Tolley®CPD

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Personal tax

Scottish higher-rate threshold unchanged in 2017/18

In 2017/18, the higher-rate threshold in the rest of the UK is set to increase to £45,000.

However, the Scottish government has announced that they will freeze all income tax rates in Scotland for 2017/18, leaving the higher-rate threshold at £43,000, unchanged from 2016/17.

news.gov.scot/news/protection-for-tax-payers

Car and van benefit

With effect from 6 April 2017 the van benefit as well as van and car fuel benefit will increase as follows:

- van benefit to £3,230;
- van fuel benefit to £610;
- car fuel benefit to £22,600.

https://www.gov.uk/government/publications/tax-and-tax-credit-rates-and-thresholds-for-2017-18/tax-and-tax-credit-rates-and-thresholds-for-2017-18

Assets made available to employees **(Lecture P1001 – 9.28 minutes)**

S205 ITEPA 2003 lays down a set of rules for calculating the taxable value of an asset provided to an employee (or a member of his family or household) that is available for his private use. The section applies to assets that do not have particular charging provisions elsewhere in ITEPA 2003 for assessing the quantum of the benefit in kind. Company cars and cheap or interest-free employer-provided loans have their own benefit-specific cash equivalent legislation, but, for other assets such as, say, the provision of a yacht, a 20% 'annual value' charge is set out in S205 ITEPA 2003.

On a strict statutory interpretation of S205 ITEPA 2003, employees should be taxed as if the asset in question were made available to them for the whole tax year, even if it is only made available for part of the year or is shared with another member of staff. There is no provision in statute for apportioning a benefit, notwithstanding case law decisions such as *Westcott v Bryan (1969)*. HM Treasury have recently stated:

> 'This has the potential for unfair outcomes which cannot be corrected by simply publishing guidance.'

S5 FB 2017 introduces provisions that now detail the parameters for calculating adjusted cash equivalents to take account of days when the asset is not available for the employee's private use. This supersedes the guidance set out in Paras EIM21634 and EIM21635 of the Employment Income Manual that is not supported by legislation. The new regime takes effect for 2017/18 onwards.

Looking at the amended legislation, S5(2)(b) FB 2017 inserts new S205(1A) – (1D) ITEPA 2003 which defines the meaning of 'private use' and makes provision for deductions from the charge under certain circumstances which are spelled out in new Ss205A and 205B ITEPA 2003.

The first of these sections provides for a deduction to be made for any day when the asset is unavailable for private use and explains the circumstances when such a deduction may apply (eg. if the asset is not in a fit condition for use or is undergoing repair or maintenance). S205B ITEPA 2003 allows for a reduction in the cost of the benefit when the asset is made available for the private use of more than one employee. This is to be achieved on a 'just and reasonable' basis.

Contributed by Robert Jamieson

Deduction of income tax at source (Lecture P1002 – 8.45 minutes)

It is estimated that, as a result of the introduction of the personal savings allowance in FA 2016 that took effect on 6 April 2016, some 95% of all taxpayers now have no tax to pay on interest received. It will be recalled that, because of this decision, the previous Chancellor removed the obligation on the part of banks and building societies to deduct basic rate income tax at source from payments of interest on the same date.

In the light of this and following further consultation, the Government have announced that, with effect from 6 April 2017, the deduction at source regime will also end for interest distributions made by:

- investment trusts;
- open-ended investment companies; and
- authorised unit trusts.

In addition, the requirement to deduct basic rate income tax at source has been dispensed with for interest paid to investors in peer-to-peer lending. Savers and investors will therefore receive these types of income gross – those with no tax to pay on their interest will no longer have to reclaim tax from HMRC.

This widening of the gross interest rules is set out in S12 and Sch 4 FB 2017.

Contributed by Robert Jamieson

Optional remuneration arrangements (Lecture P1003 – 20.10 minutes)

The use of salary sacrifice arrangements in connection with the provision of benefits in kind allows many employees to pay less income tax and NICs than would have been the case if they had been remunerated entirely in cash. Employers may also achieve a saving through a lower NIC charge. In HM Treasury's words, 'the cost of (this) tax and NIC (saving) represents an exchequer cost which is borne by the majority of taxpayers'.

In order to address this imbalance, the Government intend to limit most of the available income tax and NIC advantages by imposing a notional cost on taxable benefits based on the value of any salary given up (where this is greater than the charge which would otherwise be due under the present rules).

Unfortunately, the draft legislation in S2 and Sch 2 FB 2017 is rather widely drawn and has caused a good deal of uncertainty. The changes are not just restricted to salary sacrifice schemes but will have an impact on most flexible benefit arrangements. Employers will need to review, as a matter of urgency, their employee benefit position to see whether they are affected by these 'optional remuneration' provisions.

As mentioned above, the legislation refers to 'optional remuneration arrangements' and therefore catches much more than a standard salary sacrifice.

For example, an employee who decides to take a company car where a cash allowance is available will be taxed on the value of the allowance if this is higher than the taxable benefit of the car.

This new charge will apply for both income tax and employer NIC purposes – it will not be relevant for employee NICs.

Looking at the position in more detail, Para 1 Sch 2 FB 2017 inserts a new S69A ITEPA 2003 which introduces two definitions of 'optional remuneration arrangements':

- 'Type A' – these are arrangements under which, in return for a benefit, the employee gives up the right (or a future right) to receive an amount of earnings from his employment; or

- 'Type B' – these occur where an employee agrees to be provided with a benefit rather than an amount of earnings.

In these circumstances, the employee will normally be taxable on the 'amount foregone' (see new S69B ITEPA 2003) – this refers to the earnings given up under 'Type A' or 'Type B' arrangements. More precisely, the taxable value will be the higher of:

- the existing taxable value of the benefit; or

- the salary foregone.

The Government have decided that the changes will not apply to employer pension scheme contributions, employer-provided pensions advice, employer-provided childcare, cycle-to-work schemes, ultra-low emission vehicles, ie. those which emit CO_2 of 75 grams per kilometre or less, and benefits related to the termination of an employment. These represent what HM Treasury call 'key policy areas . . . which the Government wish to continue supporting but which could fail without the use of salary sacrifice arrangements'. The full list is set out in new S228A ITEPA 2003 (as inserted by Para 21 Sch 2 FB 2017).

The new regime takes effect from 6 April 2017, but grandfathering will ensure that arrangements in place before 6 April 2017 will be protected until at least 6 April 2018. For arrangements involving cars, vans, fuel, living accommodation and school fees, protection continues until 5 April 2021.

It should be noted that this transitional protection will be lost from the date of any variation or renewal if the terms of a pre-6 April 2017 arrangement are varied or renewed on or after 6 April 2017. There are certain limited exclusions which do not count as a variation for this purpose.

This draft legislation has triggered numerous questions and HMRC have indicated that further guidance will be provided. Employers are also conscious of the tight timescales involved.

For example:

- How will the transitional rules operate? If an employee agrees to take a company car (where cash is an alternative) on 1 March 2017 that is due for delivery on 1 June 2017, will this be covered? It is understood that HMRC accept 'normal' lead times, but hopefully this sort of situation is going to be dealt with in the guidance.

- How will the variation/renewal rules work? If there is a change to the vehicle specification in the above example that is outside the employee's control, will this result in the loss of transitional protection? Presumably this should not be the case, but further certainty is needed.

The impact of these new rules will depend on the benefits provided. It will clearly be greater on benefits with a low statutory value such as employer-owned living accommodation and on benefits covered by exemptions such as those for mobile phones, health screening, workplace gyms or parking.

Unsurprisingly, the Chancellor's announcement has had a largely hostile reception. One senior member of a well-known accountancy firm has commented:

'The denial of relief for the many basic rate taxpayers who benefit from salary sacrifice schemes sits oddly with a Government committed to helping those who are "just about managing". Salary sacrifice has been a great enabler, allowing lower paid employees to choose the benefits they want, something previously only possible for those nearer the boardroom.'

Contributed by Robert Jamieson

Employer-financed pensions advice **(Lecture B1002 – 5.30 minutes)**

S6 FB 2017 introduces a new income tax exemption where the cost of 'relevant pension advice' is provided by an employer. This can either be paid for or alternatively reimbursed by the employer in respect of:

- an employee;

- a former employee; or

- a prospective employee.

The exemption is limited to the first £500 of benefit in any tax year.

The legislation covers advice not just on pensions but also on general financial and tax issues relating to pensions which is intended to allow individuals, in HM Treasury's words, 'to make more informed decisions about saving for their retirement'. It replaces the limited regulation that only applied to pensions advice and was capped at £150 per employee per tax year – see SI 2002/205.

If an individual has more than one employment and each employer provides this benefit, the £500 exemption will apply separately to each one.

The exemption is only in point if Condition A or Condition B is met. Condition A sets out availability conditions so that the 'relevant pensions advice' must be provided under a scheme which is open:

- to all the employees generally; or
- generally to the employees at a particular location.

Thus this benefit cannot just be provided to, for example, members of the board of directors. Condition B allows the employer to provide advice to certain groups of employees on the grounds of age or ill-health without breaching the 'generally available' requirements of Condition A.

The new regime takes effect for 2017/18 and subsequent tax years.

Contributed by Robert Jamieson

New pensions advice allowance

From April 2017 a new tax free allowance is being introduced that will be available where a taxpayer seeks advice relating to their defined contribution pension and hybrid pensions with a money purchase or cash balance element. The allowance will be available in addition to the exemption for employer-arranged pensions advice to be introduced in the Finance Bill 2017.

The allowance

At any age, a taxpayer will be able to take up to £500 tax free from their pension pot to pay for retirement advice. They may do this up to three times in their life and at any age but are limited to one lot of £500 in any tax year.

Qualifying payment

To qualify for the allowance the payment must be:

- for regulated financial advice
- made direct from the pension scheme to the adviser

HMRC will publish draft regulations shortly for a 3-week consultation with detailed guidance planned early in 2017/18.

www.gov.uk/government/consultations/introducing-a-pensions-advice-allowance

MP contact cards

Summary – The costs incurred in delivering contact cards containing contact details for both the MP as well as local councillors were allowable MP office expenses.

Mr Byrne's constituency consisted of four council wards. In October 2015, he incurred nearly £1,900 posting contact cards to constituency members with each member receiving a card featuring a photo of Mr Byrne and of the local councillors for their council ward as well as contact details and surgery times for both Mr Byrne and their local councillors.

Mr Byrne claimed that these postage costs were office costs but the Independent Parliamentary Standards Authority refused to pay the claim as it considered that the contact cards had a party political purpose.

For office cost expenditure to be claimable, the following principles apply:

- The expenditure must meet the detailed requirements of Chapter 6 of the Scheme guidance (renting, equipping, running the MP's office or surgeries);
- The expenditure must be incurred wholly, exclusively and necessarily in or for the performance of parliamentary functions;
- MPs must exercise discretion to determine what expenditure to incur under this heading and whether it is 'necessary' to incur that expenditure in connection with his or her parliamentary functions and that discretion must be exercised reasonably.

Decision

The Tribunal judge held that:

> 'Mr Byrne exercised his discretion to determine that his constituents' interests would be served by having a contact card that provided contact details both for himself and local councillors and therefore arranged for his office to distribute those cards.
>
> I consider that to be a reasonable exercise of his discretion and, accordingly, I accept that the costs incurred were the costs of "running" Mr Byrne's own office and not the offices of councillors.'

Additionally he held that:

> 'For completeness, I am satisfied that the expenses were included "wholly and exclusively" in, or for, the performance of parliamentary functions. I see little, if any, evidence that the expenses were incurred for any purpose other than to further the interests of Mr Byrne's constituents'.

Liam Byrne MP v The Independent Parliamentary Standards Authority (TC05606)

Insurance premiums treated as employment income

Summary – insurance premiums paid for by the employer were employment income.

The Tribunal heard a joint appeal by Macleod & Mitchell Contractors Limited (MMCL) and William Mitchell relating to the correct tax treatment of premiums paid by MMCL in respect of various insurance policies relating to Mr Mitchell.

Mr Mitchell was the sole director and shareholder of MMCL throughout the period 2009/10 through to 2013/14. Mr Mitchell had a mixture of life, critical illness and income protection policies in his name but the premiums in question had been paid by MMCL.

The main issue for both appeals was whether the premiums should be treated as employment earnings for Mr Mitchell and so subject to primary and secondary class 1 National Insurance.

Mr Mitchel claimed that he understood from his financial advisor that the policies concerned had been taken out in the MMCL's name rather than Mr Mitchell's name. The fact that the insurance policies were all in the name of Mr Mitchell had only come to light following a PAYE audit in 2013 when HMRC asked to see copies of the policies. In 2014, all the relevant policies, with the exception of one were assigned from Mr Mitchell to MMCL in 2014.

Decision

MMCL did not seek to recover those premiums from either Mr Mitchell or the insurance companies. Had an insured event taken place while the policies were in Mr Mitchell's name, he would have benefited.

Both appeals were dismissed.

Macleod And Mitchell Contractors Limited Revenue And Customs Commissioners
William Mitchell v Revenue And Customs Commissioners (TC05633)

Class 1 liability extinguished by reimbursement?

Summary – Posting entries to directors' loan account did not extinguish Class 1 NIC liabilities.

M Najib & Sons Limited had been trading since late 2003 with two directors who were brothers.

Following a visit by HMRC in February 2012 two issues were identified:

- From 2009/10: Mileage had been paid at a rate of 40p per mile to each of its directors but there was no mileage log kept detailing business miles. It was agreed that the allowance should be reduced to remove payments for the directors' home to work mileage.

- From 2006/07, the company had paid the premiums for the directors' private health insurance.

The directors then effectively reimbursed the agreed amounts by the company debiting the directors' loan account believing that this rectified the situation.

HMRC took the view that both categories of expense constituted directors' earnings and that Class 1 NICs should have been paid.

The company appealed.

Decision

The Tribunal considered whether payments made by the company constituted earnings, any liability could be extinguished by an employee making good and penalties were payable.

The Tribunal held that:

- the overpayment of mileage was an additional payment that conferred a benefit upon the directors with the company paying home to work travel;
- although it was intended that the healthcare premiums should have been recovered by the bookkeeper through the directors' loan account that had not happened. It was of benefit to the directors to have the company meet their personal liabilities.
- a liability to Class 1 NICs cannot be extinguished by an employed earner making good the earnings in a subsequent tax year. The company was liable to pay Class 1 NICs for the years 2006/07, 2008/09, 2009/10 and 2010/11
- HMRC were entitled to raise penalties for the years 2006/07, 2008/09, 2009/10 and 2010/11. The tribunal has no power to suspend a penalty.

M Najib & Sons Limited v Revenue and Customs Commissioners (TC05641)

Proposed revisions to finance costs restriction for landlords

As we know, legislation introduced by F(No 2)A 2015 introduces changes to how tax relief on finance costs incurred by residential landlords will be given.

From April 2017 relief will be given as a basic rate deduction from tax, rather than as a deduction against residential rental income with the change being phased in over four years:

	Deduction against income	BR tax reduction
2017/18	75%	25%
2018/19	50%	50%
2019/20	25%	75%
2020/21	0%	100%

Remember:

- The rules will apply to individuals receiving residential rental income but excludes income from properties let as furnished holiday lettings;

- Finance costs include mortgage interest but not capital repayments, interest on loans to buy furnishings and fees incurred when taking out or repaying mortgages or loans;

- Any excess finance costs may be carried forward to following years if the tax reduction has been limited to 20% of the profits of the property business in the tax year.

Proposed revision

Legislation in the Finance Bill 2016 will amend this legislation to:

- clarify that the basic rate tax reduction will be available to individual beneficiaries of deceased persons' estates;

- ensure that the total income restriction to the tax reduction applies where the relevant finance costs or property profits are higher than the total income;

- make sure that total income is a measure of the net taxable income after other reliefs;

- allow the carried forward relief is given in a subsequent year where property income is received, even where the loan has been repaid.

www.gov.uk/government/publications/clarification-to-finance-costs-restriction-for-landlords

Deemed domicile – IT, CGT, IHT (Lecture P1004/ P1005 – 22.00/ 19.01 minutes)

Overview

In his Budget on 8 July 2015, the previous Chancellor proposed a major modification to the regime for taxing foreign domiciliaries who are resident in the UK. This amounted to a radical recasting of the existing rules and came as something of a surprise. Realising this, the Government announced that it would be necessary to allow those who were affected by the shake-up to make proper arrangements, with the result that the measures do not come into force until 6 April 2017.

These notes examine the widening of the scope of deemed domicile as it applies for income tax, CGT and IHT. The relevant legislation is set out in:

- S40 and Sch 12 FB 2017 (income tax and CGT); and

- S41 FB 2017 (IHT).

The main changes in this regard can be summarised as follows:

- anyone born in the UK with a UK domicile of origin who is resident in the UK in a tax year (sometimes referred to as a 'formerly domiciled resident' (FDR)); and

- anyone who has been resident in the UK for at least 15 out of the 20 immediately preceding tax years (sometimes referred to as a 'long-term resident')

will be deemed to be UK-domiciled for all tax purposes. It should be emphasised that these provisions apply for tax purposes only and will not affect an individual's domicile status under general principles. Furthermore, the circumstances of parents will not impact on children whose domicile position will be determined separately by reference to their own fact patterns.

Individuals born in the UK with a UK domicile of origin

Looking at the position in more detail, FDRs who have subsequently acquired a foreign domicile of choice (or dependency) will in future be unable to access the remittance basis. For income tax and CGT purposes, such individuals will, when resident in the UK, be taxed in exactly the same way as anyone domiciled and resident here, ie. on their worldwide income and gains using the arising basis. And they will remain taxable on any remittance basis income and gains from prior years, remitted on or after 6 April 2017, as at present.

In addition, the trust and company anti-avoidance codes will apply to the income and gains of foreign trusts and companies in exactly the same way as they do for anyone domiciled and resident here.

Those affected:

- will have the income and gains of non-UK resident trusts – where they are settlors – attributed to them on the arising basis (a similar rule will apply to the income and gains of certain non-UK resident companies); and

- will no longer be allowed to benefit from the special CGT reliefs for foreign domiciled beneficiaries of non-UK resident trusts (eg. the rebasing election introduced in FA 2008).

Non-UK resident trustees will find themselves having to provide UK tax reporting information on foreign income and gains which hitherto has not been required. In some cases, they may not have UK advisers, but they will now need to take appropriate advice in order to understand the implications of the changes to the reporting requirements for the settlor and beneficiaries. Matters will become even more complicated if the settlor has a variable residence position (ie. he moves in and out of UK residence).

As far as IHT is concerned, FDRs will also be caught by its charges, given that they will be treated as though they are domiciled in the UK. Furthermore, any trust of which the FDR is a settlor will be denied excluded property status for as long as the settlor remains resident in the UK. There is, however, one relaxation: there is a period of grace which means that the IHT provisions will only apply where the individual:

- is resident in the UK in the relevant tax year; and

- was resident in the UK in at least one of the two preceding tax years.

This let-out has been introduced because there could potentially be such a severe impact on otherwise excluded property trusts that the Government are prepared to allow what is effectively a one-year moratorium.

When determining the 10-year anniversary charge for such trusts under the new legislation, the general rules still apply. This means that, if the settlor is deemed to be domiciled in the UK for IHT purposes at the time of the 10-year anniversary, the charge will be calculated by taking the cumulative number of quarters in which he has been IHT-deemed domiciled as a fraction of the 40 total quarters in the 10-year period.

Note that the Government have rejected calls for any grandfathering provisions in relation to excluded property trusts established prior to 8 July 2015.

Leaving the UK

From an income tax and CGT perspective, the question of domicile is normally irrelevant for non-UK residents. It only comes into play in the tax year when someone returns to the UK if, as a result, the provisions relating to temporary non-UK residence are thereby engaged (ie. because the returnee has been unable to satisfy the five-year requirement). Domicile does, however, continue to be important for IHT purposes for those non-UK residents who are domiciled in the UK or who are deemed domiciled here under the rules applying to:

- FDRs; or
- long-term residents (this category is considered more fully in (n) – (y) below).

An FDR will lose deemed domicile status in his first full tax year of non-UK residence, provided that he:

- retains a foreign domicile under general law; and
- has not become deemed domiciled by virtue of long-term residence.

As an individual's place of birth and domicile of origin are both unalterable facts, anyone born in the UK with a UK domicile of origin will always be an FDR if he re-establishes residence in the UK, no matter how many years he may have spent abroad and regardless of whether he has acquired a different domicile.

Illustration

Edward was born in Wimbledon. His parents were married and his father had a domicile of origin in England and Wales. The family left the UK and settled permanently in New Zealand when Edward was four years of age.

The father established a domicile of choice in New Zealand, thereby giving Edward a domicile of dependency in the same jurisdiction. Edward retained this domicile (by choice) into adulthood, becoming successful at his work and wealthy. For local estate planning reasons, he settled substantial assets on trusts for the benefit of his family – he was now married with two children.

On 3 June 2017 (when Edward was aged 45), his firm asked him to accept a three-year posting to the UK to take the lead on a special project.

Despite Edward having lost all his connections with the UK, the FB 2017 provisions mean that, if he accepts the assignment, he will be an FDR on arrival and will be denied the benefits of his foreign domicile of choice. He will be taxed in exactly the same way as a UK-resident and UK-domiciled individual, ie. on his worldwide income and gains.

From the start of the second year of his UK residence (ie. on expiry of the IHT period of grace, Edward's worldwide assets, including the property in the various trusts which he has settled, will fall into the IHT net for the duration of his UK residence.

The tax implications of this, particularly the IHT exposure for the funds held on Edward's family trusts, may be sufficiently serious for him to decide to decline the positing to the UK.

Long-term residents

With effect from 6 April 2017, foreign domiciliaries who have been UK-resident for at least 15 out of the last 20 tax years will be deemed domiciled in the UK for all tax purposes. There is, however, one transitional exception to this rule where:

- the individual is not resident in the UK for the tax year in question; and
- there is no tax year beginning after 5 April 2017 and preceding the tax year in question when he was UK-resident.

In other words, he has not been resident in the UK for 2017/18 onwards. Since non-UK residents never need to make use of the remittance basis, this exception will only be of importance for IHT purposes.

There is one oddity about the provision described in (n) above. It can perhaps best be illustrated by a simple example. Imagine that an individual has been resident in the UK for 14 consecutive tax years on 5 April 2017. He leaves the UK on 1 November 2017. 2017/18 is his 15th year of UK-residence – remember that a split year counts as a year of residence.

He has been resident for the 15 tax years immediately preceding 2018/19 and, although he is not UK-resident in 2018/19, there is a tax year beginning after 5 April 2017 that precedes 2018/19 in which he has been UK-resident. Therefore, the transitional exception is not available. It seems counter-intuitive that an individual can be deemed domiciled in the UK during a period when he was not in fact UK-resident! Hopefully, this anomaly will be sorted out.

A non-UK domiciled individual who has less than £2,000 of unremitted foreign income and gains in a tax year is at present allowed automatic access to the remittance basis without any loss of allowances and without having to pay the remittance basis charge. The Government have confirmed that this will continue to be the case, even when the individual has been UK-resident for more than 15 years. It is understood that this decision is an entirely pragmatic one, given that the tax at stake is relatively small compared with the cost of collection. Talking of the remittance basis charge, the existing regime for those who have been resident in the UK for seven of the previous nine tax years (£30,000) and for 12 of the previous 14 tax years (£60,000) will remain in place. The £90,000 remittance basis charge (which took effect on 6 April 2015 for individuals who have been resident for 17 of the previous 20 tax years) will become obsolete on 6 April 2017.

An individual could be deemed domiciled in the UK both as an FDR and as a long-term resident. Where the conditions for both are satisfied, the less favourable rules for FDRs take precedence.

As previously mentioned, a UK-resident foreign domiciliary will be deemed to be domiciled in the UK (and therefore subject to tax on his worldwide income and gains) from the start of the tax year in which he has been UK-resident in 15 out of the immediately preceding 20 tax years. For these individuals, the remittance basis will therefore cease to apply (except as outlined in (p) above). It is important to appreciate that this change has required a reconsideration of the way in which relief is to be given for capital losses. Hitherto, a UK-resident foreign domiciliary who wishes to access the remittance basis has been able to choose either to forfeit entitlement to relief for foreign capital losses (so that he only claims relief for his UK losses) or to make a capital loss election. This election is irrevocable and has to be made within strict time limits. Making the election allows the individual to claim relief for all his capital losses, subject to provisions dictating the order of offset against his remitted and unremitted foreign gains and his UK gains (but in a generally unfavourable way). To adapt these provisions so that they operate effectively under the new regime, the following revisions have been proposed:

When an individual becomes deemed domiciled, he will be treated in exactly the same way as someone who is UK-resident and UK-domiciled from that tax year onwards. He will therefore be able to offset his capital losses against his chargeable gains without having to distinguish between his UK and foreign disposals.

If this individual later loses his deemed domicile (through an extended period of non-UK residence) but then returns to the UK so that he is once again able to access the remittance basis, he will have the option of making the capital loss election afresh.

Once a foreign domiciliary has become deemed domiciled as a long-term resident, his worldwide assets will be within the charge to IHT. Any transfers of value made by that individual will be governed by the same rules as apply to UK domiciliaries.

For example:

A gift to a child, whether of UK or foreign assets, will be a PET. A PET will fail and IHT may be payable if the donor dies within seven years of making the PET.

A transfer by a deemed domiciled individual to a trust (whether UK-resident or not) will be a chargeable lifetime transfer with an immediate 20% charge to tax to the extent that the amount settled exceeds his available IHT nil rate band. The trust property will fall within the relevant property regime and, if the settlor is able to benefit under the terms of the trust, the assets will form part of his estate by virtue of the gift with reservation rules.

An important transitional provision – rebasing relief

A number of transitional provisions are being introduced for foreign-domiciled long-term residents. For some, the criteria are narrow, but, where they apply, they can be helpful (often surprisingly so). The special rebasing relief is probably the most important.

Individuals who become deemed domiciled as long-term residents at the inception of these rules (ie. on 6 April 2017) will be able to calculate their gains on foreign asset disposals by reference to the value of the asset as at 5 April 2017.

This proposed rebasing relief may be very valuable to those who meet the requisite conditions. In order for the individual to benefit:

- he must not have been born in the UK with a UK domicile of origin (in other words, he must not be an FDR);
- he must not be domiciled in the UK under general law at any time during the tax year when the asset is disposed of;
- he must have held the asset on 5 April 2017, with the disposal taking place after that date; and
- the asset must have been a foreign situs one throughout the period from 16 March 2016 (or, if acquired later, the date of acquisition) to 5 April 2017.

An asset is not regarded as situated in the UK where it has been brought to the UK as a remittance and, throughout the period to 5 April 2017, one of the remittance exemptions in S809X ITA 2017 applies (eg. the personal effects rule or where the asset was brought into the UK for repair and restoration). Note that BIR does not count in this context as it is a relief that has to be claimed rather than an outright exemption.

In addition, the individual concerned must be in the first wave of those acquiring deemed domicile status on 6 April 2017. The effect of this rule is to restrict access to the relief to individuals who have been resident in the UK in at least 15 out of the last 20 tax years up to 2016/17 and who remain UK-resident in 2017/18. He must also have paid the remittance basis charge at least once prior to 2017/18 (and so minors will never be able to benefit from rebasing relief even if all the other conditions are met).

Rebasing relief is only available in respect of assets held directly by the individual. Despite representations, there will apparently be no rebasing for assets held by trusts or by companies.

Where all the above requirements are satisfied and the asset is disposed of for a gain on or after 6 April 2017, the asset's base cost will be taken to be its market value as at 5 April 2017. This means that, where an asset has appreciated in value in the period up to 5 April 2017, the gain to that date will fall away and will never be subject to UK tax. The individual will only pay CGT on any subsequent increase in value.

A rebasing relief election operates on an asset-by-asset basis, with the usual deadline of four years from the end of the relevant tax year (ie. the year in which the disposal took place). Once made, an election cannot be revoked.

Conclusion

The important point to emphasise is that the magnitude of the main changes is clear for all to see. Those who are going to become deemed domiciled and the trustees of non-UK resident trusts need urgently to review their position with specialist UK tax advisers. There are both pitfalls and opportunities and the right advice is essential in determining what action should be taken.

Contributed by Robert Jamieson

Revised draft legislation - Deemed domicile for IT, IHT and CGT

On 26th January 2017 HMRC published a revised version of the draft legislation which now also contains:

- an exception for protected foreign-source income of overseas trusts
- additional conditions for transfers from mixed funds

www.gov.uk/government/publications/draft-legislation-deemed-domicile-income-tax-capital-gains-tax-and-inheritance-tax

Draft legislation: Enlarging social investment tax relief

Social investment tax relief (SITR) encourages individuals to support social enterprises helping them to access new sources of finance. Individuals making an eligible investment can deduct 30% of the cost of their investment from their income tax liability, either for the:

- tax year in which the investment is made; or
- previous tax year.

The investment must be held for a minimum period of 3 years for the relief to be retained. If individuals have chargeable gains in that tax year, they can defer their CGT liability if they invest their gain in a qualifying social investment. Tax will instead be payable when the social investment is sold or redeemed. They also pay no CGT on any gain on the investment, but they must pay income tax in the normal way on any dividends or interest on the investment.

Draft legislation

Finance Bill 2017 will include provisions to enlarge the social investment tax relief scheme with effect from 6 April 2017.

- amount of qualifying investment a qualifying social enterprise can raise will increase in most cases, from the current 3 year rolling limit of €344,000 to a maximum of £1.5 million over its lifetime;
- increased investment limit will be available to qualifying social enterprises up to 7 years after their first commercial sale - older social enterprises will continue to be able to raise investments up to the limits of the current de minimis state aid scheme;
- maximum number of full time equivalent employees of a qualifying social enterprise will be reduced from 500 to 250 - volunteers don’t count towards this limit;
- excluded activities list will exclude a number of low risk activities from the SITR;
- measure makes a number of other changes to ensure the new scheme is properly targeted and meets EU rules under the General Block Exemption Regulation.

The government intends to introduce an accreditation system to allow SITR investment in affordable nursing and residential care homes.

www.gov.uk/government/publications/income-tax-enlarging-social-investment-tax-relief

Capital Taxes

Only or main residence relief claim and the burden of proof

Summary – HMRC failed to prove that the taxpayer had not occupied the property as his main residence prior to sale.

On 25 June 2004, Mr Munford bought two properties in London, one in NW11 with his wife and the other in SW3 in his sole name. This second property was renovated, after which his family moved in for six weeks before it was sold and his family moved back to the first property when his wife became pregnant.

The couple made the following elections:

- 3 March 2006: Mr and Mrs Munford elected for the NW11 property to be treated as their PPR from 24 June 2004

- 10 March 2006: Mr and Mrs Munford elected for the SW3 property to be treated as their PPR with effect from 19 December 2005.

- 17 March 2006: Mr and Mrs Munford elected for the NW11 property to be treated as their PPR with effect from 26 December 2005.

Mr Munford's tax return for 2005/06 gave details of his taxable income but, given the PPR elections made, contained no entries for any capital gains.

In September 2013 HMRC enquired as to whether the SW3 property was eligible for PPR relief. They concluded that Mr Munford had not occupied the SW3 property and that the proceeds were subject to tax. They issued a discovery assessment in July 2015 to assess a £730,000 capital gain plus related penalty determination for £190,000.

Decision

The Tribunal did not agree with HMRC's arguments that:

1. the SW3 property had been bought as an investment and only renovated in order to increase its value before sale. The Tribunal said that refurbishment prior to occupation by the family was a legitimate explanation; change of family circumstances was a reasonable excuse to decide to reoccupy the original property;

2. Mr Munford had not occupied the SW3 property and so relief should be denied. The Tribunal accepted Mr Munford' explanation that his family had moved into the property in November 2005 and lived there for the weeks leading up to Christmas. They later moved back to the NW11 house when they discovered that Mrs Munford was pregnant.

This case was about burden of proof. If the assessment had been raised within normal time limits, the burden of proof would have been on the taxpayer. With the family moving into the property at the end of November 2005 and moving out six weeks later, this result could well have been different.

As a discovery assessment was issued outside of the normal assessing time limits, it was HMRC who had to demonstrate that any loss of tax was brought about deliberately. Given that HMRC had not taken any action after receiving the PPR elections in 2006 and had only begun their enquiry in 2013. it had not discharged that burden.

The taxpayer's appeal was allowed.

Paul Munford v Revenue and Customs Commissioners (T0C5585)

Distribution in specie: SDLT due?

Summary – The Tribunal found that sub-sale relief applied to the acquisition of land but undisclosed agent was liable to SDLT

Wainscott signed purchase contracts for land from three independent vendors for a price in excess of £32 million. The company then made a distribution in specie of the land to its main shareholder, South East, assigning the benefit of the three purchase agreements. Three deeds of transfer completed the land transfer to South East.

SDLT payable by Wainscott?

The company argued that it had assigned its rights under the purchase contracts to South East, so that sub-sale relief was available and no SDLT was payable by them.

The sale contracts had each contained a prohibition against assignment that had not been removed until the execution of the relevant deeds of transfer. HMRC argued that the transfer of rights had taken place at the same time as completion, so that sub-sale relief could not apply.

The Tribunal considered, however, that there was nothing in s45 FA 2003 that referred to time and so there was nothing to prevent transactions from being carried out in this way. The only requirement was that the contract should be uncompleted at the time of the assignment.

South East was therefore the purchaser under s 45 and Wainscott's appeal was allowed.

SDLT payable by South East?

South East argued that it had acquired the land as nominee for a third company, Operations, so that it was not liable to SDLT either.

The Tribunal accepted that the deed of agreement contained a declaration of trust, whereby all real estate was held by South East on trust for Operations. However, this only concerned property already held by South East at the time of the agreement. The effect of the agreement was to appoint South East as the undisclosed agent of Operations. The Tribunal accepted that South East was under the obligation to hold the land 'to the order and account of Operations' but 'this was not sufficient to constitute South East as bare trustee or nominee for Operations'. The liability to SDLT therefore remained with South East and the appeal by South East was dismissed.

Crest Nicholson & others v Revenue and Customs Commissioners (TC05629)

Administration

Reasonable excuse - post not received!

Summary –

Following an enquiry into Mr Hussain's returns, HMRC issued closure notices, assessments and penalty determinations against which Mr Hussain as follows:

- On 15 October 2015 assessments for the periods ending 5 April 2008, 2009, 2012 and 2013 under Section 29 TMA 1970 and for the periods ending 5 April 2010, 2011 and 2014 assessments under Section 28A (1) & (2) TMA 1970 were also issued.

- On 15 October 2015 penalty determinations or inaccuracy in tax returns under Schedule 24 to the Finance Act 2007, were issued to the appellant, for the periods, 2008/09, 2009/10, 2010/11, 2011/12, 2012/13 and 2013/14

- The total assessed tax, penalties and interest amounted to over £500,000 (£385,674.40 in income tax and capital gains tax, interest of £59,536.68 and penalties of £69,337.51.)

- On 5 November 2015, a penalty determination under Section 95(1) (a) TMA 5 1970 was issued for the period ending 5 April 2008 in the sum of £144,021

Mr Hussain appealed five months later than the 30-day deadline against the assessments and determinations The issue to be determined was whether Mr Hussain had a reasonable excuse for his late appeal.

In the Upper Tribunal case Romasave (Property Services) Limited v Revenue and Customs Commissioners [2015] UKUT 254 (TCC) it was stated that 'a delay of more than three months cannot be described as anything but serious and significant.' The Tribunal also referred to the Upper Tribunal case O'Flaherty v Revenue and Customs Commissioners [2013] UKUT 0161 (TCC) that stated that permission to appeal out of time should only be granted exceptionally, meaning that it should be the exception rather than the rule and not granted routinely.

Mr Hussain claimed that neither he nor his agent had received HMRC's letters containing the final assessments and also stated that the sums involved were large, the issues complex and, if the late appeal was not admitted, he faced bankruptcy.

Decision

The tribunal was skeptical that neither Mr. Hussain nor his agent had received the documents but they had not been sent by recorded delivery and so it was possible that they were lost in the post. The tribunal accepted that the taxpayer had not received the letters and that they may not have arrived at the correct addresses.

The FTT accepted that there was a reasonable,but by no means perfect, explanation for the delay in lodging the appeals'. Given the sums involved, refusing to extend the time limit could have led to the taxpayer's bankruptcy and so in the interests of justice and fairness, the tribunal accepted the late appeal.

Manowar Hussain v Revenue and Customs Commissioners (TC5595)

Automatic enrolment for workplace pensions

The draft Automatic Enrolment (Earnings Trigger and Qualifying Earnings Band) Order 2017 comes into force from 6 April 2017 and for 2017/18 it:

- Maintains the automatic enrolment earnings trigger at £10,000
- Increases the upper limit of the qualifying earnings band for contributions to maintain alignment with the NICs lower and upper earnings limits for 2017/18.

From 6 March 2017 the Occupational and Personal Pension Schemes (Automatic Enrolment) (Amendment) Regulations, SI 2017/79 come into force adding two new protections to the list of tax protection categories:

1. Lifetime allowance 'fixed protection 2016'
2. 'Individual protection 2016'

Enactment of ESCs

With effect from 6 April 2017, the draft Enactment of Extra-Statutory Concessions Order 2017 will make provision in primary legislation for three existing extra-statutory concessions.

The concessions are:

1. ESC D40: CGT charge in respect of gains made by trustees of a non-resident trust
2. ESC F15: Transfer of value involves woodlands subject to a deferred estate duty charge; and
3. ESC 3.20: Prevents disallowance of input VAT for supplies made prior to insolvency.

March Deadlines

1 March 2017

- Due date of payment of corporation tax liabilities for accounting periods ended 31 May 2016 for small and medium-sized companies not liable to pay by instalments.

2 March 2017

- Unpaid income tax/class 4 NIC liability for 2015/16 will attract an automatic 5% penalty after this date.

7 March 2017

- Due date for filing VAT returns and for payment for 31 January 2017 quarter (electronic payment).

8 March 2017

- Chancellor will deliver Spring Budget

14 March 2017

- Due date for quarterly corporation tax instalment for large companies depending on accounting year end.
- Filing date for EC sales list deadline for monthly paper return.

19 March 2017

- Due date for pay PAYE, National Insurance, construction industry scheme and student loan liabilities for month ended 5 March 2017 if not paying electronically.
- Due date for filing monthly CIS return.

21 March 2017

- File online monthly EC sales list by this date.
- Submit supplementary intrastat declarations for February 2017 by this date.

22 March 2017

- PAYE, NI and student loan liabilities should have cleared HMRC's bank account by this date.

31 March 2017

- Companies House should have received accounts of private companies with 30 June 2016 year ends and public limited companies with 30 September 2016 year ends by this date.
- Final date to reclaim tax paid by a close company on a loan to a participator under s455 CTA 2010 if loan was repaid during the year ended 31 March 2013.
- HMRC should have received corporation tax SA returns for companies with accounting periods ended 31 March 2016 by this date.
- Claims for VAT partial exemption special method must receive approval if to be backdated to 1 April 2016 (March year ends) by this date.
- End of CT61 reporting period.
- End of chargeable period for ATED.
- Vaccine research relief ends as state aid clearance expires
- Business premises relief ends for companies (5 April for unincorporated businesses)

HMRC News

Employer Bulletin - February 2017

On 13 February, HMRC issued their latest bi-monthly bulletin. April 2017 sees the end of the tax year with all that that entails. Additionally, employers have a lot to be thinking about in the new tax year 2017/18.

End of year reporting under RTI

HMRC remind us that employers should send their last FPS of the year on or before their employees' last payday for the tax year. By inserting 'Yes' in the 'Final submission for the year' field HMRC will know that an employer has reported everything needed for year ending 5 April 2017. If the employer's software does not allow for the 'Yes' indicator on an FPS, employers should send in their last FPS and then send an EPS with the indicator ticked.

Employer's can send in an EPS with the indicator ticked if they:

- forget to put the indicator on your last FPS;
- didn't pay anyone in the final pay period of the tax year; or
- sent their final FPS early and didn't pay anyone for one or more full tax months in the last tax year.*Reporting expenses and benefits*

For amounts that are not payrolled, by 6 July 2017 employers will need to send a;

- P11D for any benefits you've not payrolled
- P11D(b) detailing Employer Class 1A NICs due on all benefits (including the payrolled ones).

Where no benefits have been paid, employers can either submit a 'nil' return or complete the '2016-2017 Employer – No return of Class 1A' form.

Remember from 6 April 2016:

- P9Ds were abolished from 6 April 2016;
- an exemption was introduced covering benefits and expenses previously covered by a dispensation. Such amounts do not need to be reported on form P11D.

Paying the right amount of tax through PAYE

From May, HMRC will use real time information to make automatic adjustments to PAYE codes as they happen, rather than waiting until the end of the tax year.

Registering for payrolling benefits and expenses

The bulletin reminds employers about the benefits of registering for the payrolling of benefits and expenses before the start of the tax year. There is no need to complete form P11D after the end of the tax year or P46(Car) for car and fuel benefits.

Construction Industry Scheme – subcontractor verifications

From April 2017 HMRC will no longer accept any telephone calls to verify subcontractors and from then they must be verified using either the free HMRC CIS online service, or commercial CIS software.

April electronic payment deadline falls on a weekend

In April the electronic payment deadline of the 22nd falls on a Saturday.To make sure your payment for that month reaches us on time, you need to have cleared funds in HMRC's account by the 21st unless you are able to arrange a Faster Payment to clear on the payment deadline.

National Minimum Wage and National Living Wage increases

These both increase on 1 April with the National Living Wage for those aged 25 and over increasing from £7.20 to £7.50 per hour and the National Minimum Wage rates will also increase for:

- 21 to 24 year olds – from £6.95 per hour to £7.05
- 18 to 20 year olds – from £5.55 per hour to £5.60
- 16 to 17 year olds – from £4.00 per hour to £4.05
- apprentices aged 16 to 18 and those aged 19 or over if they are in their first year – from £3.40 per hour to £3.50.

YouTube videos

HMRC have a number of YouTube videos showing the key payroll tasks employers come across and how to deal with them. The videos are aimed at new employers but employers and agents in general, and those new to payroll, may also find them helpful.

In addition they have produced a wide range of YouTube videos as a way of providing businesses and individuals with additional advice and support when dealing with HMRC including:

- How to correctly report your Payroll if your business is involved in a Merger or Succession
- How to Claim Tax refunds for Employment Expenses
- Employed or Self Employed

www.gov.uk/government/publications/employer-bulletin-february-2017

Pension schemes newsletter

Lump sum death benefits - information requirements

When a taxable lump sum death benefit is paid to a trust, the Registered Pension Schemes (Provision of Information) Regulations 2006 require:

- scheme administrators to provide information to the trustee on the amount of lump sum death benefit and tax paid by the scheme administrator
- trustees to pass on the information if the trustees then use the lump sum death benefit to make a payment to an individual beneficiary of the trust

This ensures the trust beneficiary has the information needed to claim a refund of the excess tax paid by the scheme administrator over and above the tax at their marginal rate.

Qualifying recognised overseas pension schemes (QROPS) online

Changes to QROPS forms in recent years now means that the system no longer captures the correct information and so from April 2017 QROPS online will no longer be accessible.

Drawdown pension tables

In January 2017 extended drawdown pension tables were published on GOV.UK and have been extended to cover gilt yields in the range of 0% to 2%. There are now only 2 tables, one for adults and one for those under 23.

These extended tables apply from 1 July 2017. From this date, the extended tables should be used where the UK gilt level is between 0% and 2%. If the gilt level falls below 0% then calculate the basis amount using the gilt yield figure of 0%.

Change of filing deadline for annual return of individual information for 2016 to 2017

The filing deadline for the annual return is being brought forward from October to July each year. Information notices for the 2016/17 annual return of individual information will be sent out by the end of January 2017 and the filing deadline for the 2016/17 annual return is 5 July 2017.

Deadline for applying for individual protection 2014 (IP2014)

The deadline for applying for IP2014 is 5 April 2017. Please remind your members that if they want to protect their pension savings using IP2014 then we must have received their application no later than 5 April 2017.

Members who want to apply for IP2014 protection must do this through the lifetime allowance online service, accessed through the guide Pension schemes: protect your lifetime allowance.

Although the deadline for IP2014 applications closes at midnight on 5 April 2017, individuals will still be able to log on and amend an existing application after this date.

www.gov.uk/government/publications/pension-schemes-newsletter-84-february-2017

Apprenticeships levy – it's nearly here

April sees the introduction of the apprenticeship levy whereby money raised from the levy goes into a training fund that is topped up with an additional 10% by the government. All employers can access the fund to help meet the training and assessment costs of apprenticeships.

HMRC has published its new guidance manual for the Apprenticeship Levy that can be viewed at: www.gov.uk/hmrc-internal-manuals/apprenticeship-levy

The levy

From 6 April 2017, all employers are liable to pay the apprenticeship levy calculated as 0.5% of total employees' earnings subject to Class 1 secondary NIC.

Earnings include amounts below the lower earnings limit and secondary threshold as well as the earnings of employees under the age of 21 and apprentices under the age of 25. Class 1A benefits, amounts subject to Class 1B NIC and earnings paid to under 16s are excluded.

There is a £15,000 levy allowance that is offset against the apprenticeship levy meaning that only employers whose annual earnings are at least £3 million will pay into the fund.

Calculating the levy

The levy due each month is calculated based on cumulative Class 1 earnings to date and is offset by the appropriate proportion of the levy allowance for the year to date. If an employer becomes liable or ceases to become liable to the levy part way through a tax year, they can still offset the full £15,000 allowance against their levy liability for the part of the tax year that they operate.

To calculate the amount due each month:

1. Work out total earnings for tax year to date		
2. Calculate the Apprenticeship levy at 0.5%	(Earnings x 0.5%)	X
3. Deduct cumulative levy allowance	(£15k /12 x months to date)	(X)
Amount of levy due to date		X
4 Deduct levy paid in previous months		(X)
Levy due for current month		X

Reporting and paying the levy

The levy is collected through the RTI system. It is reported each month using the Employer Payment Summary and collected with PAYE and NIC, with the same penalty regime applying to the apprenticeship levy as for PAYE returns and payments.

Where at the end of a month the cumulative levy allowance exceeds the apprenticeship levy that overpayment is carried forward and credited in the next month's calculation. If there is an overpayment at the end of the tax year, it is set against PAYE liabilities with any excess being repayable as a PAYE credit.

Deductibility

Payments of the apprenticeship levy are tax deductible for the employer.

Keeping records

Employers must keep records of any information they have used to calculate their levy for at least 3 years after the tax year to which they relate.

More than one PAYE scheme

Employers can choose how to apportion the £15,000 levy allowance between schemes by notifying HMRC when submitting their first Employee Payment Summary of the tax year.

The notified split then remains in force for that entire tax year.

Connected companies

Only one levy allowance is given to a group of connected companies which is split equally between the companies unless, at the start of the tax year, the connected companies elect to split the allowance for that tax year in a different way.

This means that one or more connected companies will have an apprenticeship levy to pay if the group as a whole has Class 1 earnings exceeding £3 million.

Companies are connected if one of them has control of the other or if both are under the control of the same person or persons (Ss 450 and 451 CTA 2010).

Connected charities

Like companies, if the employer is a charity and is connected with one or more other charities, only one levy allowance is available to the connected charities.

Using the apprenticeship funds

From May 2017, employers making apprenticeship levy payments will be able create a digital apprenticeship service account on the government website which will show the amount of levy paid plus the government 10% top-up.

Connected companies and charities will have a single digital account for use by all members of their group.

Whenever a payment is taken from an account to pay for training from a government approved training provider, the service automatically uses the funds that entered the account first and funds remain available for use from service accounts for 24 months, after which time they will expire.

Where there are insufficient funds in the digital account to cover the apprenticeship training costs, the employer must pay 10% of the outstanding balance.

The government will pay the remaining 90% up to the funding band maximum. Where the funding band maximum is exceeded the employer must pay all of the additional costs.

Funding bands

Every individual apprenticeship is allocated to a funding band, the upper limit of which represents the maximum amount that the government will pay towards it.

Employers that do not have to pay the levy

When the new funding system begins in May 2017, these employers can choose suitable training for their apprentices and are required to pay a 10% contribution to the cost of this training.

The government will pay the rest (90%), up to the maximum amount of government funding available for that apprenticeship.

www.gov.uk/government/publications/apprenticeship-levy-how-it-will-work

Off-payroll working in the public sector

From 6 Aril 2017 the way that the intermediaries' legislation is applied to off-payroll working in the public sector is changing. The draft Finance Bill 2017 and draft NICs amending regulations detail the changes that are being.

Last month HMRC published four guidance documents explaining the changes to be made. The first document explains the principles behind the change while the remaining three provide specific guidance to engagers, fee-payers and individuals.

It is important that public authorities, agencies and third parties supplying contractors should consider existing contracts and prepare for the change.

The changes

Previously, responsibility for deciding whether the legislation should be applied lay with the worker's intermediary. From 6 April 2017 that responsibility shifts to the public authority that the worker is supplying their services to. The reform applies to all payments made on or after 6 April 2017, including payments for work that is completed before 6 April 2017 but where payment is made after.

Where a public authority employs a worker through an intermediary, it must decide if the off-payroll working rules for the public sector apply. If they do, the fee-payer (public authority, agency, or other third party paying the intermediary) will calculate Income Tax and primary National Insurance contributions (NICs) and pay them over to HMRC. This Income tax and NIC is then deducted from the intermediary's fee for the work provided.

- The individual can pay themselves this amount through their payroll without Income Tax and NICs. Such non-taxable payments should be reported on the Full Payment Submission (FPS) submitted to HMRC.

- Where they also work in the private sector, they will need to determine if the existing intermediaries legislation rules apply to that work and where appropriate, calculate a deemed employment payment for those contracts.

- Where the individual pays a dividend from their company's profits, this can be paid tax-free up to the total of the net fee received from contracts in the public sector, where Income Tax and NICs have been deducted at source. This dividend does not need to be declared on their self-assessment return.

It is important to remember that an intermediary can be a personal service company, partnership or other individual. Most intermediaries providing a worker's services in this way will be personal service companies.

Employment Status Service

The service is optional and will replace the existing Employment Status Indicator tool.

Interested parties can use this new tool to obtain the HMRC view on whether current and prospective workers fall within the off-payroll rules. Like the current tool, the user answers a number of questions around the relationship between the worker and the public sector client they are contracted with. It is for the public authority to decide whether off-payroll working rules should apply.

If a worker thinks they have been taxed incorrectly, they can submit a repayment claim to HMRC who will then determine if they are due a repayment of Income Tax or NICs and repay as appropriate.

Guidance for engagers

This guidance outlines the steps for public authorities to consider when engaging with third parties to decide whether they fall within the intermediaries legislation effective from April 2017.

Guidance for fee-payers

This guidance outlines the PAYE responsibilities of those who pay for services provided by individuals to the public sector through intermediaries such as personal service companies from April 2017.

Guidance for individuals using personal service companies

This guidance outlines changes to the way an individual's personal service company will get paid where it is determined that the intermediaries legislation applies to services provided to a public sector organisation from April 2017.

www.gov.uk/guidance/off-payroll-working-in-the-public-sector-reform-of-intermediaries-legislation

New Avoidance schemes currently in the HMRC spotlight

On 14 February 2017 HMRC added two 'Spotlights' to its targeted list of tax avoidance schemes. They concern disguised remuneration schemes that seek to avoid the new charge on loans outstanding at 5 April 2019, under legislation to be included in Finance Bill 2017:

- Spotlight 35: Disguised remuneration using annuities
- Spotlight 36: Disguised remuneration schemes claiming to avoid the new loan charge

The schemes featured in Spotlights are generally those that HMRC consider have the widest implications and about which there is the greatest need to warn potential users. They will often be schemes that have been disclosed to HMRC and have been given a Scheme Reference Number (SRN). The issue of a SRN does not mean either that HMRC 'approves' the scheme or that HMRC accepts that the scheme achieves its intended tax advantage.

Budget 2016 included a new 'loan charge' on disguised remuneration loans outstanding on 5 April 2019. To prevent attempts to exploit the new loan charge, a targeted anti-avoidance rule will ensure further avoidance schemes do not work.

Spotlight 35

HMRC are aware of a new disguised remuneration tax avoidance scheme that uses annuities as an alternative method of paying people for their services in an attempt to avoid paying tax and NICs on their income. The scheme is mainly aimed at contractors and involves the scheme user being paid in two parts:

1. Small salary and so little or no Income Tax or NICs liability
2. Capital payment for a deferred annuity which is claimed to be non-taxable

HMRC say that these schemes represent disguised remuneration within the scope of the proposed new loan charge to be introduced on 5 April 2019 and to avoid this charge, the capital sum for such a deferred annuity must be paid back by 5 April 2019.

Spotlight 36

HMRC are aware that some promoters are claiming to have come up with schemes that enable users to get out of the loan arrangements and avoid the loan charge, in return for a fee.

HMRC say that these schemes do not work. The only way to avoid the new loan charge is by making a repayment of the loan balance or settling the tax liability with HMRC in advance. Any repayments connected to a new tax avoidance arrangement will be ignored, and the loan charge will still apply.

www.gov.uk/government/publications/tax-avoidance-schemes-currently-in-the-spotlight

Business Taxation

Trading and property allowances **(Lecture B1001 – 10.33 minutes)**

In his Budget last year, the previous Chancellor announced two new £1,000 allowances for trading and property income respectively, each to take effect from 6 April 2017. The aim of this measure was, in HM Treasury's words, 'to provide simplicity and certainty regarding income tax obligations on small amounts of income from providing goods, services, property or other assets'.

Sch 5 FB 2017 inserts a new Part 6A into ITTOIA 2005 which gives individuals full relief on trading and property income of up to an allowance of £1,000 in each case. Individuals with income of the requisite type that does not exceed their allowance will no longer have to declare and pay tax on such income. This eliminates the need for the recipients to determine their allowable expenses or to contact HMRC to declare the income.

Partial relief

The new legislation also introduces a partial relief where the individual's income is above the level of the allowance. In that case, the individual can elect to pay tax using what might be described as the alternative method, ie. based on his receipts less the value of the allowance (instead of deducting his actual expenditure). The time limit for making this election is the first anniversary of the normal self-assessment filing date for the tax year for which the election is made, eg. 31 January 2020 for a 2017/18 election.

An individual can elect, within the same time limit, not to be given full relief. In these circumstances, the tax result will be calculated using normal figures, ie. income received less expenses incurred. This option is only likely to be adopted where there is a loss and the relevant income does not exceed £1,000.

Partnerships

As far as the trading allowance of £1,000 is concerned, trades carried on in partnership do not count as a qualifying trade in the context of this relief. HM Treasury say that partnerships have been excluded 'to avoid adding extra complexity to the rules'.

Several sources of income

If an individual has more than one source of trading income, he can choose how to allocate his £1,000 allowance between the different sources. This will only be necessary where his aggregate trading income exceeds £1,000 and he has made an election to use £1,000 as his base cost. The obvious caveat is that he cannot, however, utilise this option as a means of creating a loss for any of his sources.

Real Estate Investment Trusts

In the context of the property allowance of £1,000, distributions from a Real Estate Investment Trust and income representing rent-a-room receipts do not qualify as income from an eligible property business.

Any individual with a tax reduction in lieu of what will soon be non-deductible mortgage interest costs is excluded from relief under this provision.

Anti avoidance

Note also the anti-avoidance provision that is intended to stop employers from trying to reclassify payments to members of staff (or to persons connected with them) in order to allow them to take advantage of this relief.

There is a similar property anti-avoidance rule to that described above.

Contributed by Robert Jamieson

Proving deposits are not business income

Summary – Mr Barreto largely failed to show that bank deposits were not business income.

In 2008/09, Mr Barrato, a self-employed financial adviser, reported turnover of just under £9,000 and profits of £662.

HMRC enquired into this return. Despite claims for travel to numerous clients across the country they considered that his reported income appeared to be low and this income level was not enough to support his family's lifestyle.

During the enquiry, Mr Barreto disclosed income and gains which had not been disclosed on his tax return including the sale proceeds from the disposal of a property in Cyprus, interest on various UK and non-UK bank accounts and dividends on certain listed shareholdings. These matters were not in dispute.

What was in dispute was just under £52,000 of unexplained deposits in Mr and Mrs Barreto's bank accounts. Having taken into account items that Mr Barrato could explain including dividends received and a university loan repaid by his daughter, £26,570 remained unaccounted for. Mr Barrato put forward various explanations including the repayment of a loan by a personal friend, client disbursements and the cashing in of travellers cheques following two holidays. None of these explanations proved satisfactory to HMRC.

In July 2015, HMRC issued an assessment for just under £10,000 being the tax on undeclared business income of £26,570 plus an estimated £3,000 for cash receipts not banked. They also raised assessments for the tax years 2006/07, 2007/08, 2009/10, 2010/11 and 2011/12, with estimates based on the 2008/09 assessment, adjusted for the movement in RPI. In making these assessments, HMRC relied on the "presumption of continuity" in Jonas v Bamford [1973] STC 519.

In December 2015 HMRC issued penalty notices. For 2006/07 and 2007/08 HMRC raised penalties under under s95 TMA 1970 on the basis that Mr Barreto had negligently delivered returns and reduced the maximum penalty to allow for the partial disclosure of information made by Mr Barreto in the course of the enquiry, the degree of cooperation given by Mr Barreto and the level of seriousness of the issues involved. For 2008/09, 2009/10, 2010/11 and 2011/12, HMRC raised penalties under s24 Finance Act 2007 for the submission of a 'careless' inaccurate return with 'prompted disclosure'.

Mr Barrato appealed against the assessments and penalties.

Decision

For 2008/09, in principle the Tribunal agreed with HMRC that Mr Barrato was unable to prove that the cash deposits were not undeclared business income. However, they held that £1,566.67 should be reallocated from 2008/09 back to 2007/08, the tax year to which the income related. Additionally they held that the £3,000 included as unbanked cash receipts should not be included.

Given that Mr Barrato presented no other evidence to displace the basis on which HMRC estimated the assessments for the earlier years, the Tribunal held that it was reasonable for HMRC to make the assessments on the basis that they were made. The figures should be adjusted to take account of the Tribunal's adjustments to the 2008/09 return.

The Tribunal did not disagree with HMRC's method of calculation of the penalties but said they needed to be adjusted to reflect the adjustments made to the assessments.

The Tribunal allowed the appeal in part.

Larry John Barreto v] v Revenue and Customs Commissioners (TC 05618)

Failure to pay class 2 National Insurance

Summary – The taxpayer was allowed to top of Class 2 contributions by making additional contributions.

Mr Arens had engaged an accountant to manage his tax affairs and had met all his tax and class 4 National Insurance liabilities in the relevant years. However, he failed to pay class 2 National Insurance contributions for many years and consequently only qualified for 63% of the full state pension. HMRC refused to allow him to make additional contributions on the grounds that the failure was due to the taxpayer not taking due care and diligence

Decision

The Tribunal said that Mr Arens had appointed an accountant to manage his tax affairs and, as a tradesman with little tax knowledge, he believed he was paying the correct amounts due.

He relied on his adviser to manage his affairs and as soon as he became of the class 2 issue he looked to top up his shortfall. He had exercised due care and diligence and should be allowed to make the additional contributions.

The taxpayer's appeal was allowed.

Stephen Arens v Revenue and Customs Commissioners (TC05597)

Substantial shareholding exemption reform (Lecture B1003 – 16.54 minutes)

An important exemption

Since FA 2002, many trading companies and groups have been able to obtain a capital gains exemption when selling their trading subsidiaries under the Substantial Shareholding Exemption (SSE). The somewhat unfortunate corollary is that no relief is available for capital losses arising on an SSE-qualifying disposal.

For these purposes, 'substantial' means at least a 10% stake in the relevant company's ordinary share capital (plus other economic rights such as an entitlement to profits available for distribution). Thus, as well as disposals of trading subsidiaries, the SSE applies to sales of equity interests in joint ventures and other affiliated companies. There is no distinction drawn between disposals of a UK-resident company and an overseas company.

The detailed rules are set out in Sch 7AC TCGA 1992. The main qualifying conditions for this relief are summarised below:

- The investing company must be a sole trading company or a member of a trading group throughout a qualifying period which begins at the start of the relevant 12-month 'substantial shareholding' period (see (iii) below) and ends when the shareholding is sold.

- Immediately after the disposal, the investing company must continue to be a trading company or a member of a trading group.

- The relevant shareholding investment must qualify as a 'substantial shareholding' held in the investee company throughout a 12-month period starting no more than two years before the shares are disposed of. The purpose of this time limit is to allow subsequent disposals out of what was once a substantial shareholding to continue to qualify for exemption for a further 12 months, notwithstanding the fact that the 10% minimum threshold may no longer be satisfied.

- The investee company must be a trading company or the holding company of a trading (sub-)group from the start of the 12-month 'substantial shareholding' period and ending with the disposal date.

- Immediately after the disposal, the investee company must be a trading company or a member of a trading group.

In practice, most disposals tend to meet the required conditions by reference to the 12 months immediately prior to the disposal date.

The consultation last year

In 2016, the Government launched a consultation on a possible reform of the SSE. This followed discussions with stakeholders on the benefits to the competitiveness of the UK's tax regime in the event of a relaxation of some of the SSE's requirements. One of the areas considered was the condition that both the company whose shares are being sold and the vending company/group had to be undertaking trading activities.

It was pointed out that this stipulation has lessened the attractiveness of the UK as a holding company location, particularly for real estate investment which, for SSE purposes, is not generally regarded in this country as a trading operation.

As a result, the Government have decided to proceed with several significant reforms in order to achieve their goal of making the SSE rather more favourable – see S27 FB 2017. These take effect for disposals made on or after 1 April 2017.

Removal of investing company trading condition

As already mentioned, a serious cause of uncertainty in the existing rules is the requirement that the investing company is either a trading company or a member of a trading group. While it is normally reasonably straightforward to determine this status where the company making the disposal is not part of a group, this determination often has to be made in the context of what one commentator has called 'a large, complex and changing worldwide group of which the investing company is part'.

The removal of this requirement by FB 2017 is therefore very welcome. Not only will it significantly reduce the compliance burden behind the judgment of whether an investing company meets the trading test, it will also simplify the regime itself. In addition, other restrictions such as the complications currently faced when a group disposes of its last trading subsidiary will disappear.

Extension of 'substantial shareholding' period from two to six years

The existing rules require the investing company to have held a shareholding of 10% or more of the ordinary share capital of the company whose shares are being sold for at least 12 months in the two years prior to the date of disposal. As illustrated in above, this two-year requirement enables an investing company to continue to qualify for SSE where it sells the shares in question in a fragmented fashion as long as, once the shareholding falls below 10%, the remaining shares are disposed of within a further 12 months.

It is sometimes the case, particularly in a private equity exit scenario, that a disposal may have to be fragmented over a longer timescale, for example where the investing company's holding falls below 10% because the investee company is subject to an Initial Public Offering. By extending the period from two to six years, FB 2017 is seeking to alleviate this fragmentation problem.

Removal of post-disposal investee company trading condition

Where the disposal is to an unconnected party, FB 2017 will no longer require the investee company to continue to be undertaking trading activities immediately after the disposal.

Many share sales are undertaken under a contract where completion occurs some time after the contract has become unconditional (which is the point at which beneficial ownership of the shares is lost and the disposal is made). In this situation, the investee company is presently required to meet the trading condition not just until the time of the contract becoming unconditional but – importantly – until after completion.

In a third party sale, the vending company may not be in a position to determine with certainty the trading status of the company being sold and so the removal of this trading condition represents a welcome improvement in the SSE regime.

Note that the trading requirement has been retained where the disposal is to a connected party, given that, in these circumstances, the investing company is likely to be able to influence whether the company invested in continues to trade.

Broader exemption for companies owned by institutional investors

There were hopes that the Government might be persuaded to relax the rule that the company invested in had to be trading. This would be of particular benefit to organisations such as real estate funds and sovereign wealth funds which are involved in real estate investment as well as trading activities. These funds invariably carry a high level of liquid assets. As a result, they do not usually qualify for SSE treatment and so typically establish holding structures in other, ie. non-UK, jurisdictions.

The broader exemption being proposed by S28 FB 2017 goes some way towards meeting the needs of the funds sector. It specifies that a post-31 March 2017 gain on a substantial shareholding in any company (whether trading or not) will qualify for SSE relief where, immediately before the disposal, at least 80% of the disposing company's ordinary share capital is owned directly or indirectly by 'qualifying institutional investors', eg. life assurance companies, sovereign wealth funds or investment trusts.

Contributed by Robert Jamieson

Foreign exchange losses

Summary – Foreign exchanges losses arising following a group reorganisation were allowable.

Smith and Nephew PLC is a UK company split into two sub groups:

1. UK operations with functional currency in sterling;

2. Overseas operations with functional currency in USD

Smith and Nephew Overseas (SNO), TP Limited (TP) and Smith and Nephew Finance Holdings Limited (SNFH), are all companies owned by Smith and Nephew Investment Holdings Limited. (SNIH) part of the UK operations. With the exception of large interest free intercompany receivables, SNO, TP and SNFH did not trade. Their accounts only reported notional interest on their sterling intercompany receivables.

Following a group reorganisation on 23/24 December 2008, SNO, TP and SNFH became part of the overseas part of the group and their intercompany receivables were cleared and their functional currency became USD. For the year to December 2008, the companies recognised exchange losses as a result of the fall in value of the pound against the US dollar. This was reported within their statement of total recognised gains and losses as follows:

- SNO recognised an exchange loss of $877,458,000;

- TP recognised an exchange loss of $271,925,000;

- SNF recognised an exchange loss of $178,408,000.

The losses arose because on 23 December 2008 they changed functional currency to US Dollars.

On 16 April 2014 HMRC issued closure notices under paragraph 34(2) Sch. 18 FA 1998 disallowing the losses claimed by each of the companies.

SNO, TP and SNF appealed to the First Tier Tribunal and in accordance with directions issued on 16 June 2014 their appeals have been heard together.

Decision

Both parties agreed that companies can apply one of two methods when accounting for a change in functional currency: the Foreign Operation method or the Single Rate method. Either of these may be appropriate depending on the facts and circumstances.

The companies believed that it was correct to adopt the Foreign Operation method while HMRC, the Single Rate method.

A consequence of using the single rate method is that because all of the results are translated as a single rate, there are no exchange differences that could arise.

Given that Deloitte, PwC and KPMG manuals all supported the Foreign Operations method and that EY signed an unqualified audit report for the year concerned, the Tribunal said that the Foreign Operations approach was appropriate.

The Tribunal also held that:

'…as there was a fall in the value of the assets, the Intercompany Receivables, in the present case at the second date, 31 December 2008 when compared with their value as at 31 December 2007 as stated using the Foreign Operation method in what we have found to be UK GAAP compliant accounts it must follow that the Exchange Differences are exchange losses within s 103.'

The appeal is therefore allowed.

Smith And Nephew Overseas Limited, T P Limited, Smith And Nephew Finance Holdings Limited v Revenue and Customs Commissioners (TC05644)

UK/Netherlands agreement on dividends

The UK and the Netherlands signed a competent authority agreement in December, setting out the conditions and documentary evidence necessary for insurance companies resident in the Netherlands with pooled pensions business to qualify for the treaty exemption from Netherlands tax on dividends, where the beneficial owner of the dividends is a UK pension scheme.

The agreement entered into force on 22 December 2016.

Documentation to be provided in support of a claim includes:

- confirmation that the insurance company is claiming only in respect of 'pension business' as defined in FA 2012 s 58;
- a schedule of all of the pension schemes to which the claim relates and confirmation that these are registered UK schemes;
- where pension business is reinsured from other insurance companies, a schedule of the names and addresses of those insurance companies;
- confirmation that none of the above companies will make a claim for similar treaty benefits;
- confirmation letter from HMRC to accompany the first claim and annually thereafter

Tax Journal (17 February 2017)

VAT

Backdated deregistration

Summary – Retrospective deregistration for VAT was not possible, even though the taxpayer had originally registered on a voluntary basis.

Based on their accountant's advice, on 1 November 2011 the taxpayer applied to register for VAT on a voluntary basis when it took over a café.

Having registered for VAT, the directors failed to account for VAT on sales as they believed that VAT was not payable until trading exceeded the annual VAT registration threshold. They did not submit VAT returns until they had received default surcharges and central assessments from HMRC.

So why the business thought it to be a good idea to register was unclear.

Neil Warren, independent VAT consultant, commented that:

> 'The only time a café would want to register for VAT on a voluntary basis is if it had a lot of input tax to claim on capital expenses or if most of its sales were zero rated as cold takeaway food, so it would be in a repayment situation on its VAT returns.'

In August 2014, the taxpayer notified HMRC that they had new advisers who, on 12 August 2014, applied for the business to be de-registered saying that "The business was erroneously registered for VAT when it was incorporated and has not reached the required threshold". A year later, the taxpayer's advisers asked for the deregistration to be backdated to November 2011 on the basis that the taxpayer should not have registered in the first place.

HMRC refused the request, relying on VATA 1994, Sch 1 para 13(1).

Decision

The Tribunal acknowledged that the taxpayer had chosen to register for VAT on a voluntary basis (Sch 1, para 18) and that they incorrectly believed that, once registered, they did not need to account for VAT until its turnover exceeded the VAT registration threshold.

However, deregistration applies only when HMRC receives an application to cancel the registration and that retrospective cancellation was not possible as it would have contravened Sch 1 para 13(1).

The taxpayer's appeal was dismissed.

Inspired by Service Ltd v Revenue and Customs Commissioners (TC05537)

Marriott reward program

Summary – payments to Redeemers was the 'generic service' of agreeing to provide reward stays without charging members cash

Each time customers paid for a qualifying stay at a participating hotel or a "non-hotel participant" in the Program (a sponsor), Marriot Rewards LLC issued reward points to the member.

When customers had earned sufficient points, they could use those points to gain a free reward stay at a participating hotel or to obtain other goods and services from non-hotel participants. At that point, Marriott Rewards then made a payment to the hotel supplying the reward stay (the 'redeemer').

There were two appeals to consider: one by Marriott Rewards (US) and the other by a Redeemer, Whitbread Group plc (UK).

1. HMRC refused Marriot Rewards claim under s39 VATA 1994 for recovery of some £8.3m of VAT relating payments made to Redeemers. HMRC argued that this was third party consideration paid on behalf of members staying at Redeemers' hotels.
2. Whitbread received payments from Marriott Rewards. Whitbread's appeal relates to HMRC's refusal to repay £2.4m of output tax. Whitbread argues that they supplied services to Marriott Rewards as a Redeemer and that the sums received were consideration for that supply. However, they argue that the supply took place in the US, where Marriott Rewards belonged making the supply outside the scope of VAT.

Decision

The first issue was whether the payments made by Marriott Rewards to the Redeemers were consideration for services supplied by the Redeemer to Marriott Rewards, as contended by Marriott Rewards and Whitbread, or third party consideration paid by Marriott Rewards to the Redeemer on behalf of members, as contended by HMRC.

The Tribunal found that payments to Redeemers were consideration for services that Redeemers were providing to Marriott Rewards and not third party consideration. Redeemers made a hotel room available under the Marriot Program in return for a fee.

Secondly, if the payments were consideration for services, what was the nature of those services?

Quoting from the case report:

> Whitbread argues that they were "advertising services" which, under the place of supply rules in force prior to 1 January 2010 (the period relevant to Whitbread's appeals) were treated as supplied in the US, where MR belongs. Accordingly, Whitbread argues that it had no obligation to account for output tax on supplies that it made in its capacity as a Redeemer (since, being supplied in the US, they were outside the scope of VAT).

> By contrast, MR argues that the services it received were connected with immovable property which, under the place of supply rules in force after 1 January 2010 (the period relevant to MR's appeals) were treated as made in the UK. Therefore, MR argues that services it received from UK- based Redeemers were subject to VAT with the result that MR can claim a repayment of VAT under s39 of VATA 1994.
>
> …… MR's appeal would fail if its characterisation of the supplies was wrong and Whitbread's appeal would fail if its characterisation was wrong.

The Tribunal found that the service provided was the 'generic service' of agreeing to provide reward stays without charging members cash; it was neither advertising nor connected to immovable property and so both appeals failed

Marriott Rewards LLC Whitbread Group PLC v Revenue and Customs Commissioners (TC 05634)

NHS Greater Glasgow – Fleming claim

Summary – The decision of the First Tier Tribunal was upheld and the Fleming claim was denied.

This appeal concerned a Fleming claim by the NHS Greater Glasgow and Clyde Health Board looking to recover input tax relating to business activities during a 20 year period from 1974 to 1994. It is one of a number of similar appeals by health authorities in Scotland.

As a reminder, following the House of Lords decision in Fleming (t/a Bodycraft) v HMRC [2008] STC 324 and the subsequent amendment to the law made in S121 Finance Act 2008, traders' entitlement to recover input tax for periods going back to 1973 was restored but only if claims are submitted by 31 March 2009.

On 30 March 2009 the health board had claimed £3,571,517.74 in respect of dining room expenditure, residual business expenditure and other capital expenditure. However, since 31 March 2009, the health board had altered claims, maintaining that each altered claim was simply a modification of the original claim, but was fundamentally still the same claim. By contrast, HMRC argued that the changes were new and different claims that were time-barred.

At the First Tier Tribunal, the appeal was refused on the ground that the health board had failed to prove that an amount of input tax was due to it and also that the claim to recover input tax due to a predecessor authority was a new claim which was time-barred because no figures for that Board had been included in the claim which had been made on 30 March 2009.

The health board appealed to the Upper Tribunal claiming that:

1. The First Tier Tribunal's decision did not contain adequate findings in fact or reasons and that the health board were "simply in the dark" as to the basis upon which the appeal had been refused.

2. The First Tier Tribunal had misdirected itself in law as to its jurisdiction. The Tribunal had found that the health board had substantially proved its case but had not proved that a precise amount of input tax was repayable. The Tribunal's role was to find a just solution.

3. The First Tier Tribunal's decision was unreasonable. Given that the overall conclusion that a substantial sum of VAT had been overpaid, it had been unreasonable not to make further findings accepting the health board's approach and allowing the appeal in whole or in part.

4. The First Tier Tribunal had erred in law in holding that the claim was time-barred in so far as it related to VAT paid by Argyll and Clyde Health Board. It was accepted that no element of the claim lodged on 30 March 2009 had contained any figure that related to Argyll and Clyde Health Board.

Decision

The Upper Tribunal looked at each argument raised in turn and concluded that the First Tier Tribunal had:

1. Clearly explained that it was not happy with the basis of apportionment between business ad non-business supplies nor was it happy with the extrapolation method adopted based on four out of twenty years accounting results.

2. Been correct to approach the appeal on the basis that it was for the health board to satisfy it that on the balance of probabilities that it was entitled to the repayment.

3. Not erred in law when finding that claims were new claims and therefore time-barred.

The appeal was dismissed.

NHS Greater Glasgow and Clyde Health Board v Revenue and Customs Commissioners

[2017] UKUT 19 (TCC)

Spare parts derived from end-of-life vehicles

Summary – Spare parts from end-of-life vehicles qualified as second-hand goods for the purpose of the margin scheme.

The issue was whether the profit margin scheme applicable to second-hand goods applies to the sale of parts from end-of-life vehicles.

Decision

Second-hand goods' includes movable tangible property suitable for further use as it is or after repair, and is derived from other property in which it was incorporated. The used property must have maintained the functionalities it possessed when new.

The court concluded that motor vehicle parts are therefore second-hand goods.

In Sjelle Autogenbrug I/S v Skatteministeriet (Case C-471/15) (18 January 2017)

Is a motor home zero rated?

Summary - The Upper Tribunal found that motor homes were not caravans and so zero rating did not apply.

Oak Tree Motor Homes Ltd sold motor homes, motor caravans and campervans. Between March 2007 and May 2011 it charged and accounted for standard rated VAT on supplies but later looked to reclaim the VAT, arguing that the vehicles were caravans under Schedule 8 Group 9 Item 1 VATA 1994.

HMRC refused the claim and the company appealed to the First Tier Tribunal who decided that the vehicles were not caravans and dismissed the taxpayer's appeal.

Decision

The Upper Tribunal said that caravans were defined as 'a dwelling on wheels, able to be towed' and agreed with the First Tier Tribunal's decision that because the vehicles sold by Oak Tree were able to move under their own power, they were not caravans.

Interestingly, with effect from 6 April 2013, VATA 1994, Sch. 8, Grp. 9, item 1, now definitively excludes such vehicles so clarifying the law before that date.

The standard rate applied to the taxpayer's supplies of vehicles and its appeal was dismissed.

Oak Tree Motor Homes Ltd v CRC, Upper Tribunal (Tax and Chancery Chamber)

Universities using non-UK based agents to recruit overseas students

Summary – Up to 1 January 2010, overseas agents' commission did not fall within the reverse charge mechanism but input VAT was not recoverable.

With many universities looking to recruit students from outside of the EU on to their courses, this case is a lead case for 15 similar appeals in which HMRC contend that the University is liable to output VAT on the commission that it pays to agents as a reverse charge (Section 8 VATA 1994).

Overseas agents work with overseas students to identify a range of different universities from which they can choose to make applications to. The University can appoint more than one agent in any particular region and it currently uses over 100 agents worldwide. Agents are only paid for their work if a student successfully enrols on a course with a university.

The university argues that when it pays commission to the overseas agents that commission should be split in two:

1. Third party commission paid on behalf of overseas students for support services provided by the overseas agent. As both students and agents are outside of the UK, no VAT is due.

2. Commission paid by the university for recruitment services supplied by the overseas agent. They argue that the general place of supply rule in Article 43 of the Principal VAT Directive applies in the period up to 1 January 2010, with the place of supply being deemed to be the place where the supplier was established. With the agents being outside the EU, no VAT would be chargeable up to 1 January 2010.

   From 1 January 2010, amendments were made to the legislation such that the reverse charge did apply with such supplies now deemed to be made in the UK.

   Additionally the university argued that Article 44, which excludes the general rule where intermediaries supply services, acting in the name and on behalf of another person, did not apply as:

   - Agents did not act in the name and on behalf of the University;
   - Article 44 only applies where the services supplied relate to a supply of goods from principal to consumer.

Finally, the university says that if they are liable to VAT then they are entitled to input tax recovery for a proportion of that VAT on the basis that it is residual input tax under the partial exemption special method calculation.

Decision

The Tribunal held that:

'(1) Agents make a single supply of services to the University and make no supplies to students.

(2) The place of those supplies for the periods in question was determined by reference to the general rule in Article 43 PVD. It is where the agents were established. Article 44 had no application because the agents did not act in the name and on behalf of the University.

(3) The University is not entitled to recover as input tax VAT for which it is required to account by means of a reverse charge. There is no direct and immediate link between the commission paid to agents and any taxable output of the University or the economic activities of the University as a whole.'

University Of Newcastle Upon Tyne v Revenue And Customs Commissioners (TC05639)

Flat rate scheme – Avoiding being a limited cost trader? (Lecture B1004 – 13.25 minutes)

Background

On 1 April 2017, the VAT bills of many flat rate scheme (FRS) users will increase dramatically because of the introduction of the new 'limited cost trader' category for those users who buy less than £250 of goods in a VAT quarter or spend less than 2% of their total VAT inclusive turnover for the quarter on goods.

The new category has a 16.5% rate, which means there is virtually no credit for input tax (£10 of input tax for every £1,000 of output tax for a business with only standard rated sales).

The 16.5% rate is at least 2% higher than any existing category. It will be relevant to 123,000 out of 411,000 scheme users according to HMRC estimates. Many scheme users will decide to leave the scheme and revert to normal VAT accounting (output tax less input tax) but is there anything that clients can do to avoid paying this extra VAT? In other words, will certain planning strategies avoid them being classed as limited cost traders in some or all VAT quarters?

Draft legislation for limited cost traders

The draft SI issued by HMRC on 5 December 2016 will add a new paragraph 4 to Regulation 55(A) of the 1995 VAT Regulations:

> "(4) For the purposes of this Part, "limited-cost trader" is a flat-rate trader whose expenditure on relevant goods in any prescribed accounting period, together with any VAT chargeable on that expenditure, is less than the specified amount, where—
>
> (a) "relevant goods" are goods used or to be used by a flat-rate trader exclusively for the purposes of the trader's business but excluding the following—
>
> (i) vehicles, vehicle parts and fuel except where the category of business applicable to the flat-rate trader in the Table is "Transport or storage, including couriers, freight, removals and taxis" and the flat-rate trader owns a vehicle for business use or holds a vehicle for business use under a lease;
>
> (ii) any food or beverages for consumption by the flat-rate trader or employees of the flat-rate trader;
>
> (iii) capital expenditure goods;

Example 1

John is a health and safety consultant. He trades through a limited company earning about £200,000 each year including VAT (all standard rated sales). In reality he is a labour only business; his biggest expense is rail travel (zero-rated), so the FRS is a financial winner, especially as he qualifies for the favourable rate of 12% for 'business services not listed elsewhere'.

Note – you might wonder why John can use the FRS when his annual sales exceed £150,000 excluding VAT. The latter figure is the joining threshold but once in the scheme, a business does not need to leave until gross sales have exceeded £230,000 on the anniversary date of when the business joined the scheme (VAT Notice 733, para 12.2).

John's annual VAT payments will increase by £9,000 after April 2017 because he will move from the 12% category to that of a limited cost trader at 16.5% ie £200,000 x 4.5% = £9,000.

Possible solution: if John introduces a secondary activity on 1 April 2017, buying and selling goods on eBay, then he will avert becoming a limited cost trader if his spending on these goods (plus spending on his existing goods such as stationery) is at least 2% of his VAT inclusive sales.

Note – John might want to join the annual accounting scheme on 1 April 2017 ie completing one VAT return each year instead of four. He then only needs to do the limited cost trader calculation for one period instead of four ie the relevant figure for goods is £200,000 x 2% ie £4,000.

Comment – the bizarre outcome of this suggestion is that even if the secondary activity is a disaster, and the goods on eBay are sold at a heavy loss, then the loss on the goods will be less than the VAT saving of £9,000. . So John is in a "win win" situation!

Example 2

Rebecca has annual gross sales of £30,000 including VAT and also uses the FRS and the 12% rate for other business services. Her business is also labour only with negligible input tax so her annual win with the FRS is about £1,400 compared to normal VAT accounting ie output tax charged to customers is £5,000 and VAT paid to HMRC is £3,600 with the 12% rate. She will also be classed as a limited cost trader after 1 April 2017.

Planning tip: if Rebecca introduces a secondary activity buying and selling, say, books for friends, then as long as the activity is done on a business basis (making a profit), then the purchase of books will be relevant goods as far as the £250/2% threshold is concerned.

Note - Rebecca only needs to buy goods of £250 each VAT quarter to keep her 12% FRS category. The relevant figure is £250 because 2% of her annual sales is £150 per quarter so the higher figure of £250 therefore takes effect. If she already buys stationery costing, say, about £300 a year, she only needs to buy other goods costing £700, always ensuring the quarterly total exceeds £250 of course.

Stationery stock

Many accountants have correctly identified that stationery items such as paper and print cartridges are the main 'goods' bought by FRS users who are likely to be affected by the new 16.5% rate. So is there scope for business owners to go online before the end of each VAT quarter and spend 2% of their gross sales (or £250 if higher) on envelopes, paper clips or print cartridges? This might make commercial sense with discounts usually being available for bulk purchases, and the discount savings could also give the opportunity for future sales to be made to business friends and colleagues and make a small profit as well.

The disadvantage is that you will need a bit of surplus storage space to handle the extra stock.

Example 3 - Author buying stationery

Janet is an author who is VAT registered and uses the FRS with a rate of 12%. Her annual VAT inclusive turnover is £60,000 (all standard rated as publishers are all UK based). If Janet is classed as a limited cost trader after 1 April 2017 and must adopt the 16.5% rate, then her annual VAT bill will increase by £2,700 ie £60,000 x 4.5%. She currently spends £350 each year on stationery items, so if she increased this by £851 to £1,201 (ie so that her spending on goods exceeds 2% of her gross sales), then she can continue to adopt the 12% FRS category. The VAT savings with the scheme exceed the cost of the extra stationery.

Revised buying strategy

In my last FRS session for Tolley Online Seminars, I shared the example of an accountant earning £10,000 each quarter including VAT, who spends £240 including VAT on goods. In other words, he is a limited cost trader because although £240 exceeds 2% of his gross sales, it is less than the other key figure of £250. So he must apply the new 16.5% rate.

However, there is an easy way for the accountant to avoid being a limited cost trader for three out of his four VAT quarters. This is because instead of buying his stationery (or other goods) on an even basis throughout the year (ie £80 a month), he could plan his spending so that he spends £320 in each of three VAT quarters and none in the fourth ie £320 x 3 gives the same total as £240 x 4 but means he as has exceeded the 2% and £250 spending target in three of his four VAT quarters with the figure of £320. This revised buying strategy would not be classed as tax avoidance but a better way of planning the tax affairs of the business ie just like the decision to invest in an ISA to avoid paying income tax on bank interest. This option definitely produces a "sleep easy at night" outcome.

Conclusion

The draft legislation on the new limited cost trader category states that the goods must be "used or to be used……..exclusively for the purpose of the trader's business." Applying this phrase to each of the above situations, they all fulfil this criteria because the goods are either being bought for resale at a profit or consumed in the business as is the case with the stock purchases. However, despite these suggestions, many FRS users will decide to either leave the scheme or, if they are registered for VAT on a voluntary basis, possibly deregister.

Contributed by Neil Warren

HMRC powers - what is ‘best judgment’? (Lecture B1005 – 12.11 minutes)

Introduction

An accountant I know has recently dealt with a VAT assessment raised against a restaurant business for whom he acts. There were a lot of references in the HMRC correspondence about how the officer had used his ‘best judgment’ to calculate the tax due and the accountant’s question to me was very direct: “Why it is necessary to keep going on about ‘best judgment’ – after all, it is unlikely that he would use his ‘worst judgment’?”

The starting point with this question is that ‘best judgment’ is the actual phrase used in the legislation at s73, VATA1994, giving an officer the power to raise an assessment where he thinks that tax has been underpaid. In reality, most ‘best judgment’ assessments will relate to underdeclared output tax rather than inflated input tax claims.

What the law says……..VATA1994, s73:

> “(1) Where a person has failed to make any returns……or where it appears to the Commissioners that such returns are incomplete or incorrect, they may assess the amount of VAT from him to the best of their judgment and notify it to him”

Practical issues of legislation

Let us consider two underpayments of VAT:

1. Bill the builder did a job for a private individual for £12,000 – he incorrectly zero-rated the job when it should have been standard rated.

2. Ben the café owner has only declared a 25% gross profit on his annual accounts and VAT returns, even though his pricing structure suggests he should be making at least 50%. An officer from HMRC has decided that output tax has been underpaid.

In the first situation, Bill owes exactly £2,000 in underpaid VAT – not a penny more and not a penny less. However, the underpayment of output tax for Ben will never be established as an exact figure. The only strategy available to the officer is for him to ‘guestimate’ how much tax Ben owes by carrying out a series of calculations that take into account all known factors about the business and its trading structure.

The important phrase in the previous sentence is ‘known factors’ – in other words, HMRC must take into account all information available to them about a business but do not need to carry out extensive investigations to establish all relevant facts. I always enjoy the colourful comment made by the High Court judge in the case of Schlumberger Inland Services Inc. [1987] STC 228 when he said that an assessing officer…..”is not required to possess and deploy the deductive powers of Sherlock Holmes and the clairvoyance of Madam Arcati provided that the assessment raised is not in excess of what could reasonably be payable.”

Landmark case - Pegasus Birds Ltd (EWCA Civ 1015)

Many VAT enthusiasts will remember the Pegasus Birds case back in 2004 when HMRC raised an assessment of more than £650,000 against a company which imported and sold tropical birds. Ironically, this assessment equated to about £4m of off-record sales. The officer carried out a mark-up exercise to project the total sales made by the company, and it is fair to say that he got a bit carried away with the numbers.

The first tribunal concluded that the assessment was excessive, and not made to the best of the Commissioners' judgment, concluding that 'the tax evaded was only a small fraction of that assessed.'

However, the Court of Appeal reversed the decision on the basis that the role of the tribunal was not to determine whether the assessment was excessive but merely to establish whether HMRC had used 'best judgment' in their calculations. The Court concluded that the officer raising the assessment 'did his honest and genuine best, however mistaken he may have been.' The case was sent back to the tribunal to establish the true amount of the assessment.

Overall, therefore, the long-term outcome of the Pegasus case seems to be that a tribunal will consider two stages in the process of reviewing a 'best judgment' assessment:

Is there any evidence to suggest that the officer has not used his best judgment in the calculation process eg has he acted dishonestly or unfairly, or ignored important information provided by the taxpayer?

Is there any evidence to suggest that the actual amount of tax assessed is incorrect? Is there evidence to indicate that the assessed amount should be reduced?

HMRC approach

So how do HMRC instruct their officers to approach this subject? HMRC manual VAEC1460 is worth a read (search via google) and highlights the importance (or preference) of HMRC officers having more than one piece of evidence to suggest that output tax has been understated. So going back to Ben, it would be useful for HMRC to observe how many customers come into his café on a typical trading day, and decide whether this number (based on average spend) is compatible with the declared takings figures.

HMRC assessment strategy

VAEC1510 (HMRC internal guidance note) ………Determine the overall credibility of your assessment

Once you have calculated the arrears to best judgement, you should ask yourself is this figure credible? Could the business have actually under-declared this amount of tax.

The tribunal will consider the above questions. If the amount you calculate does not pass the credibility test then your assessment may not be to best judgement. Ensure you have given enough consideration to all the facts and evidence.

If an assessment has not been made to best judgement, then it may be deemed to be invalid and cannot be maintained. In legal terms an invalid assessment is said to have never existed

The Hodges case – a defeat for HMRC

In the case of *Matthew Hodges* (TC4419), a bit of investigative work led the visiting officer to conclude that Mr Hodges had suppressed £4m of sales made by his one-man scaffolding business over a four-year period. Needless to say, the taxpayer challenged HMRC's calculations and the court agreed that the income projections were ludicrous.

The assessment had been based on HMRC's 'best judgment' but the tribunal concluded that the taxpayer's own assessment of the figures produced a much more sensible outcome (the phrase 'more nearly right' was used in the case report).

The tribunal agreed with HMRC that Mr Hodges had deliberately omitted sales from his records and that VAT had been underpaid. The reason is because HMRC carried out a 'street sweep' and identified 10 different addresses where his sign boards were displayed and scaffolding had been erected but only one of the 10 addresses was shown as a subsequent sale in his books and records. So HMRC boldly concluded that he had suppressed 90% of total sales in four years, totalling £4m. It is important to explain that the tribunal hearing was only about penalties rather than VAT because Mr Hodges' trading business (Aqua Scaffolding Ltd) had already gone into liquidation.

In such cases, the legislation gives HMRC the power to collect penalties in some cases from the company officers. Mr Hodges was the sole director of ASL.

The reason why the 90% figure is so ludicrous is because about 85% of Mr Hodges' work was for other builders, and it is fair to say that it would be very difficult to suppress 90% of these sales because of the heavy volume of paperwork involved in the contracts – invoices, CIS documents, payment certificates etc. So a more sensible approach would have been for HMRC to conclude that he might have suppressed 90% of the 15% 'private' jobs. The revised calculations produced a VAT liability of £11,153 instead of £529,536 calculated by HMRC. The final penalties were therefore established at £1,902 for dishonest conduct (VATA1994, s61, now repealed) and £5,905 for making deliberate and concealed errors on VAT returns (FA2007, Sch 24, para 19). A total penalty charge of £7,807 was much better than the figure of £394,694 calculated by HMRC.

Contributed by Neil Warren