) without any relief. However, in its ATED returns for the 2017 and 2018 periods, Hopscotch had claimed relief from ATED on the basis that the conditions in FA 2013 s 138 were satisfied; it owned the property for the purpose of developing and selling it. HMRC considered that the relief did not apply. Its closure notice referred, inter alia, to the facts that the property had not been purchased for development purposes and had first been marketed undeveloped.

The FTT first observed that the scale of the works carried out did amount to a development. The only issues were therefore whether Hopscotch had carried out a property development trade and whether it had owned the property exclusively for the purpose of developing it and selling it.

The FTT first had to decide whether Hopscotch had carried on a trade. It noted that the fact that the company had borrowed to finance the development, which was carried out for the purpose of resale, pointed towards the existence of a trade, but the fact that this was a one-off transaction, which did not relate to its business, pointed away from it being a trade.

Most importantly, the FTT found that the transaction was not ‘carried through in a way typical of a trade of property development’. The tribunal referred in particular to the relevant board minutes, which mentioned neither the expected cost of the development nor the expected profit that would result from it. Similarly, no trading account or business plan was ever produced. The tribunal concluded that Hopscotch’s decision to redevelop the property did not mean that it had ceased to own it as an investment.

The FTT however did note that if the company had carried on a trade, the fact that Hopscotch had initially acquired the property as an investment on capital account before subsequently starting a trade would not have prevented it from claiming ATED for the relevant periods. This obiter comment may be very helpful in other situations.

Hopscotch v HMRC [2019] UKFTT 288

Sourced by Joanne Houghton from Tax Journal 15 May 2019

VAT

Late registration (Lecture B1136 – 17.18 minutes)

Summary - Following some favourable assumptions, the VAT charged for late registration was reduced and the penalty cancelled.

Daniel Potts, a plumber, filed his 2014/15 tax return in January 2016. This contained self-employment pages showing turnover as £93,274. The self-employment pages informed HMRC that he should be VAT registered.

Following a VAT review by HMRC, they concluded that Daniel Potts should have been registered by 1 October 2014. This was based on calculations taking the annual turnover as shown on the income tax returns and dividing it by 12 to give equal monthly figures. However, based on a detailed breakdown of actual sales it was clear that the registration date should have been earlier on 1 July 2014.

HMRC issued a penalty assessment of £1,664.60 for failing to register for VAT at the correct time representing 20% of the lost tax

Decision

The First Tier Tribunal stated that they were aware that late registration for VAT for a person whose customers are private individuals and not VAT registered can produce very harsh consequences as in this case, where Mr Potts was unable to collect the VAT that he should have charged. In the light of this and within the bounds of the law, the Tribunal stated that they had made a number of favourable assumptions about things being done in time, or at all, which led to reduced VAT being charged as well as the penalty being cancelled.

The Tribunal considered if there was any basis on which they could revert to HMRC's initial figures. Had Mr Potts had another accountant or if he had had no accountant at all, he might have said to HMRC on receipt of their figures that he accepted them and should be liable to be registered from 1 October 2014 as HMRC's calculations showed. In these circumstances the Tribunal felt that they could and should vary the decision by saying that the effective date of registration was 1 October 2014.

As for the penalty, the maximum penalty for a failure that was not deliberate (as HMRC conceded was the case here) is 30% of the potential lost revenue.

A penalty may be mitigated from the maximum down to a minimum with that minimum being one of three amounts (20%, 10% or nothing):

- 20% for a prompted disclosure where HMRC became aware of the failure 12 months or more after the time when the tax first became unpaid by reason of the failure (10% if HMRC aware less than 12 months after that time);

- 10% for a unprompted disclosure where HMRC became aware of the failure 12 months or more after the time when the tax first became unpaid by reason of the failure (0% if HMRC aware less than 12 months after that time).

So was the disclosure prompted and when did they become aware of the failure?

Mr Pott's accountant said that he completed the tax return clearly stating that the turnover was over the limit and registration was required, and that HMRC "tacitly" accepted that 10% was correct. The Tribunal accepted that HMRC were told of the failure before they had reason to be aware of it, and so the minima for unprompted penalties applied.

HMRC were made aware when the return was filed before the end of January 2016 (The final issue is on what date did "the tax" first become unpaid by reason of the failure. Every person who is required to be registered for VAT (but who is not) is required to make a return for each quarter no later than the end of the month following the end of the quarter. In this case Mr Potts was required to pay VAT for Q4 2014 by 31 January 2015, for Q1 2015 by 31 March 2015 and for Q2 2015 by 31 July 2015. It followed that HMRC became aware of the failure within 12 months of the tax unpaid date for all periods, the penalty was a minimum of 0%.

The First tier Tribunal decided that Mr Potts should have been registered for VAT from 1 October 2014 rather than 1 July 2014, and they cancelled the penalty.

Daniel Potts v HMRC (TC07076)

Direct debit mistake **(Lecture B1136 – 17.18 minutes)**

Summary – A 15% default surcharge penalty was discharged. The company had a reasonable excuse for believing that payment would be collected by Direct debit.

In October 2016, a customer of Norfolk Premier Coachworks Limited became insolvent leaving the company with a bad debt that was subsequently assessed as £160,000. Understandably, that caused significant cash flow problems for the company.

The company had various time to pay arrangements with HMRC and other creditors and gradually got back on its feet. The company believed that the payment for period 12/17 would be made on time by Direct Debit and when it was discovered that it had not been, took steps to pay the VAT due as soon as possible. The company argued that a penalty of 15% for a two day delay seemed to be unfair and disproportionate.

HMRC stated that genuine mistakes, honesty and acting in good faith are not usually considered reasonable excuses for surcharge purposes, unless it can be shown that in the particular circumstances concerned, the actions of the trader were reasonable.

Whether there is a reasonable excuse depends on the particular circumstances in which the failure occurred and the particular circumstances and abilities of the person who failed to file their return on time. The test is to determine what a reasonable taxpayer, in the position of the actual taxpayer, would have done in those circumstances and, by reference to that test, to determine whether the conduct of the taxpayer can be regarded as conforming to that standard.

Decision

The First Tier Tribunal accepted that Mr Steward, company director genuinely believed that the payment of the VAT due for period 12/17 would be taken from NPCL's bank account by Direct Debit on 7 February 2018. Mr Steward had taken out personal borrowings to ensure that the company had the money to pay HMRC so why deliberately leave that money sitting in its bank account. The Tribunal stated that it is clear from Perrin that a mistaken belief can be a reasonable excuse if the belief was objectively reasonable. The Tribunal concluded that this was the case here.

Norfolk Premier Coachworks Limited had paid amounts of VAT due to HMRC by National Direct Debit Service/System ("NDDS") in August and September 2016 and February, March, April, May and June 2017. The NDDS is a direct debit system used for specified amounts and dates. Despite the company being informed that a separate Direct Debit had been cancelled, payments of VAT continued to be made via NDDS. The Tribunal considered that it was understandable that a person such as Mr Steward might have failed to appreciate the distinction between a Direct Debit and the NDDS. The confusion meant that he might reasonably have believed that the Direct Debit had been reinstated because the company continued to make payments by the NDDS after that date. In fact, the Tribunal accepted that Mr Steward did not know about the letters cancelling the Direct Debit. Importantly, once he became aware of the situation on 9 February 2017 (and the reasonable excuse ended), Mr Steward took steps to pay the VAT due without unreasonable delay on the same day.

Norfolk Premier Coachworks Limited's appeal was allowed and the default surcharge penalty for period 12/17 discharged.

Norfolk Premier Coachworks Limited v HMRC (TC07126)

New build granny annexe (Lecture B1136 – 17.18 minutes)

Summary – The granny annexe built in the grounds of an existing property qualified as a new build eligible for the DIY refund scheme.

The property, 15 Pelham Road, is owned by Tristin Swales, the son of the appellant, Christopher Swales. He wanted to create separate accommodation for his parents in the grounds of the property and applied for planning permission to do so on land located close to the existing house, where a shed was located.

On 23 March 2015 the council granted approval for "Erection of extension to outbuilding and conversion to residential annexe at 15 Pelham Road ...". There were no conditions in the planning approval relating to the sale or use of the new building. Nor was there anything in it that required the retention of any of the walls of the shed.

The work started in April 2016 and lasted 35 weeks. Nothing of the original shed remained except the concrete floor slab. That slab was not used as the base for any part of the new building, as a floating slab covering the whole footprint of the new building was installed and from which piles were sunk into the ground.

Having contacted HMRC, the Swales were advised that if they were building the house themselves, they may be able to take advantage of the DIY builders refund scheme (S35 VATA 1994). Under this scheme they might be eligible to claim back the VAT on building materials purchased.

However, on 31 May 2017 HMRC refused this claim and, following an upheld review, the case proceeded to the First Tier Tribunal.

The grounds for rejection of the refund were nowhere explicitly stated, but reading between several lines the Tribunal concluded that these grounds were that what was constructed was not a "new build" but an extension of an existing building because a building constructed on the site of an existing building cannot incorporate any part of that existing building above ground level. The Tribunal assumed that this was a reference to Notes 16 (c) and 18 Group 5. However, at the start of the appeal hearing it was agreed that the only issue still in dispute was whether the construction work completed was within the scope of Note 2(d) Group 5 Sch. 8 VAT 1994.

Pulling out the key bits of legislation considered by the Tribunal:

Note (2) states:

> "A building is designed as a dwelling or a number of dwellings where in relation to each dwelling the following conditions are satisfied—
>
> (d) statutory planning consent has been granted in respect of that dwelling and its construction or conversion has been carried out in accordance with that consent."

Note 16 (c) states:

> "For the purpose of this Group, the construction of a building does not include—
>
> (c) ….. the construction of an annexe to an existing building."

Note 18 that states:

> "A building only ceases to be an existing building when:
>
> (a) demolished completely to ground level; or
>
> (b) the part remaining above ground level consists of no more than a single façade or where a corner site, a double façade, the retention of which is a condition or requirement of statutory planning consent or similar permission."

Decision

The First Tier Tribunal considered Note 2(d). HMRC had argued that the plans showed the retention of three of the original walls so the planning permission given was for work on an existing building.

However, no one at the council was under the impression that the three walls were to be retained and certainly not that it was a condition of the planning consent that they must be. Demolition was to be to ground level. Indeed retaining the walls would itself have made the works unlawful under the Building Regulations.

The walls were not retained so Note 18 had the effect that in law the shed ceased to be an existing building, even though the slab was retained and built over.

The condition in Note 2(d) had been met and the refund claim was allowed.

Although not necessary to this appeal, the Tribunal went on to consider Note 16(c) and whether a refund could be denied as the construction was of an annexe. The Tribunal said that, if called upon to decide, they would have no hesitation in saying that the new property was not an adjunct or accessory to the main house. The gap of over 40 metres is sufficient to show that the property is not an annexe. The terms of the planning permission did not prohibit separate sale or disposal, and although it did use the term "annexe" the Tribunal did not agree that this term in the planning permission must be construed by reference to its meaning in Note 16 of Group 8. The couple were looking for as much independence as possible in a self-contained building and to get out from under the feet of their son Tristin.

Christopher Swales v HMRC (TC07116)

Making tax digital for VAT (Lecture B1136 – 17.18 minutes)

On 3 May HMRC updated Notice 700/22 that gives guidance on Making Tax Digital for VAT. Of particular interest is the new guidance on the use of supplier statements, petty cash transactions and charity fundraising events.

Supplier statements

Businesses receiving a large number of invoices from the same source often record the value of supplies from a supplier statement rather than from individual invoices. HMRC will now accept the use of supplier statement totals but only if all of those supplies are included on the same return and the total VAT charged at each rate is shown. Businesses must show the appropriate audit trail by cross-referencing all items listed to the invoices received, somewhere in their records.

Petty cash

Where a business uses petty cash to pay for small value items, these do not need to be individually recorded in the digital records. The business can record the total value and the total input tax allowable. This applies to individual purchases with a VAT-inclusive value below £50 and the total value of petty cash transactions recorded in this way cannot exceed a VAT-inclusive value of £500 per entry.

Charity fund raising events

Charities can find it difficult to meet the digital record-keeping requirements for volunteer run events due to the large number of supplies needing to be recorded on a VAT return. The guidance now states that, where supplies are made or received during a charity fundraising event run by volunteers, charities may treat all supplies made as covered by one invoice for the event, and all supplies received as covered by one invoice for the event.

https://www.gov.uk/government/publications/vat-notice-70022-making-tax-digital-for-vat

Agent or principal? (Lecture B1140 – 13.39 minutes)

Introduction

Deals involving three parties can often be difficult to unravel as far as VAT is concerned. It is important to establish who is the agent and who is the principal, as the VAT treatment is different in each case.

It is important to consider two questions:

(i) Contracts – according to contractual issues, which party is supplying or receiving services and to or from whom?

(ii) Commercial reality – what is the perception of the customer as far as the deal is concerned? In other words, which party does the customer consider he is dealing with?

Hairdressers, taxi firms……and others

There are many three-party arrangements in the modern business world but there have been many tribunal cases over the years involving taxi firms, so this is a good trade to consider in order to establish the approach to adopt in deciding the agent or principal question.

Example

A taxi firm might have a number of account customers and use self-employed drivers to carry out the taxi rides. The taxi firm is usually VAT registered but not the drivers because the drivers tend to earn less than the compulsory annual VAT threshold of £85,000. In this situation, is the taxi firm acing as principal for VAT purposes i.e. output tax is due on the full value of the ride charged to the account customers, or just the commission it retains i.e. the difference between the full fare and the amount paid by the drivers?

Tribunal case - backdated registration

In the recent FTT case of Bryn Williams (TC6963), the taxpayer was not VAT registered because his net commission from account customers meant his income was below the compulsory registration threshold. But the tribunal and HMRC both agreed that he was acting as principal, and the higher sales figure meant that he should have registered for VAT in 2009, with output tax due on all sales made in that period.

It is worth noting the factors that made HMRC decide that Mr Williams was acting as principal: he negotiated the contracts with the customers as his own deal; the cars bore his business logo; he received the money direct from the customers and paid the drivers; there was a shared risk with bad debts, rather than the driver taking all of the bad debt; at the time of the customer booking a ride, Mr Williams did not know which driver would carry it out.

One of the reasons this issue is so important is because HMRC has the power to correct a late VAT registration by going back up to 20 years. It is only errors made on a past VAT return that are time capped at four years.

Internet trading

It is very common in the modern age for businesses to sell goods or services online through websites. The intention of the site is to bring together buyers and sellers but there can still be a challenge in some cases to establish if the customer is dealing with the website or the main supplier. This will obviously affect the total output tax payable by either the website or supplier, so it is important to be clear about the terms of the arrangement.

Example

Sally is VAT registered and owns a website which brings together theatre groups looking to hire props for a show with other groups who have a stock of props. The key point is that the website clearly states: "If you are unable to resolve any complaint with the owner of the goods, then contact us and we will raise it on your behalf." This is a clear indication that the main supply excludes the website owner – she is acting as an agent and receiving a commission payment only.

Tribunal case – online services

In the FTT case of All Answers Ltd (TC6845), the company supplied completed essays, coursework and dissertations to students studying for exams, the essays being written by academic experts in a particular subject, enabling the students to submit them to their course providers for assessment.

The VAT challenge came down to the classic question of "who is supplying what and to whom." Was the taxpayer acting as an agent in bringing together the author and the student i.e. where output tax is only payable on the 2/3 of the commission retained by the agency? Or was the commercial reality that the author was working as a subcontractor for the taxpayer, and the taxpayer was supplying a completed essay as principal to the student i.e. output tax is due on the full payment made by the student? The court agreed with the taxpayer that the company was acting as principal, with a disputed assessment for £904,168 therefore being correct.

This case highlights the important point that if there is a contradiction between the terms and conditions of a deal and the commercial reality of what is happening in practice, then the commercial facts always take precedence. But the best tip is that you should always check that the two issues are in tandem and do not contradict each other.

Tips for internet sites

As explained above, the economic and commercial reality of a deal always supersedes what is said on a contract or sales invoice. Here are important questions to consider if a website arrangement is in place:

- Do the buyers and sellers know each other's identity;
- Who do the customers consider they are dealing with when parting with money?
- What invoices are raised by the website owner and provider of the services?
- What evidence is there that the website host is only fulfilling an agency function?

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