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Personal tax

2020/21 NIC limits and thresholds (Lecture P1181 – 19.20 minutes)

NIC limits and thresholds for 2020/21 have been announced and draft regulations have been laid before Parliament.

The above inflation increase in the primary threshold and the lower profits limit is a move towards the government's aim to raise these amounts to align with the personal allowance.

Class 1 NIC

	2020/21	2019/20
Lower earnings limit	£120 per week £520 per month £6,240 per year	£118 per week £512 per month £6,136 per year
Primary threshold	£183 per week £792 per month £9,500 per year	£166 per week £719 per month £8,632 per year
Secondary threshold	£169 per week £732 per month £8,788 per year	£166 per week £719 per month £8,632 per year
Upper earnings limit	£962 per week £4,167 per month £50,000 per year	£962 per week £4,167 per month £50,000 per year

Class 2 NIC

	2020/21	2019/20
Weekly amount	£3.05	£3.00
Small profits threshold	£6,475	£6,365

Class 3 *NIC*

	2020/21	2019/20
Weekly amount	£15.30	£15.00

Class 4 NIC

	2020/21	2019/20
Lower profits limit	£9,500 pa	£8,632 pa
Upper profits limit	£50,000 pa	£50,000 pa

Avoiding the agency trap (Lecture P1181 – 19.20 minutes)

An agency is a person or business that makes arrangements for someone to work for a third person, the end client. HMRC guidance states that employment intermediary (or agency) rules must be followed if all of the following conditions apply:

- the worker personally provides services to the client;
- there is a contract (verbally or in writing) between the client and agency;
- as a consequence either the worker's services are provided or the client, directly or indirectly, pays for the services.

A couple of examples taken from HMRC's guidance will explain how these conditions apply. More examples can be found by following the link at the end of this article.

Example 1 - agency finds Nick work

Nick registers with various agencies. The Find-a-job Agency puts him in touch with a person who wants a decorator for 2 weeks.

Nick will:

- engage directly with the client to establish what work they want doing, carry out the work and provide the client with an invoice
- pay the agency 5% of the fees he charged the client

Nick is personally providing the services to the client but the agency legislation does not apply because there is no contract between the client and the agency.

Example 5

John enters into a contract with Tyneside Conservatories Limited (TCL) to supply and fit a conservatory. Once TCL have the structure in place John is so impressed with the work he asks TCL to provide workers who can install electrics and central heating. TCL tells John he can supply the labour at £40 per hour and John agrees to pay TCL for the workers providing their services.

Both the plumber and the electrician, the workers, personally provide their services to John, the client. There is a contract between TBL (the agency) and John (the client) to provide the workers' services, so the conditions in the agency legislation about a worker personally providing their services and the contract appear to be satisfied. However, it is possible that the agency rules do not apply as the work may fall into to one of the excepted categories (see below)

PAYE and reporting

Under the agency rules, your client will need to treat the workers it supplies as if they were their employees and account for PAYE and national insurance on the payments they receive from the company.

However, where another party is the contractual employer, such as an umbrella company, that party should be responsible for accounting for PAYE and national insurance on the worker's pay, including the money received from the work that you have arranged.

Exceptions to agency rules

HMRC guidance states that the agency rules do not apply if the worker falls into one of the following categories:

- worker provides their service without either the agency or end client having the right to supervise, direct, or control how they do the work;.
- Worker always works from their own home, or on premises not controlled or managed by the client - unless the type of service being provided to the client means the worker has to be at those premises;
- provides their services as an actor, singer, other entertainer or model.

This means that where a worker is professionally qualified, skilled or experienced and accepts an engagement, they should not fall within the agency rules provided they are not subject to supervision, direction or control over the manner in which the services are supplied.

So what is meant by each of these three terms?

1. Supervision: Someone checks or has the right to check the work that the worker is doing to make sure it meets a required standard. This can involve helping the worker develop their skills and knowledge.
2. Direction: Someone provides instructions, guidance, or advice as to how the work must be done.
3. Control: Here someone tells a worker how to do the work, with the possibility that they could ask the worker to move from one job to another.

Reporting where PAYE does not apply

If your client arranges the services of other workers to a customer but consider that they are not responsible for PAYE and NI, they must send quarterly reports to HMRC giving details of the worker's name and address plus:

- how they were engaged and paid for their work;
- why your client believes they are not responsible for PAYE and NI;
- details of anyone else who is an agent in the supply chain for the worker's services.

Not just employment agencies

Remember, agency rules do not just apply to employment agencies. Individuals, partnerships or companies supplying workers to clients could also be caught by these rules. In theory, if your client is undertaking a project for a company, and that company asks your client to find a worker to do some work for them, your client could be caught by these rules. To avoid the rules, they should leave the worker to contract directly with the end client as the rules do not affect workers engaged directly by the end client. Clearly this is not always practicable.

https://www.gov.uk/government/publications/employment-intermediaries-personal-services-and-supervision-direction-or-control/employment-intermediaries-personal-services-and-supervision-direction-or-control

IR35 review (Lecture P1181 – 19.20 minutes)

A common issue raised over the course of the review has been businesses' concerns over what payments the rules apply to and from when. The government has listened and taken action early to give businesses certainty and more time to prepare to ensure the smooth and successful implementation of the reforms that come into force in April.

HMRC has announced ahead of the publication of the government's review that changes to the operation of the off-payroll working rules will only apply to payments made for services provided on or after 6 April 2020. Previously, the rules would have applied to any payments made on or after 6 April 2020, regardless of when the services were carried out. It means organisations will only need to determine whether the rules apply for contracts they plan to continue beyond 6 April 2020.

https://www.gov.uk/government/news/hmrc-announces-change-to-the-off-payroll-working-rules

Corresponding deficiency relief denied

Summary - Corresponding deficiency relief, relating to chargeable event gains on surrendered life assurance policies, cannot be used to reduce the rate at which a taxpayer's capital gains are charged.

The case concerned the use of corresponding deficiency relief relating to surrendered life assurance policies. Broadly, the relief applies where the total benefits from a policy over its life exceed both the premiums paid for the policy as well as gains from earlier partial surrender. Once calculated, the relief is effectively used to reduce income tax payable on the policy surrender but only to the extent that income is liable at the higher rate tax. The relief effectively serves to increase the basic rate band so unless income is liable to income tax at higher rate or dividend upper rate on some income, there will be no tax reduction and deficiency relief will be of no benefit. Deficiency relief will not reduce the amount of tax due on income liable at the additional rate or the dividend additional rate of income tax. Any relief that is not claimed in the year that it is calculated is lost.

Andrew Scott invested substantial sums in life assurance policies. On the final surrender of these policies, it was calculated that he was entitled to in excess of £20 million of corresponding deficiency relief in 2006/07 and 2007/08. This relief greatly exceeded the income taxable at the higher rate and Andrew Scott considered that the claims should have a similar effect on his chargeable gains, so that they were chargeable at the lower rate of 20% rather than at the higher rate of 40% (under the rules in force at that time). In the years concerned, he claimed his chargeable gains totalling just over £23 million over 2006/07 and 2007/08 should be taxable at 20%.

Andrew Scott's argument was based around parliamentary intention at the time seeking to unify the rates of income tax and CGT. He argued that he should be able to use the unused part of the deficiency relief as relief from his higher rate of capital gains tax. When calculating his unused basic rate band for CGT, his total income should be reduced by the full amount of the deficiency relief, so producing a 'negative' total income figure that should be deducted from the basic rate limit. Extending the band in this way would mean that a substantial sum of gains would fall to be taxed at only 20%.

In total he claimed his chargeable gains of £8.8 million in 2006/07 and £14.7 million in 2007/08 should be taxable at 20%.

Decision

The Court of Appeal acknowledged the government's statutory objective at the time. However, they concluded that this did not mean that unused deficiency relief could be extended to CGT.

They stated that 'negative' total income was not a meaningful concept. The Court agreed with HMRC, and the courts prior to this hearing, that when calculating the unused basic rate band, the total income could only been notionally reduced to zero and no further. No deficiency relief was available for gains purposes.

The Court stated that if Parliament had intended to extend the basic rate band for CGT purpose by the full amount of the corresponding deficiency relief, it would have stated this in a clear manner.

The taxpayer's appeal was dismissed.

Andrew Scott v HMRC [2020] EWCA Civ 21

Saving for a pension **(Lectures P1182/ P1183 – 17.22/ 19.14 minutes)**

An important report

Late last year, the Office of Tax Simplification (OTS) published a 92-page report entitled 'Taxation And Life Events: Simplifying Tax For Individuals'. In this context, the OTS explored individuals' experiences of engaging with tax – essentially income tax and NICs – in relation to a wide range of significant life events such as having a child, entering the workplace, changing jobs, saving for a pension, drawing a pension in retirement and helping others who are less able to look after their own affairs. This chapter examines their thoughts on the pension saving landscape.

A little history

The Government launched the first old age pension – for men over 70 – in 1908. Then, in 1921, they came up with the idea of tax relief for pension contributions. A universal state pension was introduced in 1948. As the number of pension savers and providers grew over the course of the next few years, the area, in the words of the OTS, 'attracted more regulation to promote greater fairness across the population and to protect savers from misappropriation of their pension savings'.

Occupational pension schemes (i.e.. schemes provided by employers) are of two main types:

- defined contribution (DC) schemes where the savings accumulate over time so that, when the individual retires, they can either buy an investment (known as an annuity) which will pay out a set amount each year or keep the investment and 'draw down' sums as and when needed, with the amount of the potential pension being dependent on the size of the accumulated fund; or

- defined benefit (DB) schemes where the savings secure the right to a pension equal to a specified amount, based on, say, the employee's final salary or a career average calculation (DB schemes are still common in the public sector, but most private sector DB arrangements have closed, at least for new entrants).

In addition, individuals can have a personal pension – this operates on a DC basis. It is the only type of pension available to someone who is self-employed. An individual enrolled in an occupational scheme may also contribute to a personal pension.

In 2006, a comprehensive reform of pensions and taxation took effect to rationalise the tax system as it applied to pensions. This was in response to criticism that the regime for pension saving had become so complex that it was actually discouraging individuals from providing a pension for themselves. The OTS commented:

> 'The outcome was one income tax regime across all individual and occupational pensions (previously, there had been eight). Individuals with existing pension savings had the option to opt out entirely from the new regime or to go into it with some protection for funds over the new limits.
>
> As part of (these) 2006 reforms, limits were placed on annual and lifetime pension saving through the mechanism of the annual allowance (AA) and the lifetime allowance (LTA).'

For 2019/20, the AA is £40,000, although this can reduce on a sliding scale to a minimum of £10,000 once a threshold of £150,000 is exceeded (this depends on the individual's level of income and pension saving). The LTA for 2019/20 is £1,055,000.

Despite the ostensible simplification in 2006, pension saving and related tax issues have become increasingly complex for many pension holders over the last 14 years, mainly as a

Another difficulty has been the introduction of the money purchase annual allowance (MPAA) in 2015 which was brought in to limit future relief for pension contributions where an individual had flexibly accessed their pension pot in certain circumstances. The MPAA was initially set at £10,000 per tax year, later reduced to £4,000 for 2017/18 onwards.

It is now time to examine some of the problem areas.

NIC interaction

NICs are paid by employees and employers, based on the employee's salary. Pension contributions made by employees do not affect the amount of NICs which they pay, although such payments have a beneficial knock-on effect on the employee's income tax liability. Intriguingly, it has always been the case that employer pension contributions are not included in the base on which NICs are calculated. This misalignment, as the OTS pointed out in 2016, means that employees and employers often enter into salary sacrifice arrangements, as a result of which the employee reduces their gross salary and the employer increases their pension contribution accordingly. This salary reduction leads to lower NIC costs for both employee and employer, which in turn could be used further to boost the amount saved into the individual's pension.

Given that this arrangement has a very high exchequer cost, one wonders whether we might be in line for a change in the rules before too long.

'Relief at source' and 'net pay' schemes

When providing pensions for their staff, employers have a choice between operating what is known as a 'relief at source' scheme or a 'net pay' scheme (Ss192 and 193 FA 2004). For employees with earnings at or below the level of the personal allowance (currently £12,500), the different way in which these arrangements work means that someone in a 'relief at source' scheme effectively pays less for their pension than someone in a 'net pay' scheme, even though they both end up with the same amount in their pension pot. As the OTS explain, 'this anomaly arises from the interaction between the mechanics of the tax relief and the personal allowance'.

Unfortunately, many employers tend to choose 'net pay' schemes, given that the administration for these arrangements is rather more straightforward – see Illustration 7 below.

Example 1

Kate works for Anmer Enterprises Ltd, earning £12,500 in 2019/20. Under auto enrolment, her employer operates a 'net pay' scheme to which Kate's contribution is £625. All of this is deducted from her pay – in other words, her annual salary becomes £12,500 – £625 = £11,875. However, because Kate's full income was already covered by her personal allowance, she receives no benefit from the tax relief available on her contribution.

With a 'net pay' scheme, Kate would never have to claim tax relief separately, even if she were liable to pay at higher rates, and Anmer Enterprises Ltd's pension fund does not need to recover basic rate tax from HMRC on Kate's contribution. Note the comment above about easier administration.

Kate's friend, Megan, is employed by Wizard Solutions Ltd which operates a 'relief at source' scheme. She receives exactly the same salary as Kate, but, instead of paying £625 out of her qualifying earnings into the scheme, Megan makes a net contribution of £625 less 20%, i.e.. £500. The pension fund recovers this 20% from HMRC, regardless of the level of Megan's income.

Consequently, Megan is £125 per annum better off than Kate as a result of Wizard Solutions Ltd choosing to operate a 'relief at source' rather than a 'net pay' scheme.

Government statistics show that a very large number of employees – well in excess of 1,000,000 – are affected by this issue. It seems anomalous that, for some people, the availability of tax relief depends not on their tax status but rather on which type of scheme has been adopted by their employer.

AA and LTA charges

There are two restrictions which are intended to limit the amount of pension tax relief available to any one individual:

1. the AA; and
2. the LTA.

The AA sets an upper limit on how much an individual's pension savings can grow from one year to the next with the individual continuing to benefit from full income tax relief. The way in which this growth is determined varies between DC and DB schemes, given that the modus operandi of each is very different. Growth in the context of a DC scheme is measured by the amount saved into the pension fund. For DB schemes, the calculation is much more complicated: it is necessary to work out, by reference to a special formula, how much the individual's pension entitlement has changed over the last 12 months.

Remember that any unused AA can be carried forward for up to three years. In other words, it may be possible to have available more than the standard £40,000.

If the growth limit is exceeded, a free-standing income tax charge is triggered at the taxpayer's highest marginal rate(s). This is known as an AA charge. The OTS say:

> 'Knowing that an AA charge exists is not obvious. The rules are complex and widely misunderstood. HMRC's guidance is unclear and open to interpretation. At one point, it recommends that taxpayers go to a financial adviser specialising in tax and pensions.
>
> An individual must be warned by their pension provider by 6 October if their contributions into a particular scheme have exceeded the AA for the previous tax year. They may also be warned that they are in danger of incurring an AA charge in some other circumstances. However, in general, no warning will be received if the person has more than one pension scheme, though some public sector scheme administrators give members a statement for each of their schemes that a member is in, if they exceed the AA when looking across those schemes.
>
> The calculation is different depending on whether the scheme is a DB or DC scheme. Guidance on www.gov.uk is comprehensive and includes a calculator, but is difficult to navigate and the distinction between the different calculation methods for DB and DC pensions is not made clear. It lacks examples to illustrate the various terms. A flow chart to guide people through the calculation is essential.'

So the OTS are not that impressed with HMRC's assistance!

Once calculated, the AA charge can be paid in one of two ways:

1. direct to HMRC through self-assessment; or

2. through the pension fund by a process known as 'Scheme Pays'.

This latter alternative is always voluntary for the taxpayer, but it goes without saying that 'Scheme Pays' necessarily reduces the individual's entitlement to a future pension, given that some of the value of the fund is being used to meet the charge.

There is no limit to how much can be saved by an individual into one or more pension funds over their lifetime. However, if the value of their pension entitlement exceeds the LTA, another form of stand-alone income tax charge will be incurred. This is called the LTA charge. It applies to the total value of all pensions from registered schemes of which the individual is a member. Both DC and DB schemes are covered. It does not require the state pension to be included.

The calculation of the aggregate value of an individual's pension depends on the type of scheme:

- For DC pensions, it is the value of funds saved and accumulated by investment growth.

- For DB pensions, the value is arrived at by multiplying the annual pension by 20 and adding any cash lump sum.

With DB arrangements, savers usually receive an annual statement showing the value of their pension. The possibility of exceeding an individual's LTA can therefore readily be spotted. By contrast, with DC pensions, it is not easy to make such a forecast. This is because DC pensions increase in value not only through regular and irregular saving of money but also because of the growth in value of the fund's investments. This growth is impossible to predict and so savers into DC pensions may find themselves subject to the LTA charge through no decision of their own.

The MPAA

The MPAA rules are intended to prevent the practice of 'recycling' where earnings saved into a DC pension (which have already attracted tax relief) are taken out and subsequently invested into another DC pension, qualifying for further relief. Of course, this became much more of a practicable proposition following the introduction of the 'pension freedom' arrangements in 2015.

The legislation works by creating a revised annual limit (£4,000 for 2019/20) on the amount which can be saved into DC pension schemes where the saver takes money out of any other DC pension scheme which they have. Unfortunately, many people who have more than one personal pension and who access one of their pension pots under the 'pension freedom' rules seem to be unaware that their ability to continue to save tax-efficiently into, say, their main pension may now be significantly restricted. They can also be subject to HMRC penalties for not notifying their other pension providers that they are subject to a greatly reduced AA. See Illustration 8 below for an example of the sort of problems which the MPAA in its current form can create.

Case study - Karen

Karen is 57. Since leaving school at the age of 18, she has had a variety of jobs. Karen's parents struggled financially in their retirement, but Karen does not want to be in that position. As a result, she has always tried to put money aside for her old age. She has several pension pots from different employers and has also been saving separately into a personal pension scheme since her 35th birthday.

One year ago, the retail business where Karen was working went into administration and she was made redundant. Fortunately, she found another job three months later and hopes to continue working until state pension age which, in her case, is 67.

When Karen was made redundant, she took stock of all her pension funds. One of them contained only £11,000 and so, in order to tide her over, she took out £3,000 as a lump sum, using a flexible access drawdown arrangement. She did some research before going ahead with this withdrawal and saw that people were being encouraged to take professional advice. However, as this was a small pot and not really material to her overall savings, Karen did not think that there would be much point in spending money on tax and financial advice.

She subsequently discovered that, as the £3,000 represented more than 25% of the fund's total of £11,000 (25% x £11,000 = £2,750), she would have to pay income tax on the excess £250, but this modest tax bill seemed a small price to pay.

Karen's new job pays her a good salary and so she wants to increase the amount which she saves each month. She has 10 years left in which to build up this latest pension pot and the money column which she reads in the Daily Mail encourages people to save as much as they can, even in their 50s and 60s, because of the tax relief which provides another 20%.

Karen plans to save around £650 per month in total. She is shocked when she is informed that she will not receive tax relief on much of this money. She is told that something called the MPAA means that anyone who takes a lump sum from a pension pot (where they are liable to pay income tax on all or any part of it) can only obtain tax relief on future contributions of up to £4,000 in any one year.

To say the least, Karen is surprised. Having taken just £3,000 rather than £2,750 means that, over the next 10 years, she will lose around £7,600 in tax relief (assuming that she continues to contribute at the present rate until she is 67). This figure is worked out by taking 20% of the excess of her annual payments over £4,000 for a 10-year time frame. Thus:

		£
12 x £650 = £7,800 for 10 years		78,000
Less: MPAA (x 10)		40,000
		38,000
20% thereof	£7,600	

Karen is informed that the MPAA rule is intended to stop people from abusing the system. She does not understand why the restriction should apply to her. She thought that the new system was meant to be more flexible than before and to allow people to make better use of small pension pots.

Conclusions

The OTS feel that:

1. the Government should consider the potential for reducing or removing differences in outcomes between 'net pay' and 'relief at source' schemes, especially for employees on modest incomes;

2. HMRC should ensure, sooner rather than later, that their guidance on the tax consequences of particular pension arrangements and choices is fuller and clearer than it currently is;

3. the Government should review the impact of the AA and LTA rules and consider how the deliver against the legislation's policy objectives; and

4. the Government should assess the operation of the MPAA, given its very real possibility for producing unfair results.

Contributed by Robert Jamieson

Year-end tax planning for individuals (Lecture P1184 - 15.27 minutes)

With the end of the tax year fast approaching, now is a good time to check that clients have taken advantage of all of the reliefs and allowances that are available to them.

Annual allowance for pensions

The current annual allowance for pension contributions is £40,000, higher for those who have any unused relief from the previous three tax years.

Unfortunately, high earners have their annual allowance restricted by £1 for every £2 that their total income, including employer's pension contributions, exceeds the £150,000 threshold. This can reduce the allowance to a minimum of £10,000.

Now is a good time to check to see if your clients have any available funds, and available allowance, so that they can invest in their pension fund before the end of the tax and receive tax relief at their marginal rate of income tax.

ISA planning

Individuals are able to invest up to £20,000 per annum into an ISA, where income generated and any gains made on closing the account are income and capital gains tax-free.

Unfortunately, any unused allowance in a tax year cannot be carried forward so make sure that clients do not miss out on investing funds in appropriate ISAs before the year.

For the under 40s, up to £4,000 of their ISA allowance can be invested in a lifetime ISA, receiving a 25% bonus on the amount invested. Clients must be careful to only use these funds for allowable purposes; failure to do so will mean that the 25% bonus will be withdrawn. The money can be used towards the purchase of a first home, in the event of a terminal illness or by waiting until they are 60 and then withdrawing the money invested.

Personal savings and dividends allowance

The personal savings allowance is an income tax free allowance on interest earned, with the amount of the allowance varying depending on the taxpayer's marginal rate of tax. The tax-free amount is:

- £1,000 for basic rate taxpayers; and

- £500 for higher rate taxpayers.

The allowance is not available to additional rate taxpayers.

All taxpayers, irrespective of their marginal rate of tax, receive the first £2,000 of dividend income tax free. Any excess dividends are then taxed at the taxpayer's appropriate marginal rate being 7.5% for dividends falling into the basic rate band, 32.5% in the higher rate band and 38.1% for additional rate taxpayers.

Where individuals are not currently benefitting from these allowances, consideration should be given to see if rearranging their tax affairs for the following year might put them in a better position, particularly for married couples and civil partners who may not maximising the use of their total allowances.

IHT planning

Individuals should consider whether they can make use of any IHT gift exemptions before the year-end, but it's also worth considering whether they may be able to benefit from these exemption going forward.

Annual exemption: The first £3,000 of gifts in a tax free are covered by this exemption and where not used, the allowance can be carried forward for one tax year, enabling £6,000 to avoid IHT the following year.

Wedding gifts: Where clients are considering making gifts in consideration of marriage, certain amounts may be gifted tax-free: £5,000 to a child, £2,500 to a grandchild and £1,000 to anyone else.

Gifts out of income: Make sure that clients are aware that recurring gifts out of their income, rather than wealth, can be gifted annually tax free. So regular birthday and Christmas gifts should not a problem.

One-off gifts: Up to £250 person may be gifted each year to individuals provided that no other IHT exemption applies to the same gift.

Tax efficient investments

Higher arte taxpayers, who are not risk-averse, could consider investing in EIS, SEIS and VCT investments. Provided that the relevant conditions are satisfied, the individuals will benefit form income tax relief on investment and also avoid CGT on the eventual sale of the investments.

CGT planning

Where an individual is considering disposing of capital assets, it might be worth bringing that sale forward to ensure that they use their £12,000 annual exemption> remember, any unused annual exemption is wasted as it cannot be carried forward to a future year.

Remember gifts of assets between spouses and civil partners are CGT free and owning the assets jointly, would mean that on disposal, the couple would benefit from two annual exemptions.

Where a sale is planned, is it possible to spread it over two tax years to benefit from two year's worth of annual exemption?

Transferring the personal allowance

Where a taxpayer is married or in a civil partnership, 10% of the £12,500 personal allowance can be transferred if not being used. It can't be transferred to a higher rate taxpayer and so only applies to individuals in the basic rate band.

Created from the seminar by Alexandra Durrant

Giving shares to employees (Lecture P1185 – 18.54 minutes)

Basic provisions

Businesses often consider offering shares to their employees as remuneration and reward. This can be by way of an option to acquire shares, either through one of the approved schemes or an unapproved scheme. The employee is given an option to acquire shares in the company at a specified price in the future. The treatment will depend on the nature of the scheme. Directors are often key employees and will be offered these types of incentives. Where these notes refer to employees, the provisions equally apply to directors.

However, there can be other circumstances in which employees can find themselves as shareholders without having received those shares through an option scheme, normally simply by being awarded shares by the employer.

Any shares acquired by an employee by virtue of their employment are called 'employment related securities' and are subject to a vast tranche of anti-avoidance legislation mainly due to the creative way in which shares and share schemes were used to mitigate tax and National Insurance Contributions in the late 1990s. This means the rules are complex and employers may find themselves having to deal with difficult issues even where what they are doing is not motivated by a desire to avoid tax.

General principles

This legislation does not apply just to shares, but to all securities as defined by s.420 ITEPA 2003. This encompasses shares, loan stock and other debentures, futures, units in collective investment schemes and instruments conferring rights over securities. It also includes rights under phantom share schemes although these are really just cash bonus schemes and so normally not dealt with under these rules.

The legislation can only apply to securities acquired by reason of the employment (s.421B ITEPA 2003); this can include former or prospective employments. However, any right or opportunity to acquire securities given by the employer is treated as by virtue of the employment unless the person offering the right or opportunity is an individual and is made in the course of normal domestic or personal relationships. HMRC have become much stricter on this particular point. For example, they had previously accepted that employees undertaking MBOs via a new company vehicle were obtaining shares in that vehicle as entrepreneurs and not by virtue of their employment. This is no longer acceptable; it has made the structuring of such transactions difficult.

Considering the exclusion of shares transferred by reason of domestic relationships, the important point to note is that this only applies where the transferor is an individual so the company cannot issue new shares to the employee; they must receive the shares from the individual with whom they have the domestic relationship.

ERS (employment related securities) are taxed under the general principles relating to employment income, falling within s.62 ITEPA 2003. This means that any ERS received for which the employee pays less than market value will be taxed on the difference as employment income. This principle was established in the case of Salmon v Weight.

It would be useful if the regime relating to ERS was as simple as that! Since the basic tax charge is calculated as being the difference between the market value and the price paid, it would be in the interests of employers to minimise the market value to mitigate the tax payable by the employee. This can be done in various ways and legislation has been put in place to counter all of the common devices to reduce value. It is this legislation which causes such significant problems when considering the taxation of ERS. It should be noted that the legislation detailed below operates in addition to any tax charge which arises under general principles i.e. it does not supersede a general charge under s.62 ITEPA 2003 on acquisition of securities except in particular circumstances.

Anti-avoidance legislation

The basic principles relating to ERS are then enhanced by the stringent anti-avoidance legislation often generically referred to as the 'Schedule 22' provisions although these are now found in Part 7 of ITEPA 2003. If the securities have certain properties, there are ongoing tax consequences. In basic terms, where the legislation applies, increases in value after issue of the shares may be liable to tax as employment income rather than being taxed under the often more beneficial capital gains tax code. An employee often assumes that they will get capital gains treatment of gains on shares but are then caught by employment income rules creating a considerable unexpected cost.

The legislation catches the following situations:

- Restricted securities;
- Convertible securities;
- Shares which have been artificially suppressed in value;
- Shares which are artificially enhanced in value;
- Shares acquired at less than market value (not caught by general legislation);
- Securities disposed of for more than market value;
- Post-acquisition benefits received in relation to ERS;
- Restricted securities.

One of the easiest ways to reduce the market value of securities is to restrict the rights on the shares or make them subject to forfeiture in particular circumstances. Although many such restrictions will be for commercial reasons, for example to retrieve shares from employees who leave their employer, many were used for tax avoidance purposes. This led to the introduction of stringent anti-avoidance legislation on any shares which fall within the definitions of restricted securities.

Securities are defined in s420 Income Tax (Earnings and Pensions Act) ITEPA 2003. Restricted securities are then defined in s423 ITEPA 2003.

There are three types of restrictions which will bring an ERS within these provisions but only if the restriction reduces their market value. The three types are as follows:

1. there will be a transfer, reversion or forfeiture of the ERS on the operation or non-operation of a specific event and the person will not be entitled to compensation at least equal to their market value at that time;

2. there are restrictions on the freedom of the person holding the ERS to dispose of those ERS or retain the proceeds of the sale; or

3. there are any provisions under which disposal or retention of the ERS may result in a disadvantage to the holder, the employee or any person connected with them.

There are exceptions to these rules. Shares will not fall within these provisions if:

- shares are unpaid or partly paid and will be subject to forfeiture if the calls are not met; or
- the individual must dispose of the securities where employment is ended because of misconduct.

UNLESS the main purpose (or one of the main purposes) of the issue of the ERS was the avoidance of tax or National Insurance Contributions (NICs).

Where there are ERS which are restricted securities, there is no charge on acquisition under s62 ITEPA 2003 if the restriction is the type under the first heading shown above and they will cease to be restricted securities within five years of acquisition. This arises because of s425 ITEPA 2003.

It is possible to elect to disapply this under s425(3) ITEPA 2003 i.e. to have the tax charge remain in place. There are a number of conditions that need to be fulfilled. It will be seen later why it might be advantageous to do this.

There is a charge to tax in relation to restricted securities on the occurrence of a chargeable event. The following are chargeable events:

- The shares ceasing to be restricted;

- Variations being made to the shares without them ceasing to be restricted securities; and

- Shares being disposed of for consideration whilst still being restricted.

There is no charge under the rules if all of the following apply:

- The ERS are shares in a company of a particular class;

- The provision (by virtue of which the ERS are restricted securities) applies to all the company's shares of the same class;

- The event which affects the ERS has not been done as part of a scheme or arrangement the main purpose (or one of the main purposes) of which is the avoidance of income tax or NICs;

- All the company's shares of the class (other than the ERS) are affected by an event similar to that which is a chargeable event in relation to the ERS; and

- EITHER the company is employee controlled by virtue of holdings of shares of that class OR the majority of the company's shares of the class are not ERS.

The legislation tells us that the formula for calculating the tax charge on the happening of a chargeable event is:

UMV x (IUP – PCP – OP) - CE

- UMV is the unrestricted market value
- IUP is the initial untaxed proportion
- PCP is the previously chargeable proportion
- OP is the outstanding proportion
- CE is the amount paid.

The rationale behind this is discussed below – it is not as complicated as it looks!

It is useful to understand the rationale behind this formula. The charge on initial acquisition of the shares is based on the market value of the restricted shares which takes into account the restrictions attaching to the shares. If they had no restrictions the market value would be higher. This higher value is known as the IUMV – initial unrestricted market value.

As restrictions are lifted the actual market value (AMV) of the shares moves closer to the unrestricted market value (UMV). The proportionate increase in AMV is taxed at that time using the above formula.

There are tax elections which the employer and employee can make:

- An election to ignore the restricted securities rules and take the unrestricted market value into account on acquisition of the shares (s431 ITEPA 2003); and

- An election to ignore the future outstanding restrictions on a subsequent chargeable event (where not all restrictions are lifted) (s430 ITEPA 2003).

Where the main purpose of the issue of ERS is for the avoidance of tax or NICs, then the election under the first heading above is treated as being made automatically so the charge on acquisition will always be made by reference to the unrestricted market value.

Why might such an election be made? This is probably best illustrated by an example.

Example 1

a) Restricted shares are acquired with a market value of £7. The unrestricted market value at that date is £10. £7 is paid for the shares.

What is the tax charge on acquisition?

MV at acquisition (restricted)	7
Less: amount paid	(7)
Taxable	-

If an election under s431 is made to ignore the restricted securities rules:

MV at acquisition (the IUMV)	10
Less: amount paid	(7)
Taxable	3

There will be no further tax charges as the unrestricted market value has been used.

b) A chargeable event occurs at which time AMV = 12 and UMV = 15. What is the charge assuming no s431 election was made?

Applying the formula: UMV x (IUP – PCP – OP) – CE:

$$15 \times \{\frac{10-7}{10} - 0 - \frac{15-12}{15}\} = 1.5 \text{ charged}$$

If an s430 election is made:

$$15 \times \{\frac{10-7}{10} - 0 - 0\} = 4.5 \text{ charged}$$

c)A second chargeable event occurs when AMV = 15 and UMV = 16.

Assuming no s431 or s430 elections were made on past events:

$$16 \times \{\frac{3}{10} - \frac{1.5}{15} - \frac{16-15}{16}\} = 2.2$$

If an s430 election is made:

$$16 \times \{\frac{3}{10} - \frac{1.5}{15} - 0\} = 3.2$$

d) A third chargeable event occurs when AMV = UMV = 20 when all restrictions are lifted.

Assuming no previous elections:

$$20 \times \{\frac{3}{10} - (\frac{1.5}{15} + \frac{2.2}{16}) - 0\} = 1.25$$

In summary:

	S431 election	S430 election after event 1	S430 election after event 2	No election
On acquisition	3	-	-	-
After event 1	-	4.5	1.5	1.5
After event 2	-	-	3.2	2.2
After event 3	-	-	-	1.25
Total tax charge	3	4.5	4.7	4.95

The elections have resulted in earlier charges to tax but less charge overall. If the share value has decreased over time then the election would have resulted in a higher charge. The advantage of the s431 election is to give certainty of the charge on acquisition and if the share values increase dramatically, the difference in overall tax payable can be significant. It is important to acknowledge, however, that the tax charge would not be repaid if the value of the shares goes down and clients must realise that risk.

In reality, it is fairly standard to put a s431 election in place and the difference in value is often nothing like as extreme as is suggested in examples such as that above.

Convertible shares

Convertible securities are those which have a right of conversion into other shares or securities. The right to convert does not have to be exercisable only by the employee but the right of conversion must exist at the time of acquisition by the employee.

The legislation operates in a similar way to the restricted securities provisions. The initial tax charge is based on the market value as if the shares were not convertible unless the main purpose for the arrangements is the avoidance of tax in which case the right to convert is not ignored.

There is then a tax charge on a later chargeable event. These chargeable events are:

- Conversion of securities;
- Disposal of securities whilst they are still convertible;
- Release of entitlement to convert.

The formula for the taxable amount is as complicated as that for restricted securities but is rarely encountered in practice. Basically, it brings into charge to income tax the uplift in value which the individual gets on conversion or on disposal. If there is a release of entitlement to convert, any amount received is taxed as income.

Shares with artificially enhanced market value

The major catch-all piece of legislation relating to securities that have an artificially enhanced market value has been very widely drawn and would have caught many of the abuses that were used in the past as tax-saving measures in connection with employee shares.

This is a rather nasty provision as it potentially charges tax on an annual basis in respect of artificial increases of 10 per cent or more per annum in the value of securities. A considerable amount of monitoring will therefore be required on the part of a company whose shares are rapidly increasing in value.

There will be a danger, on occasion, that HMRC will seek a tax charge under this provision because they see the share value of a fast-growing business as increasing other than by genuine commercial means. However, this should not be the case unless there is some element of artificiality, for example the use of non-arm's length transactions (whether intra-group or with non-corporate shareholders); eliminating or devaluing some shares to enhance the value of others; or the use of alphabet shares.

Where there is an increase of more than 10% over the charging period (which will normally be the tax year) then a tax charge will arise on the difference between the market value and market value if non-commercial increases were disregarded. You ignore the effect of any restrictions on the valuation but then restrict the tax charge based on the restrictions (on the basis that this will come into charge under the restricted securities provisions at some point so does not need to be taxed here).

Shares with artificially depressed market value

This legislation is specifically designed to catch or deter the avoidance of tax using depreciatory transactions. It has been drawn up in order to deter the issue of securities to employees that have an artificially depressed market value, i.e. one achieved by means other than those having genuine commercial purposes. Once those factors ceased to apply, the value of the shares would be enhanced, potentially free of income tax charges.

This legislation was also extended to cover situations where securities are disposed of or cancelled.

Charges can also arise at 5 April if there has been a post-acquisition depreciatory transaction relating to restricted securities at any point during the previous seven tax years.

As in the case of securities with artificially enhanced market values, it may often be a matter of judgment as to whether a transaction falls within this legislation. Regrettably, HMRC have no procedure for offering advance clearances.

A charge on acquisition applies where the market value of the employment-related securities at the time of acquisition has been reduced by at least 10 per cent as a result of 'things done otherwise than for genuine commercial purposes within the period of seven years ending with the date of acquisition'. In these circumstances, the employee will be treated as receiving employment income for the tax year in which the acquisition occurs. The taxable amount is the market value at the time of acquisition assuming the actions that have suppressed the value did not happen less the actual market value at the time of acquisition.

Securities acquired for less than market value

On the face of it, this legislation seems strange as there is a basic charge under s62 ITEPA 2003 if someone acquires shares for less than market value. However, this legislation at Chapter 3C is aimed at two scenarios:

1. Where a non-UK resident employee acquires shares in circumstances where there is no UK tax charge (although this is less common since 6 April 2015) or

2. Where an employee agrees to pay or subscribe full market value for the shares but the acquisition or subscription price is left outstanding.

The tax charge is based on an assumption that the amount not taxed is a notional loan and therefore that a notional loan benefit arises each year for which the amount is outstanding. If there is no payment of the 'loan' when the shares are sold (which might have been the case with non-resident individuals) there is a supplementary tax charge when the notional loan is deemed to have been discharged.

It should also be noted that the notional loan rule does not apply if the main purpose of the arrangements is the avoidance of tax or National Insurance contributions in which case the amount of the notional loan is employment income in the year of acquisition.

Shares disposed of for more than market value

Where ERS are sold for a consideration that exceeds their market value, there may be a charge under Chapter 3D. Market value is taken to be the same definition as applies for capital gains purposes.

The taxable amount is the disposal consideration less the market value of the time of disposal less any expenses of disposal. This clearly converts a capital gain into income tax and will particularly tax situations where an employee is guaranteed a minimum sale price by their employer.

The case of Gray's Timber Products Ltd v R&C Commrs considered this point.

The company's managing director, on taking up his position, had subscribed for shares in the company's holding company. That holding represented five per cent of the issued ordinary shares. The director and the majority shareholders then entered into a subscription and shareholders' agreement which provided, amongst other things, that, in the event of a change in control, the other parties to the subscription agreement were to procure that the director's original shareholding be purchased on terms which would give him an enhanced payment, in addition to the return of his original investment, disproportionately greater than the amounts received by other shareholders or his percentage of the equity shares. Thereafter the entire share capital of the holding company was sold to an unconnected third party. The total consideration paid was £5,903,219, of which a total of £1,451,172 was paid to the director.

HMRC contended that those shares, as employment-related securities, and sold as part of the sale of the whole share capital of the holding company, were sold for more than their market value. Consequently, they contended that the sale occasioned a charge to income tax. By contrast, the company maintained that the shares in question were sold for their market value, so that the whole of the consideration received by the director fell to be brought into computation of his capital gain on the disposal.

The special commissioner concluded that the director's disposal of his shares was taxable as income as he had disposed of his shares for more than their market value. The market value of each and every £1 ordinary share was calculated simply by taking the total paid by the outside purchaser, namely £5,903,219, and dividing that figure by the number of ordinary shares issued. The company appealed but lost (by a majority) in the Court of Session (Gray's Timber Products Ltd v R & C Commrs [2009] BTC 589). When, as in the present case, there had been an arm's length disposal of a whole class of shares, the market value of individual shares, and of holdings of such shares, falling within that class, would normally be obtained by dividing up the total consideration paid by the number of shares sold. When personal arrangements relating to an individual shareholder, whose shareholding fell to be treated as employment-related securities, resulted in that shareholder receiving what amounted to a disproportionate proportion of the total consideration paid by the purchaser of the whole class of shares, then the provisions came into play. There was no dispute that the director had received a disproportionately greater amount for his shares in the equity share capital of the company than its other shareholders did.

The subscription agreement foresaw that as a possibility which had materialised. Accordingly, it resulted in the application of the relevant legislation.

The company lost again in the Supreme Court (Grays Timber Products Ltd v R & C Commrs [2010] BTC 112). In estimating the market value, attention had to be focused on the asset that needed to be valued. In this case it was the rights attached to the shares acquired by the purchaser, no more and no less. In the present case, the valuation did not have to take account of the actual sale of G's shares at a special price enhanced for reasons of G's special position as managing director. There was no escape from the conclusion that the enhanced payment that G received was caught by these provisions.

Post-acquisition benefits

There is a final piece of legislation that needs to be considered – s447 ITEPA 2003 which charges an employee who 'receives a benefit in connection with employment-related securities'. The benefit is then charged to income tax in the year it is received. It does not apply if the benefit is otherwise chargeable to income tax unless something has been done which effects the ERS as part of a scheme the main purpose of which is to avoid tax or National Insurance contributions.

An example might be a company paying dividends as part of scheme to replace remuneration in order to reduce tax liabilities. Chapter 4 could be applied in that case, notwithstanding that dividends would be taxable. Another example where the legislation might apply in general terms might be amending the company's articles to improve the rights of certain shares leading to an increase in value.

Contributed by Ros Martin

Capital Taxes

Main residence relief denied (Lecture P1181 – 19.20 minutes)

Summary – The fact that the property was marketed for sale within two months of tenants moving out, showed that the taxpayer never intended to occupy the property permanently or with any degree of continuity.

Carol Adams bought a two-bedroom terraced house in Hampstead in 1994. At this time she was living in Wellington House in Belsize Park, and working in central London

She carried out extensive works to restore the Hampstead property to high standards, with the intention being that she would occupy the property in her retirement. Once restored, she let the property for some 18 years with the last tenants moving out in August 2013.

In September 2007, following the sale of her Belsize Park property, she bought Wild Meadows Livery in East Sussex. She moved into the property with her niece and together ran a livery business. The business was unsuccessful and closed on 31 October 2012.

When her tenants moved out in August 2013, Carol Adams claimed that she moved in to live in the property at the same time as renovation works were undertaken. On 9 October, the Hampstead property appeared for sale on Zoopla with all furniture and kitchen appliances available.

Having sold the property for a substantial gain, she claimed that she was living in the property as her main residence between 14 August 2013 and 23 February 2014. Under the legislation in force at the time, she argued that the last 36 month qualified as deemed occupation for PPR relief. She filed her tax return for 2013/14 claiming private residence relief of £113,941 and lettings relief of £40,000.

HMRC denied the relief arguing that she had never occupied the property as a residence at all or alternatively, if she had occupied it as a residence, the property was not her main residence.

Carol Adams appealed

Decision

The First Tier Tribunal stated that where a person has more than one residence, and has not made a nomination under 222(5) TCGA 1992, a taxpayer's main residence is the one that is properly regarded as the individual's principal or more important residence.

The Tribunal found that Carol Adams bought the East Sussex livery property primarily as a place to live and, that it was her main residence from 28 September 2007 until, at least, August 2013 and from February 2014 until today.

The Tribunal rejected the idea that Carol Adams was living in her Hampstead property as her main residence in September 2013. There was evidence that she had paid council tax and some gas and electricity bills in relation to the property, but this did not show that there was occupation of the property as a residence. The photos on the Zoopla website showed no evidence that the property was being occupied as her main residence. There were no

clothes in the open wardrobe in the bedroom, no toiletries or towels on the towel rails in the bathroom and the shelves in the rooms were empty. In addition her two Labrador dogs had remained at all times in East Sussex. The property had never been her main residence and relief was denied.

The appeal was dismissed.

Carol Adams v HMRC (TC07552)

Sale of company – three points of appeal (Lecture P1181 – 19.20 minutes)

Summary – Entrepreneurs' relief was denied as the company's activities were substantially non- trading but the transactions in securities rules did not apply. Overseas money loaned was taxable as remitted income when payments were made by the UK company.

The case involved three companies. Dr and Mrs Allam owned Allam Marine Ltd (AML), an engineering company and Allam Development Ltd (ADL) a property development company owned by Dr Allam. In late 2010, for commercial reasons linked to acquiring Hull City Football Club, shares in AML were transferred to a new company controlled by Dr Allam and his wife, Allamhouse Ltd. HMRC gave clearance that the share transfer would not be caught by the transactions in securities legislation.

In July 2011, Dr Allam transferred shares in ADL to AML Ltd for £4,950,000 and claimed entrepreneurs' relief of £524,000. HMRC rejected the claim arguing, in accordance with their guidance, that its activities included 'to a substantial extent activities other than trading activities'. Under that guidance 'substantial' meant more than 20%. By contrast Dr Allam argued that this percentage should be at least 50%.

On 24 March 2017, HMRC issued a counteraction notice assessing income tax of just over £1.3 million that HMRC said was "the amount of tax which [Dr Allam] would have been liable to pay if [he] had received the consideration [of £4,950,000] as a qualifying distribution". HMRC accepted that there was a commercial objective to the transactions and that Dr Allam wanted to receive cash because he regarded ADL as his pension fund and wanted to raise cash to make investments in Egypt. These were the reasons for the transaction. However, despite this, HMRC's argued that Dr Allam could have structured the transaction in a way in which he would have received cash and paid income tax on it and so he must be taken to have had as one of his main purposes the obtaining of an income tax advantage. They suggested that the transaction could have been undertaken as a share exchange followed by a dividend. Dr Allam appealed, arguing that obtaining an income tax advantage was not a main purpose of the transaction and therefore the transactions in securities rules did not apply. The sale of shares to AML was the simpler transaction to do. That transaction would have provided him with the cash fund that he required for his retirement. The natural transaction to undertake with the company was to sell the shares in ADL to AML for cash.

The final part of this case concerned the remittance basis. Dr Allam was resident but not domiciled and was entitled to use the remittance basis. Previously Dr Allam had loaned nearly £7 million generated from income and gains made abroad to Allamhouse, claiming 'business investment relief ' (s809VA ITA 2007) so that the remittance basis did not apply at the time. This relief is available if funds are used to make a "qualifying investment" or are remitted to the UK and used to make a "qualifying investment" within a 45-day period. Where funds are used to make a "qualifying investment", they are treated as not having been remitted to the UK. Subsequently, Allamhouse had made payments totalling £2.9

million to Dr Allam that HMRC argued were loan repayments and so funds being remitted as income/ gains to the UK. They sought additional income tax of £1,305,000.

Dr Allam appealed all three amounts

Decision

The First Tier Tribunal reached the conclusion that the legislation contained no numerical threshold or that non-trading activities should predominate. They stated that 'to a substantial' extent should be given its 'ordinary and natural meaning' in the context of the company's activities as a whole. Having considered ADL's activities, the Tribunal found that ADL's rental income and related asset base showed that its property investment and rental activities were substantial and that entrepreneurs' relief was denied.

When considering the second issue, the First tier Tribunal said that :

> 'an individual obtains an income tax advantage where he or she receives consideration on which he or she pays capital gains tax and that amount of tax is less than the income tax which he or she would have paid if he or she had received the consideration as an income distribution.'

Dr Allam was successful in his appeal as his aim was to unite ADL and AML under common corporate ownership to support the bank financing of a property development and the desire to create a cash fund for his retirement. The Tribunal stated that these :

> 'reasons are either "commercial" or "personal" reasons, to adopt the terminology used by HMRC, but the crucial point is that they are not the purpose of obtaining an income tax advantage.'

The First Tier Tribunal found that the payments made by Allamhouse to Dr Allam resulted in the withdrawal of business investment relief. If Dr Allam wanted these payments to be treated as an investment going forward, he needed to demonstrate his intention to reinvest the proceeds in the company. He did not do this and so the payments received by Dr Allam should be treated as remitted to the UK and included in his taxable income. However, Dr Allam was entitled to relief from double taxation in respect of Egyptian tax paid on the amounts treated as having been remitted from abroad.

Assem Allam v HMRC (TC07532)

Adapted from Tax Journal (7 February 2020)

Is entrepreneurs' relief here to stay? (Lecture P1181 – 19.20 minutes)

Over the years we have seen a number of reliefs for business related disposals come and go, only to be replaced by something else. First there was retirement relief, followed by taper relief and currently entrepreneurs' relief. Are things about to change again? You may have read in the Conservative Party manifesto that the government plans to review and reform entrepreneurs' relief as the government said that they recognise that it has not fully delivered on its objectives. With Boris Johnson re-elected, does this mean that there will be an announcement on Budget day of the proposed review?

Remember, under entrepreneurs' relief, qualifying individuals are entitled to claim relief on up to £10 million of gains on the disposal of qualifying business assets and shares, meaning that they are only taxed at a rate of 10%. Is it right that this lower rate of tax should apply at a point when an individual is ceasing to be an entrepreneur? The answer depends on what was, and going forward, what is the aim of the relief. Alastair Darling originally said that the relief was intended to 'encourage small business to expand' and help people who have reached retirement'. The relief is expensive, costing £2.2bn in 2018/19 but does it achieves it aims?

In an article in Taxation (30 January 2020) members of the tax world were asked what they would recommend doing with entrepreneurs' relief. Suggestions included:

- introducing an upfront incentive in some way:
  - lower rate of tax for entrepreneurs' in their first few years
  - allowing unused personal allowances to be carried forward where losses arise;
  - incentives or tax holiday where a business employs a minimum number of people or locates to areas of low employment;
- An incentive to encourage businesses to reinvest retained profits rather than holding them as liquid assets/cash;
- Seeing entrepreneurs' relief reinvented as a form of rollover relief, with relevant gains sheltered to the extent that proceeds were reinvested in a further qualifying business within a defined period of time;
- Increasing and or introducing a variable holding period so that greater entrepreneurs' relief is available for those that have been 'entrepreneurs' for longer;
- Introduction of tighter qualifying tests to ensure the real entrepreneur workers benefit from the relief (increase in the 5% shareholding test, inserting a minimum working hours per week test and an extension of the ownership period);
- focus relief on individuals selling trading businesses either unincorporated or through a company and deny the relief where assets are held outside of the business.

In summary, some would argue that the relief does little to encourage entrepreneurial activity and business investment. Relief at the end of the business life cycle provides a useful way for businesses owners to plan for their retirement but does nothing to initiate entrepreneurial activity. Presumably we will hear more on the matter in the next Budget.

SDLT on a garage office and paddocks (Lecture P1181 – 19.20 minutes)

Summary – The property including the garage office, stables and paddocks were a correctly treated as residential property for SDLT purposes.

Craig and Julie Goodfellow bought a property in Hampshire, described in the land agent's particulars as a family home set in 4.5 acres with six bedrooms, gardens, swimming pool, garaging, stable yard and paddocks. They paid SDLT of £126,750 on the basis that it was residential property.

Nearly a year and a half later, they submitted a claim for a refund of £48,500 on the basis that the property had been misclassified and was in fact mixed use property. They argued that the space above the garage was used as an office for Craig Goodfellow's business and that the stable yard and paddocks were used by a third party for grazing horses. The paddocks were undeveloped land and were by definition non-residential. Hence the property was mixed use.

HMRC submitted that the detached garage, stable yard and paddocks formed part of the grounds of the residential property and were correctly classified as residential. They denied the refund.

The Goodfellow's appealed.

Decision

The Estate agent's particulars were the fullest description of the property that the Tribunal had and did not help the Goodfellow's case. The property was described as an equestrian property but with no reference to any current commercial activity or the prospect of future development being possible. There was no suggestion that the property was anything other than a country residence. That was clearly also the view of the Goodfellow's solicitors who acted on the purchase, as the SDLT return was made on the basis that the whole of the property was residential.

The tribunal found that the room above the garage was wholly residential. It could readily be used as a guest suite, play room, or a games room for teenagers. There was no evidence that it had ever been let out or was separately rated for office use. Craig Goodfellow was simply working from home, so that he did not have to make the long journey to his company's headquarters in Essex.

The Tribunal found that the paddocks and stables formed part of the grounds of the property and were residential. Without the paddocks and stable yard, the house would cease to be an equestrian property. There was no evidence that any commercial arrangement had been made at any material time for the use of the paddocks. Only a peppercorn rent was paid. Equally, there was no evidence that any livery business had been in operation at the time of completion of the purchase, nor that they were sold subject to the rights of an existing occupier.

Applying s116 FA2003 that defines what a residential property is for SDLT purposes, the Tribunal concluded that the whole property including grounds, was a residential property.

Dr Craig Goodfellow Mrs Julie Goodfellow v HMRC (TC07507)

Administration

Careless accountant

Summary – The discovery assessment for the two tax years were valid. The taxpayer's accountant had been careless as he was not qualified to advise his client the avoidance scheme involved.

John Hicks was a self-employed derivatives trader. During 2008/09, he entered into a tax avoidance scheme known as the "the Montpelier Scheme" that had been disclosed under the DOTAS scheme. The arrangement was marketed to self-employed derivative traders who worked at least 10 hours per week. Under the scheme the trader acquired dividend rights with the intention that the cost of acquiring such rights was a deductible expense of the trade but the dividend income was not taxable as trading income under s730 ICTA 1988.

John Hicks acquired rights to £1,500,000 of dividends costing £1,498,035. Entities controlled by Montpelier lent him the funds to acquire the rights and in total he paid Montpelier £150,000 under a Professional Service Agreement, £75,000 of which was contingent upon agreement of losses by HMRC. John Hicks claimed a £150,000 deduction in in his 2008/09 accounts.

By excluding the dividend income under s730 and deducting the fees paid, his taxable profit were reduced to nil and he created trading losses that were carried forward and set off against his trading profits in 2009/10 and 2010/11.

HMRC opened an enquiry into his 2008/09 return but not for the two years that followed. In March 2015, they issued discovery assessments for both 2009/10 and 2010/11, seeking to deny the loss relief claimed.

John Hicks argued against the validity of the discovery assessments raised in respect of the loss relief claims.

The First Tier Tribunal had found in favour of John Hicks stating that although HMRC had made a valid discovery assessment that was not "stale", neither the taxpayer nor anyone acting on his behalf had acted carelessly or deliberately in relation to the loss claim. Additionally, the information provided to HMRC was adequate to alert a hypothetical officer to the potential insufficiency of the original assessment.

HMRC appealed arguing that the accountant had been careless when acting on John Hick's behalf, meaning that the discovery assessments would be valid if made within the relevant six-year time limit. Both tax years would be caught.

Decision

The Upper Tribunal disagreed with the First Tier Tribunal by concluding that John Hick's accountant had formed an opinion on the tax avoidance scheme without the qualification to do so. He gave advice that a reasonably competent tax adviser would not give, and failed to give the tax advice a reasonably competent tax adviser would give. The accountant gave positive advice about whether John Hicks should use the scheme, despite having no expertise in this area of tax and without flagging that he lacked this experience.

The time limit for a discovery assessment was therefore six years, not four, and the assessments were valid.

HMRC v John Hicks [2020] UKUT 0012 (TCC)

Not reading emails

Summary – Having agreed to paperless communication, deleting email notifications from HMRC believing they were spam was not a reasonable excuse for failing to file a return or pay the related late filing penalties.

Benjamin Smith had consented to paperless filing. On 6 April 2017, HMRC posted a Notice to File to his online account, and sent him an email saying that a new message had been posted to on that account.

However, Benjamin Smith was not expecting to receive communications from HMRC because he had understood from a conversation with their helpline that he would not have to file a tax return. He assumed the email message was spam, and deleted it. He made the same assumption, and took the same action, when he received subsequent email messages from HMRC. He did not access his online account. Finally, he received a letter from HMRC informing him that he had incurred penalties of £1,300.

He appealed arguing that issuing a notice to file a tax return to an electronic mailbox did not amount to giving valid notice under tax law (s8 TA1970). He also argued that there was no evidence of the terms of agreement for paperless communication and more specifically, he did not remember agreeing that he would have to go into his online account to find out what HMRC wanted to communicate.

Decision

The First Tier Tribunal stated that, under the provisions of the Electronic Communications regulations, the paperless notices were deemed to have been 'given'. The Tribunal stated that by ticking the consent to paperless communication box in his personal tax account he was agreeing to a number of things. More specifically, HMRC's Terms & Conditions state:

> "When statutory notices, decisions, estimates and reminders relating to your tax affairs and tax credits are issued to you using your secure online mailbox, a notification email will also be sent to your registered email address to inform you of this,"

In rejecting his spam argument, the Tribunal made reference to HMRC's Terms & Conditions as well as the content of their emails. Both specifically stated that, unlike most phishing emails, "For security reasons, we have not included a link with this email."

Normally confirmation that a return was not required might have amounted to a reasonable excuse for the failure to file a return. However, in this case, that excuse was overridden as they found that a reasonable person would have expected to receive communications from HMRC and checked their mailbox.

The penalties were upheld and the appeal dismissed.

Benjamin Liam Smith V HMRC (TC7510)

Reasonable excuse and scam email

Summary – The taxpayer provided no reasonable excuse for his late appeal. The scam email that resulted in him losing money was not considered a reasonable excuse for failing to file a return as the scam had happened after the event in question.

HMRC's end of year reconciliation showed there had been an underpayment of tax because the Stanislav Horwath's taxable Employment and Support Allowance had not been included in the 'previous pay' notified to his employers. This gave the appearance that he had more of his personal allowance left than was actually the case, resulting in a PAYE underpayment for his last employment of that tax year.

HMRC was unable to collect the underpaid tax though his tax code as he had multiple subsequent low paid jobs. Consequently, he was issued with a Notice to File a return in March 2017. He failed to submit this on time by 30 June 2017.. He ignored all of HMRC's warning letters and by the time that he finally submitted his return the penalty had risen to £1,600, even though the tax due was only £286. He submitted his return in October 2018.

Stanislav Horwath argued that he had a reasonable excuse for not filing his return on time. Until the position was fully explained to him, he was not aware that his Employment and Support Allowance was taxable or that he had to file a return for 2015/16. In addition, his son who shared the same name had been in dispute with HMRC over another matter which he said had led to a mix up in respect of letters received from HMRC.

To make matters worse, he received an email that he believed was from HMRC confirming that he was due to receive a tax refund. The email was in fact a scam. Subsequently monies were fraudulently withdrawn from his bank account. He argued that he believed that the penalty notices were also a scam.

Stanislav Horwath appealed but out of time.

Decision

The First Tier Tribunal refused the appeal out of time as there was no reasonable excuse. The notice to file and penalty notices were issued before the scam email occurred. Stanislav Horwath had not produced any credible evidence to show why he was unable to appeal the penalties as and when they arose. He did not provide any reason why he could not have sought help to file his return or submit an appeal to HMRC sooner than 18 December 2018, more than 13 months after the first penalty or to the Tribunal in July 2019 when he lodged his Notice of appeal.

The tribunal stated that the late filing penalties had been charged in accordance with legislation and so the penalties were confirmed.

Stanislav Horvath v HMRC (TC07519)

Year end planning and compliance for employers (Lecture B1183 – 12.59 minutes)

Now is a good time to remind ourselves and our clients of what payroll tasks need to be completed leading up to, over and after the end of the tax year 2019/20.

Final pay run

For those operating monthly payroll, the last pay run will be for month 12. Remember, for anyone running a weekly, fortnightly or four weekly payroll, then an additional 53 week pay run may be required, which must be entered on Final Payment Submission (FPS) as week 53, 54 or 56 respectively.

File the final FPS

The FPS is filed every time a payroll is run and must be filed on or before payday. When the last payroll for the year is run, the FPS will be submitted and in the filed marked 'Final submission for the year' YES can be entered. The final FPS submission for the year needs to be submitted by 19th April 2020. This allows for corrections and amendments to be made after the final payroll has been run. Provided the amendments are made by this date, a revised FPS can be run and submitted to HMRC.

Final Employment Payment Summary (EPS)

An EPS needs to be submitted if there is a need to adjust the amounts being paid to HMRC. For example, this could for items like CIS deductions or SMP payments.

An EPS would also be needed if no employees had been paid on the last payment period.

Final payroll checklist

It is worth running through a checklist to ensure that you have not missed anything so check:

- Do PAYE/ NI amounts paid to HMRC agree to payroll deductions records? Reconcile and amend any discrepancies.
- Do CIS deductions made through payroll agree what has been paid over to HMRC?
- Check that claims have been made on an EPS to recover:
  - SMP/SAP;
  - Employment allowance;
  - CIS suffered if limited company;
- If not, submit final EPS and amend final payment to HMRC by 19th April 2020.

Late error found

Where an error is discovered after 19th April 2020:

- For 2018/19 and before – submit an Earlier Year Update (EYU) that shows the difference between the final FPS and the corrected year-to-date amounts.

- For 2019.20 onwards – The EYU is no longer used. The error is reported on a 2020/21 FPS. In this situation, the payroll would be run as normal in 2020/21 and filed; a second FPS would then be run showing the 2019/20 amendment, stating the actual pay date in 2019/20 as the pay period. It is important that HMRC know that this is an amendment and so you would use the 'late reporting' reason 'option H', showing HMRC that you are making a correction to an earlier submission.

P60s

All employers must issue P60s to all employees working for the employer and on the payroll at the end of the tax year 2019/20. This must be done by 31st May 2020 at the latest.

The P60 shows gross taxable pay, tax deducted and national insurance contributions for the current and any previous employments in the tax year.

Anyone who left during the year will have been issued with a P45 and so no P60 is produced.

Preparing for 2020/21

It is important to check that the payroll software is ready for the next tax year by downloading any updates that are required and checking that the following are correct:

- Personal allowances;

- Tax bands;

- Tax rates;

- NIC thresholds;

- Current rates for statutory payments such as SMP, SAP, SSP etc;

- Current National Minimum Wage rates.

It is important to update employee records by rolling them forward to 2020/21. As we know, the basic personal allowance is unchanged for 2020/21 so we know that the standard tax code will be 1250L.

The start of the tax year is the only time that we can remove any week 1/month 1 indicators without HMRC permission.

We should make sure that any other tax codes notified by HMRC on Form P9T are reflected in employee records. Failure to do so will result in employees paying the incorrect amount of tax going forward.

P11D

If expenses and benefits are not being payrolled, these must be reported on form P11D by 6th July 2020. The relevant Class 1A NICs must be paid over to HMRC by 19th July 2020.

Employment allowance

It is worth checking to see whether, under the new rules relating to the Employment Allowance, claiming this allowance on the first EPS of the tax year.

Created from the seminar by Alexandra Durrant

Employment allowance for larger employers (Lecture B1181 – 16.38 minutes)

The government has published the draft Employment Allowance (Excluded Persons) Regulations 2020. From April 2020, the NICs employment allowance will apply to those employers with a secondary class 1 NICs liability below £100,000 in the preceding tax year.

The allowance claim will no longer be carried forward from one tax year to the next and employers will have to submit a fresh claim every year, with the requirements set out in a statutory notice.

This £100,000 threshold will apply cumulatively in the case of connected employers and the allowance will be operated as de minimis state aid.

Tax Journal (24 January 2020)

Focus on engagement letters (Lecture B1184 – 11.24 minutes)

This article identifies what can go wrong with engagement letters and how you can reduce the chances of things going wrong. In addition, the article will briefly consider issues relating to liability caps and "distance selling".

Retainer Issues

A common cause of claims relating to engagement letters is not understanding the scope of the retainer between the adviser and the client.

It is important to clarify who you are acting for to clarify to whom a duty of care is owed, what that duty is, what the client is responsible for and what the adviser is responsible for.

An accountant might act for a company and have an engagement letter for the company, but what happens when the Directors ask for advice in their personal capacity? Such advice would need a separate engagement letter. There is a need to consider: Who is my client? Who am I acting for?

It is important to think about: What am I doing and what am I not doing? This needs to be made clear. Without a clear engagement letter, there is a significant risk that a Court will hold that the retainer is wider than you might expect.

For example, if you are acting on a transaction in a tax scenario, are you advising on the tax consequences or a transaction, or are you advising on the most tax efficient way of structuring the transaction? If the engagement letter doesn't make it clear, you may find that you are liable for failing to advise on a more tax efficient structure.

What about where you are preparing Tax Returns for a client, based on the information he provides to you? Are you obliged to audit or verify that information? The engagement letter needs to be clear.

What if there is more than one adviser? What is your responsibility, what is the responsibility of the other adviser? Responsibilities may overlap or other tasks may be omitted from the two letters. It is important to ensure that all aspects are covered.

Fees

It is important that the fee structure is clear, that the client knows what he is paying for, and what is covered and not covered within the fee quote.

What if the work undertaken expands? The client needs to know if the fee quoted will be increased and why. Any increase in fees should be notified and agreed in advance of the work being undertaken.

Unenforceable Engagement Letters

If the engagement letter is not valid, so if it hasn't been agreed by the client, you can't prove that the client received it, or the appropriate notice under the Consumer Contracts Regulations hasn't been sent, then the engagement letter may not be enforceable and any terms contained therein, including any liability cap, will not apply. Appropriate systems need to be in place to ensure that the engagement letter is enforceable and that there is clarity as to the terms of the agreement entered into between the adviser and the client.

Reducing the chances of things going wrong

It is important that you have a system when you open a file to automatically:

- issue an engagement letter;
- check that the client has received it; and
- chase up the return of that engagement letter.

Don't create the task to chase the engagement letter at the point that you send out the engagement letter, as the ones that don't get sent out will fall through the gap.

It’s worth having an automatic diary review every six to 12 months, to think about whether or not the engagement letter needs amending for additional work that has been agreed. It is all to easy to forget to do this.

To ensure that the client has received your engagement letter, send it with a covering letter asking them to do something else, like to pay money on account. When the money comes in, this provides your evidence that they did receive your letter asking them to sign the engagement letter. If for some reason they fail to sign the actual letter, you do at least have a n audit trail that they received the letter and have not objected to it.

The engagement letter should state on it which terms of business have been used. Don't just say "enclosed terms of business". The terms of business need to have a date on them so that it is clear which version of the terms of business have been used.

Think carefully about when to review and reissue the engagement letter. For each client, consider when this would be appropriate. Annual clients can be reviewed annually but for other clients it might be more appropriate to review it for each transaction.

Liability caps

You need to have a system in place that allows you to alter the cap. One of the factors the Court will take into account in determining whether or not the cap is reasonable, is the fact that the cap can be changed depending on the client's circumstances.

Ideally the cap should go into your covering letter and not within the terms of business. This demonstrates that the cap can be changed. Highlight the cap in bold to bring it to the client's attention and think about the level of the liability cap but don't go too low! In determining whether a cap is reasonable, a Court will consider:

- Client's ability to pay;
- The parties' abilities to insure; and
- The ability of the parties to negotiate.

The lower you go, the more likely that cap is likely to be held as unreasonable, resulting in it being struck out by the Courts and an unlimited liability resulting.

Is a 'Multiple of fees' a reasonable approach? Is this an adequate representation of the risk? The level of fee may indicate the extent of duty, but doesn't usually indicate the level of quantum that may apply so a multiple of fee is vulnerable to being struck out for being unreasonable.

Distance selling

It is important to consider at matter level, not client level, whether the client for that matter level is a consumer and, if so, whether the contract is a distance or "off premises" contract. If so, the appropriate notice will need to be sent to the client. So for each matter you must consider whether you have met the client.

If the appropriate notice is not sent, it may be a criminal offence, but can also render the contract unenforceable. This means the liability cap, if any, contained within the contract is unenforceable and it may be impossible to recover any fees incurred in relation to the transaction.

Fees

If your engagement letter has a fee included in the engagement letter for the transaction, have a fee alert at, say, 75% of the way through the work. If at that point, you are not almost at completion, think about why not.

- What has caused the fee to overrun? Is it that you've spent too long and if so, why have you spent too long?

- Is it that the matter has become more complicated? If so, explain to the client, issue a new engagement letter, or a revision to the engagement letter. The way the client will be expecting a higher bill.

- Is it that somebody in the firm is not experienced enough, spending too long and lacks expertise? If so, you can write off the time, supervise that individual, ensure they are suitably trained and so avoid a claim.

- Is it that the client is becoming difficult? What is causing the difficulty with the client? Look to mange any issues before the client complains.

If a new/revised engagement letter is needed, issue it before you issue an invoice for the higher fee to the client, so that no issues arise with the client.

Contributed by Karen Eckstein

Professional Negligence Solicitor and a CTA – Consultant with Womble Bond Dickinson
Author of book Managing Risk – A Guide for Accountants and Tax Advisers

Deadlines

1 March 2020

- Corporation tax due for periods to 31 May 2019 (SMEs not paying by instalments)
- Check HMRC car mileage fuel rates

2 March 2020

- 5% penalty for unpaid income tax/class 4 NI for 2018/19 7 March 2020
- Submit returns and pay VAT for quarter to 31 January 2020 (electronic payment)

14 March 2020

- Quarterly corporation tax instalment for large companies based on year end
- EC sales list for monthly paper return

19 March 2020

- Non electronic PAYE, NIC, CIS, student loan liabilities due for month to 5 March 2020
- File monthly CIS return

21 March 2020

- File online monthly EC sales list
- Submit supplementary intrastat declarations for February 2020

22 March 2020

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

31 March 2020

- Accounts to Companies House:
    - private companies with 30 June 2019 year ends
    - public limited companies with 30 September 2019 year ends
- CTSA returns for companies with accounting periods ended 31 March 2019
- Deadline to reclaim tax paid by a close company on a loan to a participator if loan repaid during the year ended 31 March 2016.

News

Pension rules amended to help consultants

Last year it was widely reported in the Press that current pension legislation has caused unintended consequences for NHS doctors, leading many doctors to dramatically reduce their working commitments. The issue appears to relate to the tapering of the annual allowance for high-income individuals with threshold income of over £110,000 and adjusted income of over £150,000.

The current annual allowance is £40,000 each year and any unused annual allowance can be carried forward for up to three years. The allowance is tapered for high-income individuals. The problem for doctors arises because the annual allowance for defined benefit schemes is calculated as the increase in the capital value of the scheme in the tax year and not the contributions made to the scheme. The British Medical Association has produced a useful factsheet for doctors explaining how exceeding the pension annual allowance effects them, which states that:

> "Due to the way pension growth is calculated in the NHS, there can be large theoretical pension growth from a modest rise in pensionable pay and consequently a consultant with taxable earnings of just over £110,000 can be 'fully tapered' resulting in an available AA of only £10,000"

The sheet goes on to say:

> "Tapering of the AA results in a 'cliff edge' effect around the threshold income of £110,000. If your taxable income is below £110,000 then you are not subject to tapering. Consequently, you retain the standard AA regardless of how much your pension grows that year. If, however, your taxable income is just over £110,000 then you need to calculate your adjusted income. If this figure is over £150,000, your AA tapers by £1 for every £2 this figure is above £150,000. In the case of a consultant with a pension growth of £100,000 but a threshold income of £110,000, they retain a standard AA, but even as little as £1 of additional income would result in AA reducing to the minimum of £10,000. This £1 of extra income could increase the tax payable by £13,500."

In January this year The Times reported that the Treasury is considering an increase in the £110,000 threshold to £150,000 for all workers. With the median earnings of consultants being £112,000, the Treasury estimate that some 90% of doctors would no longer experience the problem.

This solution may work for the majority at present but not for all concerned. There are also concerns about what will happen when pension funds top £1,000,000 as this is being blamed for many doctors choosing to retire early.

-https://beta.bma.org.uk/media/1549/bma-fast-facts-the-annual-allowance-explained.pdf

Scottish Budget 2020/21

The Scottish government delivered its budget on 6 February 2020 setting out plans to:

- increase the basic and intermediate rate thresholds by inflation and freeze the higher rate and top rate thresholds of income tax
- maintain residential land and buildings transaction tax (LBTT) rates and bands at their current level
- add a third LBTT band for non-residential leases at a rate of 2% where the NPV of rent is over £2m.
- maintain the most generous non-domestic rates regime in the UK ensuring more than 95% of properties in Scotland are subject to a lower poundage than they would face in other parts of the UK
- deliver 100% relief for reverse vending machines from 1 April 2020 to support the Deposit Return Scheme in advance of introduction
- increase the standard rate of Scottish landfill tax to £94.15 per tonne and the lower rate to £3 per tonne.

Tolley Guidance (news.gov.scot/news/t/budget-2020)

Reform of inheritance tax

The All-Party Parliamentary Group on Inheritance & Intergenerational Fairness (APPG) has published a report proposing major reforms to the inheritance tax regime. The APPG is an informal group of cross-party MPs who have summarised their views but carry no legal weight.

With limited opportunity to make tax free gifts during lifetime and no reliefs for qualifying businesses and shares, the system will be simpler but many will lose out.

Their suggestions are summarised below:

- Spouse exemption and exemption for gifts to charity remain;
- PETS, CLTs, lifetime exemptions replaced by lifetime gifts > £30,000 pa taxed at 10%;
- Death estates greater than £325,000 would be taxable at 10- 20% with:
    - £325,000 transferable to spouse on first death;
    - abolition of residential nil rate band;
    - no CGT uplift on death - gain held over until donee sells the asset;
- Agricultural and business property relief would be abolished but tax on qualifying assets could be paid by instalments over 10 years;

- Trusts taxed in the same way as individuals but with no nil rate band;

- Domicile abolished as a connecting factor for IHT and instead based on years of UK whether resident in 10 out of the last 15 years/whether assets are situated in the UK;

- Trusts set up by foreign domiciliaries no longer protected if a UK resident can benefit and the settlor has been UK resident for more than 10 out of 15 tax years;

- Abolition of gift with reservation of benefit and pre-owned asset rules as gifts taxed already;

- Someone who gives away the home can still live in the property although on a later sale by the donee the home would not be eligible for main residence relief on that post-gift period of occupation.

https://www.step.org/sites/default/files/Policy/Reform%20of%20inheritance%20tax%20report%20Jan%202020%20final%20ALT.pdf

Business Taxation

Suppression of partnership takings (Lecture B1181 – 16.38 minutes)

Summary – The partnership deliberately failed to record cash sales; the Tribunal accepted HMRC's calculation of unreported profits.

Ghulam Rubani and his partners, Mr Hussain and Mr Shabir, traded in partnership as Shama Bingley. They ran a restaurant that also offered a takeaway service.

Following a Code of Practice 9 Civil Investigation into cases of Serious Suspected Fraud in relation to tax year 2012/13, HMRC issued a closure notice in respect of that year for unreported profits of £145,672, as well as discovery assessments for years 2011/12, 2013/14, 2014-15 and 2015/16 to tax unreported profits in excess of £350,000.

At a meeting with HMRC, the partners agreed that cash takings were not properly recorded and that the amount of cash sales had therefore been under-declared. The partners suggested that the deficiency was much lower than HMRC had arrived at, being around £100,000 from June 2009.

HMRC's figures were based on 118 slips obtained from the partnership that reflected activities from Sunday to Saturday for seventeen specific weeks between 14 October 2012 and 23 March 2013. For each slip, the total shown was significantly higher than the figure recorded for accounting and tax purposes. HMRC took these to be the true record of cash takings.

Decision

The First Tier Tribunal did not accept the partners' explanation for the discrepancy in takings. The partners stated that the slips were not the cash takings but rather a record of the cash in the till each day. They appeared to be stating that each day the partners brought in cash from home, unconnected with the business, put it in the till for use during the day, and then took it home again. The Tribunal did not consider this explanation to be plausible. In their view, the only rational explanation was that the slips represented actual sales of the business.

Having been in business for six years, the partners must have been aware that the tax liabilities for the business could not be properly assessed without accurate accounts and yet no such accurate accounts were kept. Their action was deliberate behaviour.

The appeal was dismissed.

Ghulam Rubani T/A Shama Bingley v HMRC (TC07527)

Mixed partnerships – profit reallocation (Lecture B1181 – 16.38 minutes)

Summary - Profits of two mixed LLPs, that had been allocated to a corporate member and transferred offshore, were reallocated to Nicholas Walewski, as member of both LLPs.

Nicholas Walewski had set up an equity fund in Luxembourg that was managed by one UK LLP and with trades executed by a second UK LLP. Nicholas Walewski was a partner in both LLPs.

Nicholas Walewski also set up a company, W Ltd, which was a corporate partner of both LLPs and where he was the sole director and employee. He had a contractual right to a salary of £200,000 per annum and a bonus. W Ltd paid out substantial dividends to its offshore owner that in 2014 and 2015 exceeded £70 million. Nicholas Walewski's children were named beneficiaries of the Kleber Trust that owned the offshore company in receipt of the substantial dividends that were paid.

Having shared the profits between the members of the LLPs, including W Ltd, HMRC sought to reallocate nearly £20 million from W Ltd to Nicholas Walewski under the mixed partnership anti-avoidance legislation. These rules operate to prevent individuals allocating profits to a connected corporate partner in order to reduce the amount of tax which is payable. HMRC argued that the profit allocated to W Ltd did not relate to his activities as an employee of the company, but rather because of his ability to enjoy them via the offshore trust to which W Ltd paid its profits.

Decision

The First Tier Tribunal needed to decide whether the profit allocated to W Ltd was justified based on the work that Nicholas Walewski performed as an employee of the company or for an alternative commercial reason.

The Tribunal concluded that his activities could not be split between him as member of the LLPs, employee or director of the company. He had effectively been performing a single role for multiple entities. As the Tribunal said 'he wore one hat in many places'. He had been working full-time for both LLPs and W Ltd at the same time.

The Tribunal concluded that the only reason for the allocation of profit to W Ltd was by reason of Nicholas Walewski 's ability to enjoy those profits and so W Ltd's profit should be reallocated to Nicholas Walewski.

The appeal was dismissed.

Nicholas Walewski v HMRC (TC07554)

Off-payroll working – small company (Lecture B1182 – 7.15 minutes)

This session considers the criteria that affect the categorisation of a company as small or non-small for the purpose of whether it needs to consider the new 'off-payroll working in the private sector' from 6 April 2020.

The definition of a small company in draft s60A and s60C (ITEPA 2003) as set out in the Draft Finance Bill 2020 makes reference to the definitions used in the Companies Act 2006 (s382 and s383 CA 2006 to be precise).

Two out of three criteria need to be met.

- Turnover not exceeding £10.2 million;
- Balance sheet total (assets) not exceeding £5.1 million;
- Not more than 50 employees.

A company retains any previous small status unless it breaches these limits for two consecutive years. Having become non-small, it can only become small again if it meets the limits again for two consecutive years.

Draft s60C ITEPA 2003 indicates that a company that is a subsidiary cannot qualify as small if the undertaking that is the parent undertaking does not qualify as small (for which s383 CA 2006 requires it to consider if it is small by looking at its group as a whole).

Example

A parent and subsidiary company in the UK when taken together are just below the audit threshold and therefore do not breach the limits at Section 382 of Companies Act 2006.

However, above the parent company in the UK there is an LLC resident in the US with many very large group companies.

Are the UK parent and its subsidiary small companies for the purpose of whether it has to operate the off-payroll working rules?

Analysis

A subsidiary can be a small company in its own right for its own accounts preparation and filing purposes without reference to the wider group.

But for this specific tax purpose, s60C forces us to look at the wider group.

As set out above, draft s60C ITEPA 2003 indicates that a company that is a subsidiary cannot qualify as small if the undertaking that is the parent undertaking does not qualify as small.

S.383 CA 2006 requires the parent undertaking (here the US LLC) to consider if it is small by looking at its group as a whole.

This makes sense, otherwise the group could just create multiple service procurement subsidiaries ensuring each is small and avoid the new rules.

So the UK parent and its subsidiary in the above example must apply the new rules on off-payroll working in the private sector from 6 April 2020.

Contributed by Malcolm Greenbaum

Domestic and cross-border group relief claims

Summary – Domestic group relief claims remained valid, even though subsequent cross border claims were made and withdrawn in respect of the same profits.

LINPAC Group Holdings Ltd claimed group relief for the years ended 31 December 2006 and 2008 in its tax returns, utilising losses of other UK group companies (the 'domestic claims'). The company subsequently made further claims for group relief for those years (the 'cross-border claims'), this time using losses of group members resident in other EU member states. The company later accepted that the cross-border claims did not meet the criteria for entitlement and sought to revert to the domestic claims.

HMRC argued that the domestic claims were no longer open to the company because its making of the cross-border claims involved the withdrawal of the domestic claims by virtue of FA 1998 Sch 18 para 73 and it was too late to make those claims afresh.

Decision

The First Tier Tribunal rejected HMRC's argument. In Marks & Spencer Plc v HMRC [2014] STC 819, the Supreme Court had held that a later claim could be valid even if an earlier claim had not been withdrawn. It therefore followed that earlier and later claims could coexist and that an earlier claim could remain valid after the making of a later claim.

Although the cross-border claims did not expressly keep the domestic relief claims open, the Tribunal decided that there was no implicit withdrawal. Instead, the cross-border claims were being advanced as preferred alternatives to the domestic claims, conditionally upon their proving to be well-founded.

Furthermore, the viability of the cross-border claims had not been finally settled before the expiry of the time limit for making them. A requirement to withdraw the unquestionably valid domestic claims before making the still speculative cross-border claims would have made it excessively difficult, if not practically impossible, to advance the cross-border claims. The result would have been that the putative EU right to cross-border group relief would have been impossible in practice to exercise.

LINPAC Group Holdings Ltd v HMRC (TC07556)

Adapted from Tax Journal (14 February 2020)

First major action for J5 group

The joint chiefs of global tax enforcement (J5) — an alliance of tax authorities from the UK, Canada, the Netherlands, United States and Australia — carried out their first major operational activity on 22 January. The J5 was formed in 2018 in response to a call from the OECD for greater international cooperation to tackle tax crime.

A series of investigations centred on a Central American financial institution, believed to be facilitating tax evasion and money laundering across the globe. According to HMRC, action in the UK targeted proceeds amounting to over £200m. These operations are said to have gathered significant information, with further criminal, civil and regulatory action is expected to follow in each country.

Andrew Sackey, partner at Pinsent Masons, commented:

> 'The first J5 day of action has been more than just a tentative proof of concept. J5 partners have clearly mined a great deal of information to coordinate and deliver a global response that, in the UK alone, targeted suspected tax evasion and money laundering believed to total £200m. Their ambition however was greater still, investigations have been launched into an international financial institution located in Central America, whose products and services are believed to be facilitating money laundering and tax evasion for customers across the globe; the J5 is therefore targeting the system — the corporates who are believed to have enabled the evasion, and the individual taxpayers who avail themselves of unlawful services.'

He added:

> 'The nature and scope of this activity is a demonstration of intent, and J5 partners will be emboldened by the apparent success of this first action and it's more critical than ever for corporates to ensure their governance procedures are fit for purpose',

Tax Journal (31 January 2020)

Senior Accounting Officer failure

In this case penalties were imposed on:

- Castlelaw (No. 628) Limited for failure to notify HMRC the name of its Senior Accounting Officer ('SAO') for the accounting period ended 31 March 2016;
- Mrs Douglas for her failure as the Company's SAO to provide an SAO certificate for Castlelaw for the accounting period ended 31 March 2016.

Large companies (including companies in large corporate groups) must nominate a senior accounting officer who must certify each year that the group has appropriate accounting arrangements in place.

In this group of more than 100 companies, a dormant company with no tax profile was inadvertently omitted from the group structure chart that was submitted with the SAO certificate for the group. In previous years it had been included. Technically this meant that the company did not comply with the regulations and both the company and the senior accounting officer were subject to penalties of £5,000.

The tribunal was clearly troubled by this but found that it had no power to reduce or remove the penalty.

Castlelaw (No. 628) Limited & Irene Douglas v HMRC (TC07540)

Taken from Andrew Hubbard's weekly tax summary

VAT

Kickboxing classes (Lecture B1181 – 16.38 minutes)

Summary - kickboxing is not a subject ordinarily taught in school and so private classes did not qualify for VAT relief under the exemption for private tuition.

Premier Family Martial Arts LLP provided kickboxing classes across a range of age groups from children as young as 3 (little dragons) to adults who are in middle age. There is no external accreditation for teachers. The progression of pupils is measured by a system of grading or belts but there is no formally-codified general standard which underlies the assessment. Instead, the process is a subjective assessment by tutors. Pupils are put into groups for which there are weekly lesson plans and homework.

At the time, kickboxing did not form part of the UK's national curriculum and was not included on either the GCSE or A level lists of sports that were suitable for assessment. Kickboxing is a sport that had been proposed for inclusion but rejected on the basis that it was not recognised by Sport England.

To be exempt the activity must fall within Article 132(1)(j), transposed into UK legislation as Item 2 Group 6 Schedule 9 VATA 1994 as:

> "The supply of private tuition, in a subject ordinarily taught in a school or university, by an individual teacher acting independently of an employer".

HMRC argued that the supply of kickboxing classes was standard-rated and as a result Premier Family Martial Arts LLP was liable to be registered for VAT with effect from 1 April 2018; consequently, the LLP was liable for output tax for the period from 1 April 2018 onwards amounting to £411,497.00.

Premier Family Martial Arts LLP appealed.

Decision

The Tribunal confirmed that both parties agreed that the only question that needed to be determined was whether the tuition given in the kickboxing classes was tuition ordinarily taught in a school.

The Tribunal concluded that the word 'ordinarily' should be construed as 'commonly' (see *Hocking*) so that exemption can only apply where the activity is commonly taught at schools. The Tribunal said that the relevant question was not what the national curriculum said but what actually happens in practice and it was perfectly possible for schools in the UK to commonly teach kickboxing even if kickboxing was not part of the UK's national curriculum. However, unsatisfactory evidence was provided to suggest that it was commonly taught at schools in the UK, or the EU as a whole and so the appeal was dismissed.

Premier Family Martial Arts LLP v HMRC (TC07509)

Supply of crafts and a magazine (Lecture B1181 – 16.38 minutes)

Summary - The supply of educational children's boxes were a mixed supply of crafts and a magazine of standard and zero rated items.

ToucanBox is an online retailer of children's activity boxes designed to be educational and entertaining and are aimed at 3-8 year old children. Customers subscribe to receive these boxes on a regular basis, either monthly or fortnightly, having already trialled a free box.

The company supplied three different types of box: Super, Grande and Petite. From the outset, the Super and Grande boxes had been treated as mixed supplies of standard rated craft materials and a zero rated book. The Petite boxes did not initially include the magazine and the company accepted that during that period, the Petite box consisted of a standard rated supply of craft activities. From August 2015 when the magazine was included in the box, the company treated the boxes as a mixed supply.

The gross revenue figures for the periods from January to June 2015 (before the introduction of the magazine) was roughly half the revenue compared to that from July to December 2015 (after its introduction). The company stated that there were no other changes in the business (apart from the introduction of the magazine) which could account for this. The company regularly conducted customer surveys to obtain feedback from customers. The products evolved in response to that feedback. One such change was made to the Petite box that went from craft activities to only to include a magazine. The magazine had 12 pages containing activities separate from the crafts. The possibility of selling the magazines separately was discussed, but not pursued at the time. The magazines are now sold separately. Results from the survey confirmed that customers saw the magazine as being an equally important element of their product.

HMRC accepted that the first two box types that included a book were mixed supplies but that the Petite boxes were standard rated. The company argued that the Petite box was a mixed supply of a zero-rated magazine together with standard-rated craft products.

Decision

The First Tier Tribunal agreed that the supply was a mixed supply. The two products were capable of being sold separately as had been demonstrated by the fact that the box was initially sold without the magazine and that the magazine is available for separate purchase. This was supported by the company's survey that showed that a typical consumer viewed the box as a supply of crafts and a magazine, not a single supply of crafts. Both the magazine and the crafts were equally important to the customers.

The appeal was allowed.

Dodadine Limited t/a ToucanBox v HMRC (TC07505)

As Andrew Hubbard commented in his case summary:

> "Although HMRC tried to cast doubt on the significance of the survey, the tribunal did attach some weight to the findings. This is a good example of how a taxpayer can use real evidence, rather than assertions, in order to prove its case and the lessons learned here may be valuable in other disputed cases."

Ski lift passes (Lecture B1181 – 16.38 minutes)

Summary – The provision of lifts to transport skiers to the top of an indoor slope was a supply of a cable-suspended passenger transport system. As transport services, the lower rate of VAT applied

Snow Factor Limited operate a snow dome and conference centre in Glasgow, which include an indoor ski slope with two drag lifts used by customers to convey them to the top of the ski slope.

No charge was made to use the slope but there was a charge for customers wanting to use of the lifts. Unsurprisingly, the majority of customers chose to use the lifts but a small number of Nordic and freestyle skiers chose not to.

The issue in this appeal was the correct VAT treatment of the money paid by customers who use the lifts.

Snow factor Limited argued that the supply was taxable at the reduced rate as it was "the transport of passengers by means of a cable-suspended chair, bar, gondola or similar vehicle designed to carry not more than 9 passengers" (Item 1, Group 13, Sch 7A VATA 1994);

HMRC argued that the supply was excluded from item 1 by note 1 that reads:

> 'Item 1 does not include the transport of passengers to, from or within—
>
> (i) a place of entertainment, recreation or amusement'

In defence Snow Factor Limited claimed that buying the lift pass resulted in customers saving time and so being able to ski down the slope more frequently. Note 1 was not relevant as admission to the slope was free and so there was no supply of a right of admission for consideration.

Decision

The Upper Tribunal posed the question "Why does a customer purchase a lift pass?" The Tribunal concluded that customers bought a lift pass 'to ski down the slope without the effort and inconvenience of walking up it'. As the minority had demonstrated, skiers could gain access to the slope without a pass. Snow Factor Limited supplied access to the lifts for consideration.

It was common ground between the parties that the word "supply", where it appears in Note 1, must be given its technical VAT meaning of something done for a consideration. The Upper Tribunal agreed with Snow Factor Limited that Note 1 was not applicable because there was no supply, for consideration, of a right to use the slope in the snow dome. Use of the slope was free.

Snow Factor Limited v HMRC [2020] UKUT 0025 (TCC)

Incorrect zero-rating certificate (Lecture B1181 – 16.38 minutes)

Summary – Marlow Rowing Club had a reasonable excuse for issuing an incorrect zero-rating certificate.

Following a devastating fire to the clubhouse in August 2011, the members of the old club decided to construct a new facility, to be owned by a limited company.

Marlow undertook the construction of a "Water Sports Hub" building to be used by itself and other sports clubs in the local area and also to provide a gym facility for which it offered membership to non-club members.

It issued the zero-rating certificate to a supplier of construction services on the basis that the building was intended to be used "for a relevant charitable purpose otherwise than in the course or furtherance of a business".

Prior to issuing the certificate, Marlow sought advice from VAT accountants and counsel. At the time, a case (*Longridge* on Thames ((TC2574)), had been heard by the First Tier Tribunal and concerned a similar project. The Tribunal had found in favour of *Longridge* but the case was appealed. Marlow Rowing Club's accountants advised them that the *Longridge* appeal would need to succeed for Marlow to issue the certificate. The accountants had suggested that Marlow should seek HMRC's opinion prior to issuing the certificate.

In November 2013 Marlow Rowing Club issued the certificate and nine days later the Upper Tribunal upheld the *Longridge* decision.

On 18 November 2014 HMRC issued a routine compliance check into the issuing by Marlow Rowing Club of the Certificate. On 27 July 2015 a Notice of penalty assessment was issued. Marlow Rowing Club appealed to the First Tier Tribunal on 21 June 2016.

On 1 September 2016 the Court of Appeal issued its decision in Longridge finding in favour of HMRC. In the light of this decision, Marlow Rowing Club did not seek to argue the Certificate was correctly issued but appealed against the penalty on the basis it had a reasonable excuse.

The First Tier Tribunal stated that Marlow Rowing Club was clearly aware that the Longridge decision was not final at the time that it made its decision to issue the zero-rating certificate and was clearly aware that its actions in issuing the certificate would not be agreed by HMRC. The Tribunal concluded that Marlow did not have a reasonable excuse. A trader in the same position as Marlow would have sought HMRC's opinion before issuing the certificate, could have appealed any disagreement with HMRC and should have requested that the decision was stayed behind the Longridge case.

Marlow appealed to the Upper Tribunal arguing that, as an unregistered entity, if HMRC had refused to allow the certificate to be issued, this would not have been appealable. For an appeal to be eligible for statutory review or a hearing before the tribunal, the relevant supply must have taken place.

Decision

The Upper Tribunal confirmed that the First Tier Tribunal had erred in law. In order to appeal a decision, the zero-rating certificate had to be given before the supply was made. A negative decision from HMRC with no certificate, meant no appeal. The Upper Tribunal also stated that had Marlow Rowing Club proceeded without issuing the certificate and so paid over the standard rated VAT, it was uncertain as to whether the builder would have cooperated in enabling Marlow Rowing Club to reclaim that VAT at a later stage if it was subsequently confirmed that zero rating was appropriate.

The Upper Tribunal remade the First Tier decision by concluding that Marlow Rowing Club did have a reasonable excuse for incorrectly issuing the zero-rating certificate.

Marlow Rowing Club v HMRC [2020] UKUT 0020 (TCC)

New rules on EU call-off stock **(Lecture B1185 – 10.04 minutes)**

Call-off stock v Consignment stock

Call-off stock - is the term used to described trading in goods where the customer for the goods is known to the supplier at the time when they are moved from one EU country to another. These procedures were subject to change at EU level with effect from 1 January 2020. The UK is obliged to comply with these new rules until at least 31 December 2020, i.e. when the temporary Brexit withdrawal deal expires.

Consignment stock – these arrangements are completely different: in this situation, goods arrive in another EU country, and the identity of the final customer is unknown. In most cases, the UK business storing goods in the other EU country will need to register for VAT in that country, so that domestic VAT can be charged when the goods are supplied onwards to the final customer.

Call-off stock – new legislation from 1/1/20

To avoid the need for the supplier to register for VAT in the Member State of destination, Article 17a of Directive 2006/112/EC sets out the new rules which permit the intra-community supply of the goods to be treated as occurring when the goods are called-off and the final supply is made to the customer.

That means that the physical movement of the goods from the Member State of origin (plus the UK until 31 December 2020) to the Member State of destination does not give rise to an intra-community supply. The goods that are held as call-off stock in the Member State of destination are considered, for VAT purposes, to still be within the scope of VAT in the Member State of origin.

The intra-community supply takes place when the goods are called off by the customer. At that point, the normal VAT accounting rules for a cross border sale of goods apply i.e. the customer accounts for acquisition tax and the sale is zero-rated for the supplier.

HMRC has published draft legislation in order to implement the new rules but has confirmed that there is no obligation for a business to change its arrangements to meet these new conditions.

However, where a UK business wishes to access this simplification for dealing with call off stock arrangements with its EU customers and ensure a VAT registration in another EU state is not triggered solely from engaging in this type of arrangement, the regulations would need to be followed.

The changes will be included in the next Finance Act, so the legislation will have retrospective effect.

Call-off Stock Register

This register should be maintained by suppliers, giving details of all call-off stock movements and the dates when stock is 'called off' by the customer. In other words, the supplier has an on-going record of all goods held and transferred under call off arrangements. The following details must be kept in the register:

a) the VAT registration number of the customer of the goods subject to the call-off stock arrangements;

b) the description and quantity of the goods intended for him;

c) the date on which the goods intended for him arrive in the warehouse – this becomes relevant for the 12-month rule considered below;

d) the taxable amount, description and quantity of the goods supplied to him and the date on which the customer's intra-community acquisition of the goods is made;

e) the description and quantity of the goods, and the date on which the goods are removed from the warehouse by order of the supplier;

f) the description and quantity of the goods destroyed or missing and the date of destruction, loss or theft of the goods or the date on which the goods were found to be destroyed or missing.

Contracts

The wording of contracts or trading terms between customers and suppliers should cover call-off stock arrangements. In the past, contracts might have been silent on these issues but it is important that both the supplier and customer are aware of the VAT procedures that are in place;

Business establishment

Call off arrangements only apply when the supplier does not have a business establishment in the EU country where the goods are stored. If a supplier opens a business establishment in an EU country where call-off stock is held (this is different to a warehouse storing goods – a business establishment has the physical and human presence necessary to run a business), then the supplier would become VAT registered in that country and the call-off arrangements would cease. Domestic VAT would then be charged on future sales to customers in that country;

EC Sales Lists

The ESLs will reflect the sales of goods under these arrangements;

Substitute customer

- If the call-off stock will instead be sold to another customer in the same EU country, i.e. not the original customer for whom the stock was intended, this does not create a trigger for the supplier to get a VAT number in the country where the goods are held. The call-off arrangement can continue with the new customer – however, certain conditions apply:
- The supplier must decide not to supply the goods to the original customer and at the same time decide to supply them to the substitute customer;
- The substitute customer must at that time be registered for VAT in the Member State of destination;
- The supplier must include the substitute customer's VAT registration number in its EC Sales List;
- The supplier must record the intention to supply goods to the substitute customer in the Call-off Stock Register, noting the customer's VAT registration number.

Note - the introduction of a substitute customer does not change the application of the 12-month rule which applies to the goods and not to the customer – see para 3.6. The substitution can be in respect of the all or some of the goods held.

12-month deadline –

If goods are not called off by the customer within 12 months of their arrival into that country, then the supplier will need to register for VAT in that EU country and account for domestic VAT. In other words, a deemed supply has taken place in the country where the goods are held. This is an important change which means that the call-off stock register should clearly show the movement dates for all stock. For practical purposes, HMRC has confirmed that the date when the goods arrive into the warehouse in the country of destination can be used as the relevant arrival date as far as the 12-month deadline is concerned.

Other relevant events

The guidance refers to other situations where a call-off arrangement will end and the supplier will be deemed to be acquiring goods in the EU country where they are held and will therefore need to register for VAT in that country. For example, if the customer receiving the call-off stock deregistered from VAT in his country, this would be a relevant event because the customer can no longer account for acquisition tax if he is not registered for VAT. Another relevant event would be if a 'substitute customer' is not based in the same EU country as where the goods are held.

VAT returns

A sale will be made when the customer calls-off the stock, the customer accounting for acquisition tax on their own return. The sale by the supplier will be zero-rated as an intra-EU supply (including the UK until 31 December 2020) between VAT registered businesses.

Summary

Overall, the supply of goods from a business in the UK to a VAT registered business customer in another EU state remains one on which no UK VAT should be chargeable. It is a question of ensuring that UK suppliers hold all of the required details to evidence and monitor goods under a call-off arrangement and that all of the required conditions (such as keeping details of the VAT registration number of the business customer and a call-off stock register) – are met.

Contributed by Neil Warren