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Personal tax

Domicile and remittance basis (Lecture P1241 -17.18 minutes)

Summary – HMRC could not issue a partial closure notice covering the taxpayer's domicile without a calculation of the tax due as a result of rejecting the taxpayer's remittance basis claim. The taxpayer had to supply details of their overseas income and gains.

For the tax years 2014/15 and 2015/16, Epaminondas Embiricos believed he was non-UK domiciled and claimed the remittance basis in his tax returns.

Having opened enquiries into the claims, HMRC concluded that the taxpayer was in fact UK domiciled and the remittance basis was denied. A claim for the remittance basis does not require the taxpayer to quantify the amount of the claim and so HMRC issued an information notice request to enable them to calculate the amount of tax that was now due.

The taxpayer believed that the details were 'not reasonably required until his domicile status had been confirmed' and so applied for a partial closure notice, allowing him to appeal the domicile decision.

However, HMRC stated that it could not issue a closure notice until it had quantified the amount of tax which would be due on the basis that the remittance basis was denied. To do so, they needed details of the foreign income and gains specified in the information notice issued. The domicile decision could not be separated from the remittance basis tax calculation.

The taxpayer appealed.

HMRC relied on the Court of Appeal's decision in Regina (Archer) v HMRC [2017] EWCA Civ 1962 where a closure notice was held to be valid only if it stated the amended amount of tax for which the taxpayer was liable. The taxpayer argued that this decision was restricted to final closure notices and had no application to partial closure notices.

On appeal, the First Tier Tribunal confirmed that the Archer decision predated the introduction of partial closure notices, that resulted in a 'fundamental change' in the rules so that Archer did not apply to partial closure notices. The First Tier Tribunal disagreed with HMRC, concluding that a partial closure notice denying the taxpayer's claim to benefit from the remittance basis should be issued. The partial closure notice did not need to specify the amount of tax due.

HMRC appealed to the Upper Tribunal.

Decision

The Upper Tribunal overturned the First Tier Tribunal's decision which it stated was flawed. The rules relating to partial closure notices had been adapted from the closure notice legislation, and not created separately. The rules were part of the existing closure notice system and so partial closure notices are subject to the same statutory restrictions as closure notices and must contain a calculation of the tax due.

After the First Tier Tribunal's decision, another First Tier case was heard, The Executors of Mrs R W Levy v HMRC [2019] UKFTT 418 TC ("Levy"). This case concluded that a partial closure notice cannot be issued without specifying the amount of tax due. Although not binding, it served to support the decision made by the Upper Tribunal.

Note: In its decision, the First Tier Tribunal had concluded that if it was wrong about the partial closure notices, then the information requested would be reasonably required by HMRC, and the appeal against the notices would be dismissed.

HMRC v Epaminondas Embiricos [2020] UKUT 0370 (TCC)

Private use by car dealership director (Lecture P1241 -17.18 minutes)

Summary – Two cars taxed as off road when not used did not prevent the cars being treated as available for private use by the director, and so were taxable as a benefit in kind.

Tim Norton Motor Services Ltd runs a Ford car dealership selling new and second-hand cars, as well as undertaking repair work. The company directors are Tim Norton and his wife who live about 10 miles from the company premises.

The company employs some 20 people and typically has around 50 new and second-hand cars on its site at any one time. In 2001 the company bought a rare Maserati and in 2005, a Ford GT40. The keys for both cars were kept in a locked box, in a locked safe in the office. Only Tim Norton had access to the box and he was the only person insured to drive the cars.

The two cars were:

- used to attract business at trade shows and race events, including one in Le Mans;
- taxed as off road except when taken out to an event;
- occasionally used for private journeys and declared on P11Ds when relevant.

However, following a 2016 PAYE audit, HMRC concluded that these cars had been made available to Tim Norton for periods longer than had been declared on his P11Ds. Consequently, HMRC issued NIC determinations for the years 2010 to 2017, income tax assessments for the years 2012/13 to 2014/15 and 2016/17, and a closure notice for 2015/16.

Tim Norton Motor Services Ltd and Timothy Norton appealed HMRC's decisions. The company argued that there was no additional private use issue as the cars were taxed as off road when not used and an SORN was submitted when needed.

Decision

When a car is made available for private use to an employee, even if they do not actually use the car, a benefit arises. The issue in this case was whether the company had taken sufficient steps to prevent the cars from being available.

The First Tier Tribunal concluded that the restriction arising from the SORN was not a real restriction on private use, as Tim Norton could easily remove the SORN restriction and be able to drive the car. This was not enough to convince them that the car had not been available for private use.

Consequently, the Tribunal found that in any year where the cars had actually been used for private journeys, they had effectively been made available to Tim Norton for the entire year. In fact, they went further, concluding that the cars were available for private use for more years than had been declared on P11Ds. However, the Tribunal accepted that the evidence showed the Ford GT40 was used for business only in the years 2011/12 to 2012/13.

The appeals were largely dismissed.

Tim Norton Motor Services Ltd and Timothy Norton v HMRC (TC07973)

Temporary Workplaces **(Lecture P1242 – 15.51 minutes)**

Introduction

s.338 ITEPA 03 denies a deduction from earnings for travel expenses incurred in 'ordinary commuting', which is travel between:

- the employee's home and a permanent workplace; or
- a place that is not a workplace and a permanent workplace.

A permanent workplace is defined in s.339 as a place the employee regularly attends in the performance of the duties of the employment and which is not a temporary workplace.

Temporary workplace

A temporary workplace is a place the employee attends to perform a task of limited duration or for some other temporary purpose.

A workplace is not regarded as temporary if the employee's attendance is during a period of continuous work of a significant extent (being at least 40% of working time) lasting:

- More than 24 months; or
- Comprising all, or almost all (i.e. at least 80%) of the period for which the employee is likely to hold the employment.

It becomes permanent at the time that it is reasonable to assume one of the above is true. This could be at the start of the work, or during it (for example, if an existing 18-month secondment is extended by another 12 months).

Example

Karen works for a firm of architects at its Petersfield branch. She is sent to work full-time at the branch in Andover for 15 months, at the end of which she will return to the Petersfield branch. Andover is approximately 36 miles north-west of Petersfield.

Although she is spending all her time at the Andover branch, it will not be treated as her permanent workplace, as her period of attendance will not exceed 24 months. Therefore, Karen can claim a deduction for the costs of travel to and from her home to the Andover branch.

The allowable travel is from Karen’s home (or other starting point) to the temporary workplace, even if this is shorter than the journey to her permanent workplace, or she drives past her permanent workplace to get there. If her employer only reimburses the difference in mileage between the two journeys, the employee can claim a deduction for the balance.

Note that if Karen was recruited on a 15-month contract to work at the Andover office, this would be her permanent workplace (as she would be working there for all of her period of employment) and no travel would be deductible.

Subsistence costs

Where travel is deductible, any reasonable subsistence costs (for example hotels and evening meals) will also be deductible, although this is not likely to be relevant in Karen’s case, given the distances involved.

Separate temporary workplaces or one permanent workplace?

It is possible for different workplaces situated close together to be regarded as one (s339(7)). This says that, when determining where a temporary workplace is, you should ignore any modification of the place at which duties are performed if it does not, or would not, have any substantial effect on the employee's journey, or expenses of travelling, to and from the place where they are performed.

In the recent case Narinder Sambhi v HMRC (TC07717), the appellant was on a long-term secondment from Birmingham to London, working at various different sites in south and central London, whilst staying in east London.

The FTT found that

- the journey times to each site from his accommodation differed by no more than half an hour; and
- the cost varied by no more than £14.

In the Tribunal’s view, the change of worksites was not substantial. His work at various sites in Greater London would therefore be treated as one workplace, which had become a permanent workplace after he had been in London for more than two years.

What does the employment contract say?

Contractual terms are very important in establishing whether somewhere is a permanent or temporary workplace. For example, if an employee is being taken on to carry out several short-term assignments at various sites, they will all be permanent workplaces if each location is dealt with under a separate contract. In contrast, if all the work is covered under a single contract, it is likely that many of the locations will be regarded as temporary workplaces, with travel allowable.

In both N Ratcliffe v HMRC TC2814 and Paul Nowak v HMRC (TC07307), the appellants worked at various locations for their employer, but where work at a particular site was covered by a separate contract, that site was held to be a permanent workplace, with travel not allowable for the employee.

Contributed by Kevin Read

No transfer of assets abroad (Lecture P1241 -17.18 minutes)

Summary – The sale of UK shares to an offshore company owned by an offshore trust followed by dividend payments by the UK company did not fall foul of the transfer of assets abroad rules.

Andreas Rialas was UK resident and ordinarily resident, but not UK domiciled. Together with Mr Cressman, they each owned 50% of the shares in Argo, a UK incorporated company.

Around December 2004, the relationship between the shareholders deteriorated, and Andreas Rialas found a buyer for the company but only if Mr Cressman was not involved with Argo. To facilitate the sale Andreas Rialas formed a new company, Farkland that was incorporated in the British Virgin Islands, and whose shares were owned by an offshore discretionary trust in Cyprus, with assets held for the benefit of Andreas Rialas' family.

Mr Cressman agreed to sell his 50% interest in Argo at market value to Farkland, with the purchase funded by a third-party loan. Following this, Argo declared and paid interim dividends of £2,153,873 in 2005 and £3,318,460 in 2006 with half of the dividends being paid to Farkland in respect of the 50% shares that the company now owned. The other 50% was paid to Andreas Rialas, who continued to own the other 50% of the Argo shares.

Farkland later sold their shares in Argo to a third-party company.

HMRC assessed Andreas Rialas to tax on his own dividends as well as the dividends received by the trust arguing that, under the transfer of assets abroad regime, he had the power to enjoy the income and had procured the transfer of assets abroad.

The First Tier Tribunal disagreed with HMRC. Although he had arranged the sale of Argo to a subsequent third party, Andreas Rialas had no power to force Mr Cressman to sell his Argo shares to the Farkland.

HMRC appealed to the Upper Tribunal.

Decision

The Upper Tribunal agreed with the First Tier Tribunal. Andrea Rialas had had no control over whether Mr Cressman agreed to sell the shares. He should not be treated as if he had carried out the share transfer and so the transfer of assets abroad rules did not apply.

HMRC had put forward an alternative argument that the £10 transferred by Andreas Rialas to set up the discretionary trust in Cyprus was a transfer of assets abroad and that all subsequent transactions were associated operations. Rejected by the First Tier, this argument was also rejected by the Upper Tribunal. The dividend payment was not made 'by virtue or in consequence of' the transfer of the £10. The dividend payment was only guaranteed once the business partner sold his shares.

The appeal was dismissed.

HMRC v Andreas Rialas [2020] UKUT 0367 (TCC)

Loss creation scheme defeated

Summary - Arrangements entered into by the taxpayers fell within the Ramsay principle and therefore did not create the losses that they were designed to achieve.

The taxpayers had entered into arrangements, known as the 'volatility investment strategy', that were designed to produce (at each taxpayer's choice) either capital losses or income losses. These were intended to be set against the taxpayers' capital gains or certain categories of taxable income.

The scheme involved each taxpayer entering into 'trades' with Schroders bank. Under each trade, the taxpayer entered into two forward contracts with the bank, to be settled around a month later on the 'valuation date'. The price was fixed, but the nature of the securities passing under the contracts depended on the movement of the FTSE-100 index. If, at the valuation date, the index was within a certain range, the trade would be settled such that it resulted in a (small) gain for the taxpayer. If, at the valuation date, the index was outside the chosen range, the trade would result in a (large) loss for the taxpayer. This would be offset by a similarly-sized gain, but the gain would be tax-free because it would arise from a disposal of gilts.

If a trade fell into the first of these categories (with the taxpayer making a gain), the taxpayer simply entered into another trade, and continued until they had entered into a trade that fell into the second category (a loss-making trade).

Decision

The First Tier Tribunal had no difficulty in finding that the transactions underlying each loss-making trade should be considered together and amounted to circular self-cancelling composite transactions which gave rise to neither a gain nor a loss. The case fell within the *Ramsay* principle. The facts in this case were similar to those in *Ramsay* itself, and as in Ramsay, the purported losses were not 'real world' losses as was required by the relevant legislation.

In the case of the capital losses, the First tier Tribunal found that they would not have been allowable in any event, because the arrangements had a main purpose of tax avoidance and so were caught by the capital loss targeted anti-avoidance rule (TAAR) in s16A TCGA 1992.

Padfield & Ors v HMRC (TC07983)

Adapted from the case summary in Tax Journal (22 January 2021)

Chargeable event gains (Lecture P1243 – 24.51 minutes)

Chargeable event gains will typically arise in relation to single premium insurance bonds. This is a product which pays out on the death of the 'insured' but which is an investment product designed to give growth in value in a tax effective way. It is a wrapper for investments rather than insurance. Cash can be withdrawn by the bond holder at any time (subject to any restrictions imposed by the insurance company) and there is no limit on the amount which can be invested. There are tax implications of withdrawing money in some cases.

For reasons which are explained below, it is often the case that even where a single premium is paid, the bond is split into units. Most policies are ‘non-qualifying policies’. A qualifying policy is one that is designed to last 10 years or more, with premiums being paid yearly or more frequently. So the kind of products not within this regime include term assurance (which pays out only on death with no investment aspect), insurance for destruction or damage to assets and medical insurance.

It is important to understand the terminology. The policyholder is the legal owner of the policy; the life or lives insured are the people whose death triggers a payout and the insurance year is the year commencing on the date policy is issued.

What is the tax treatment of contributions on the assumption that these are paid in a single contribution in cash?

- There is no deduction or relief for income tax purposes;
- There is no capital gains tax impact as it is a cash transaction;
- If the payer is the beneficiary, then there is no inheritance tax impact as there is no transfer of value. If the initial cash or policy is gifted to someone else or to a trust then it would be a potentially exempt transfer or chargeable lifetime transfer depending on the recipient.

If we are considering the tax treatment of encashment of the bond, the first thing to ascertain is whether this is an onshore or an offshore bond. An onshore bond will be held by a UK insurance company which is paying corporation tax on its profits. There is a tax credit of 20% on any withdrawals. Offshores bonds are held by persons in places such as IOM, Dublin, Luxembourg or the Channel Islands and is not normally subject to UK corporation tax. There is no tax credit on withdrawals.

A tax charge arises when a chargeable event occurs. This is not subject to capital gains tax but instead falls within the chargeable event gain provisions. This is a mechanistic calculation which means that it may not be relevant if the policy is actually standing at a gain.

There are three stages:

1. Identify that a chargeable event has taken place;
2. Calculate any gain using rules in legislation;
3. Determine who is taxed on the gain.

Chargeable event gains are taxed as the highest slice of income.

The typical chargeable events that we see are:

- Assignment of rights for consideration;
- Death;
- Full surrender of rights;

- Partial surrender or assignment.

Assignment

Assignment of a policy for no consideration is not a chargeable event and transfers between spouses or civil partners are disregarded even where this is done for consideration. This can be used for planning purposes.

Death and surrender of rights

A surrender of a policy is where is fully encashed. However, it is important to note that HMRC consider that some changes in policy terms also represent a full surrender (for example, a change in the first death/last survivor on a joint policy; adding or removing critical illness cover) so most policies restrict this.

Even though chargeable events include death of the insured, if no death benefits arise, then there is no chargeable event (for example, the first death where joint lives are assured).

The calculation of the gain on death, full assignment and surrender is basically the same. It is calculated as:

Total Benefit Value of the Policy

LESS Premiums Paid and Chargeable Event Gains already charged

The total benefit value is the sum payable on termination of the policy plus any capital sums previous paid (such as on partial surrenders, see below). On death, the total benefit value if the surrender value of the policy before death plus any previous capital withdrawals. On assignment, it is the surrender value plus any previous capital withdrawals.

The chargeable event gain arises at the point of the chargeable event.

Examples

An individual pays £20,000 into an insurance bond and makes no withdrawals before encashing it when its value is £35,000. The chargeable event gain is £15,000 as it is simply the difference between these two figures.

An individual pays £20,000 into an insurance bond. She withdraws £3,000 which gives rise to a chargeable event gain of £1,000 before encashing the bond and receiving £35,000. Total benefit value is £35,000 plus £3,000 but the premium paid is £20,000 and the gains charged previously are £1,000. So the chargeable event gain is £17,000.

An individual pays £20,000 into an insurance bond and makes no withdrawals before assigning it for £30,000 when its surrender value £32,000. The chargeable event gain is the difference between the surrender value and the original premium, being £12,000. The consideration received is of no relevance.

An individual pays £20,000 into an insurance bond and makes no withdrawals. The insured dies when the surrender value is £37,000 but the estate eventually received £38,500 when the bond is encashed. The chargeable event gain is the difference between the surrender value at the date of death (£37,000) and the original premium (£20,000) so is £17,000.

Partial surrender

Part surrenders are chargeable events but there is an annual 5% allowance each year (cumulative) and if the surrender is within the available allowance, then there is no chargeable event gain at the time. It is important to remember that these apparently 'non-chargeable' events are taken into account on subsequent events as they are included in the total benefit value of the policy (see above). A surrender in excess of the allowance will crystallise a chargeable event. The quantum of this is the excess withdrawal regardless of whether the bond is standing at a gain. If further premiums are added to the policy, then you also get 5% of those going forward.

The partial surrender is deemed to occur at the end of the relevant insurance year in which it arises which may be in a different tax year to the date the actual partial surrender took place.

Examples

George contributes £200,000 to an onshore policy in year 1. He withdraws £45,000 in year 4. The chargeable event gain is £5,000. He has four years' worth of 5% withdrawals allowances (£10,000 p.a.) so it is only the excess of this that is chargeable.

Marjory pays £10,000 into an insurance bond, and then makes a supplementary contribution of £5,000 in year 3. She withdraws £3,000 in year 5. The cumulative total of withdrawals that can be made before a chargeable event gain arises is (£10,000 x 5% x 5) + (£5,000 x 5% x 3) = £3,250. So the withdrawal is within those limits and no gain arises.

The position is more complicated when there are successive part disposals as you need to know what you take into account and what you don't. The answer depends on whether or not there have been any 'excess events'.

If there have been no previous partial surrenders which have generated a chargeable event gain, then you simply add up all the partial surrenders and compare that to the cumulative 5% allowances to see if a chargeable event gain arises in the current insurance year. If you have previous excess events that have generated a chargeable event gain, you have to disregard any amounts of the cumulative 5% allowances which have already been utilised and any other partial surrenders that have already been taken into account in calculating the previous gain.

Examples

An individual invests £10,000 in an insurance bond, withdrawing £500 in year 2 and £4,000 in year 5. The 5% income allowance each year amounts to £500. The partial surrender in year 2 is covered by this so no chargeable event gain arises. When we come to year 5, we have £2,500 of cumulative allowances and £4,500 of withdrawals. So the chargeable event gain is £2,000.

A further withdrawal is made in year 7 of £2,000. The cumulative 5% allowances for 7 years equals £3,500 but we have already taken into account £2,500 in calculating the partial surrender gain in year 5 so we only have £1,000 to consider. No previous partial surrenders have been exempt so they are also ignored. So the chargeable event gain here is the withdrawal less £1,000 which is itself £1,000

We then need to consider if it is better to surrender full units rather than partial units. This explains why it is common to see large single premium bonds split into numerous smaller bonds.

An individual invests £500,000 in a bond with 1,000 units. In year 2 it is worth £530,000. She wants to withdraw £132,500 to fund cashflow issues in her company.

If she partially surrenders the whole amount from a number of units, the chargeable event gain would be £82,500 as she can only offset £25,000 x 2 being the 5% allowances available. Each individual unit is worth £530 so she could surrender 250 units to get the relevant figure. The gain on each would be £30 so the total chargeable event gain would be £7,500.

Top slicing relief

Top slicing relief is available because chargeable event gains are made in a single year whereas the growth in value will (typically) have arisen over the life of a bond. This can cause the income tax to be artificially high on some surrenders, exacerbated by the chargeable event gain being treated as the top slice of income.

The steps to calculate this are as follows:

1. Divide the gain by the number of complete years the policy has been in place (this is the 'slice');

2. Work out how much of the 'slice' falls into the higher rate or additional rate band and what the tax rate is on this (the 'extra tax');

3. Multiple the extra tax by the number of complete years

4. Deduct this from the individual's tax liability on the chargeable event gain. The difference is the top slicing relief.

Example

An individual has a salary of £130,000 and then makes a chargeable event gain of £45,000 which was taken out 5 years before. It is an onshore bond and top slicing relief is claimed.

No personal allowance is available so the tax on chargeable event gain without top slicing relief would be £20,000 x 40% plus £25,000 x 45% less the basic rate tax credit of £45,000 x 20%. This is £10,250.

The sliced gain is £9,000. The income does not exceed the additional rate threshold so there is £500 personal savings allowance available and so tax due is £8,500 x 40% x 5 = £17,000 less basic rate tax credit of £9,000. So top slicing relief of £2,250 can be claimed.

This calculation has caused problems historically because of the question about loss of personal allowance.

Let us take an example. An individual has income of £40,000 and then makes a chargeable event gain of £90,000 on a policy held for 10 years. Total income without top slicing relief is £130,000 causing complete loss of the personal allowance. However, the 'sliced' gain is only £9,000 which is well below the threshold at which the personal allowance start to reduce.

It has always been HMRC's view that you do not get the personal allowance back in the top slicing calculation but this was disproved in the FTT HMRC v Marina Silver decision (TC07013). The legislation was then amended for chargeable events occurring on or after 11 March 2020 although for cases arising on earlier dates, the principle in the Silver case could be argued.

In the above example, no further tax would be due on the gain as the whole of the sliced gain falls within the basic rate band and is covered by the basic rate credit assuming that this is an onshore bond.

Deficiency relief

Deficiency relief is designed to mitigate some of the effects of having partial surrenders taxed on a figure which does not reflect the underlying gain on the bond.

It is not effective as it only applies on full surrender of a bond and only assists someone who is a higher rate taxpayer.

If the total allowable deductions are greater than the total benefit value, then the gains which have arisen on previous chargeable events arise as a deficiency.

If the total benefit value exceeds the total allowable deductions, then the deficiency is equal to the total of the previous gains, less the excess.

Total allowable deductions are the total premiums paid under the policy. The total benefit value are the capital amounts having been withdrawn from the policy at any point, and including the 5% withdrawals which have previously not been taxable

The tax reduction is calculated by matching the amount of the deficiency with that part of the individual's taxable income which is taxed at the dividend upper rate, and, if there is any deficiency remaining, then with the part taxed at the higher rate with the equivalent for Scottish or Welsh taxpayers.

Example

Romi took out a policy with a premium of £20,000

- In year 2 she withdrew £8,000 from the policy by a part surrender;
- In year 5 she surrendered the policy for £13,000.

She was UK resident throughout.

Her taxable income is £52,000. The threshold at which higher rate is paid is £50,000.

Tax treatment

- The part surrender in year 2 produces a gain of £6,000 (£8,000 less (2 x £20,000 x 5%));
- The total allowable deductions are £20,000 being the initial premium;
- The total benefit value on surrender is £13,000 + £8,000 = £21,000;

- The amount of deficiency = £21,000 - £20,000 - £6,000 = -£5,000;

- The relief is given by extending the basic rate band so, in reality, she will only benefit from £2,000 of the deficiency relief. The excess relief cannot be carried back or forward or used in any other year.

Following on from some criticism of the way in which the chargeable event gain legislation operated, HMRC changed the legislation in 2017 so that a policyholder can apply to have a tax charge recalculated where it is disproportionate. The application must be made in writing to HMRC within 4 years of the end of the tax year in which the gain arose and there are various factors HMRC will take into account in deciding whether the gain is disproportionate. No recalculation will be made if the gain is connected with arrangements where the main purpose or one of the main purposes if the avoidance of tax.

Contributed by Ros Martin

Capital Taxes

Employment lacking for entrepreneurs' relief (Lecture P1241 -17.18 minutes)

Summary – Entrepreneurs' relief was denied as the taxpayer was not an employee for the required 12 months before selling his shares.

Bglobal Metering Limited operated a smart metering business for commercial businesses, local authorities and other public bodies.

In March 2007, Bglobal plc was set up as a vehicle through which Bglobal Metering Limited would be listed on the Alternative Investment Market. The listing sought to provide capital to roll out the company's smart metering technology across residential markets.

Peter Kennedy held close to 24% of the company's shares and was a director of the company. There was an unsigned service agreement between Peter Kennedy and Bglobal dated 22 March 2007 under which he was employed. His salary was £150,000 pa which included director's fees.

However, from May 2009, Peter Kennedy started to provide consultancy services to Bglobal through his personal service company, PBK Consulting Limited. From this time, he received a salary from the consulting company as well as director's fees paid by Bglobal.

On 15 August 2013 following a disagreement, Peter Kennedy ceased to be a director of Bglobal and his 2013/14 tax return stated that his employment ceased on that date. His consultancy work stopped at the same time.

In September 2014, following the sale of two business units, Bglobal was de-listed from AIM. The company made a capital distribution to shareholders from which Peter Kennedy realised a gain of £2.5 million. The company entered members' voluntary liquidation and on 16 September 2015, Peter Kennedy crystalised a further gain of nearly £450,000 on the final distribution to members. In his 2014/15 and 2015/16 tax returns, Peter Kennedy claimed entrepreneurs' relief against both gains.

HMRC opened enquiries into both years and, in July 2018, issued closure notices denying the entrepreneurs' relief. HMRC argued that Peter Kennedy was not an officer or employee of Bglobal plc throughout the period of one year ending with the date of each disposal.

Although his role as director had ceased in 2013, Peter Kennedy argued that he had continued to be an employee, as his written service agreement was never properly terminated.

Decision

The First Tier Tribunal agreed that Peter Kennedy had been carrying out duties as director between May 2009 and August 2013 but ceased from that date.

Although Peter Kennedy had a written service agreement from April 2007, the Tribunal concluded that this ceased when he started working through his personal service company.

From this time, he received director's fees of £6,000 a year but his consultancy fees were paid to PBK Consulting.

As his directorship terminated more than 12 months prior to sale, there was no further employment relationship, and he was not eligible to claim entrepreneurs' relief.

The appeal was dismissed.

Peter Kennedy v HMRC (TC07987)

Freezing operations – an update (Lecture P1244 – 21.09 minutes)

At times during the 12-year period since 2008, there have been significant falls in the value of UK land and buildings. This has led clients who are owners of property investment companies to consider the possibility of 'freezing' part of their estates for IHT purposes.

Shares in property investment companies do not qualify for 100% business relief. Individuals holding such assets therefore need to seek other alternatives in an effort to minimise their IHT liabilities. Typically, these involve the client pegging the current value of their property investment company shares and passing on any potential capital growth to the next generation. This can be achieved by an outright gift or by a transfer into a trust.

Let us imagine the shareholders of a property investment company. It does not matter whether this company is involved in commercial properties or residential properties or both.

The shareholders will normally hold ordinary shares which have the following attributes:

- voting rights;
- dividend rights; and
- an entitlement to share in any capital appreciation.

The shareholder's first tax planning step is to create a new class of 'growth' share, usually by way of a bonus issue. These new shares will only be eligible for voting, dividends and any winding up or sale proceeds once the present value of the company has been distributed to the holders of the original ordinary shares. The rights attaching to these original shares can be altered by amending the company's Articles of Association to restrict their right to receive future dividend and winding up (or sale) proceeds to a sum equal to the present market value of the company. This amendment will have the immediate effect of freezing the value of the original shares at this amount.

The new bonus shares will initially be worth very little. Indeed, they may well have a nil value, given that they should have no voting rights, no dividend rights and no capital value other than their nominal value of, say, £1 each. However, they will grow significantly in value over the next few years as the property market continues to flourish. It is these new shares which are then given to the donor's children or, alternatively, put into trust (particularly if the capital growth may be substantial).

Illustration 1

Charles, who is aged 72, holds 100% of a company which owns a number of let commercial properties. The value of Charles' property company is currently £4,800,000.

In recent years, Charles has been drawing annual dividends of £240,000 from his company.

New 'B' shares are issued to Charles by way of a bonus issue, with his original ordinary shares being redesignated as 'A' shares. The company's Articles of Association are changed so that the 'B' shares are only entitled to votes, dividends and capital on a winding up (or sale) in the event that the 'A' shares have already received a total of £4,800,000 since this planning stratagem was implemented.

At this stage, the 'B' shares are worth virtually nothing. After all, unless there is a liquidation or sale, it will take 20 years before a 'B' shareholder qualifies for votes or dividends. Charles therefore makes an immediate gift of these shares to a discretionary trust for the benefit of his adult son, Henry, and Henry's issue.

Five and a half years later, Charles dies at a time when his property company is worth £8,400,000. In the meantime, the 'A' shares have paid Charles dividends totalling £1,500,000 since the share reorganisation.

As a result, the 'A' shares in Charles' estate are valued at £4,800,000 – £1,500,000 = £3,300,000 and the 'B' shares held by the discretionary trust are worth £5,100,000, i.e. the balance of the company's value. The 'B' shares have captured the property company's subsequent capital growth of £5,100,000 (£8,400,000 – £4,800,000 + £1,500,000) and the 'A' shares have been frozen at their original value of £4,800,000 less the dividends received by Charles over the last five and a half years. Note that the value of the 'B' shares falls completely outside Charles' estate on death.

The IHT saving for Charles' estate, compared with what the position would have been if he had not undertaken this form of planning, is 40% x £5,100,000 = £2,040,000.

In Illustration 1, the bonus issue of the new shares and the reorganisation of the original share capital fall within the provisions of S127 TCGA 1992, as a result of which there is no disposal for CGT purposes at that time. The subsequent gift of the 'B' shares to the discretionary trust will be a market value transaction, but any gain should be nominal in view of the fact that the deemed proceeds will be very small. If necessary, holdover relief under S260 TCGA 1992 is available as long as the settlor, the settlor's spouse and their minor children are excluded from benefit.

From an IHT perspective, the share reorganisation is a non-event, but the gift of the shares to the discretionary trust constitutes an immediately chargeable transfer. However, on the assumption that the settlor has all or most of his IHT nil rate band available, it is unlikely that detailed negotiations will need to be entered into with HMRC's Shares and Assets Valuation team about the IHT value of this transfer.

It will be sensible for the client to involve a share valuation specialist from the outset, both to value the company at the time of the initial planning and at the time of the shareholder's death and, in particular, to confirm the low initial worth of the 'B' shares following the amendment of the Articles of Association.

An alternative strategy is to ensure that the 'B' shares have no voting or dividend rights (and so remain virtually worthless) until such time as the company is wound up or sold or until the 'A' shares are transferred to the 'B' shareholder. This latter event would normally occur on the death of the 'A' shareholder. As a result, there is little to any value in the 'B' shares for creditors or divorcing spouses while the 'A' shareholder remains alive and in full control of the company.

It is generally considered that using this type of structure can turn out to be sound IHT planning. It may not be cheap to implement (perhaps £10,000 + VAT upwards), but, when one considers that every £1,000,000 of capital growth will eventually equate to a tax saving of £400,000, it begins to sound like reasonable value for money.

Contributed by Robert Jamieson

National heritage assets

National heritage assets may be given conditional exemption, deferring any inheritance tax due, on condition that they are available for the public to view under specific terms that are agreed with HMRC.

Previously, HMRC had confirmed that they would not consider that these conditions had been broken where property closure or opening was delayed due to COVID-19 restrictions. HMRC has now extended this relaxation of rules until April 2021.

Originally, HMRC had stated that national heritage property owners would be expected to make their property available later in the year to make up for any lost days. This part of the guidance has now been removed.

https://www.gov.uk/government/publications/capital-taxation-and-tax-exempt-heritage-assets#history

Non-UK resident buying UK property

HMRC has asked the ATT to share information received from HMRC about the new SDLT surcharge for non-residents purchasing property in England and Northern Ireland from 1 April 2021.

From 1 April 2021:

- A non-UK resident buying <u>residential</u> property in England or Northern Ireland will have to pay the new rates of SDLT.

- The new rates will be 2% higher than the rates which apply to UK residents.

SDLT Residence Tests

Individual buyers will be non-UK resident if they are not present in the UK for at least 183 days during the 12-months before their purchase.

Corporate buyers will be non-UK resident if they are not UK resident for Corporation Tax purposes at the date of buying the residential property. However, special rules will apply for UK resident companies which are under the direct or indirect control of non-UK resident persons.

Trusts will be non-UK resident if any trustee is a non-UK resident under the SDLT residence tests – except if:

- if the trust is a bare trust; or
- if any beneficiary is entitled to remain in the property for life or entitled to income arising from the purchased property.

Partners in a business partnership buying a residential property together will be treated as joint buyers and if any partner is non-UK resident the new rates will apply.

Claiming a tax refund/relief from this tax charge

Individual buyers may be able to claim a tax refund if, after the purchase, they are present in the UK for at least 183 days in the two-year period beginning a year before the purchase and ending a year after the purchase.

Also, if they are a crown employee and/or their spouse or civil partner is one, they will be able to claim an up-front relief from this tax charge.

https://www.att.org.uk/technical/news/new-rates-tax-non-uk-residents-buying-property-england-northern-ireland

Administration

Failure to take corrective action (Lecture P1241 -17.18 minutes)

Summary – Penalties for failure to take corrective action required by follower notices were upheld but the amounts payable were reduced from 42% to 24% of the tax advantage denied under the notices.

In an attempt to mitigate his income tax and NICs payable, Michael Bentley entered into a scheme marketed as 'IR35 arrangement', that was promoted by Montpelier tax advisers.

Following enquires by HMRC, closure notices were issued in 2009 and 2011 for each of the three years in question, increasing both income tax and NICs: by the following amounts:

- 2005-2006: £30,010.49 (from £3,308.87 to £33,319.36);
- 2006-2007: £32,146.52 (from £2,287.99 to £34,434.51);
- 2007-2008: £25,031.96 (from £2,409.17 to £27,441.13).

Montpelier appealed these notices on behalf of Michael Bentley. The appeals were put on hold pending the outcome of the appeal in Robert Huitson v HMRC [2015] UKFTT 488. Following this decision where the scheme failed, HMRC issued accelerated payment and follower notices to Michael Bentley in respect of all three years. The follower notices required him to take the necessary corrective action by a specified date in 2017 but Michael Bentley did not take such action until April 2019.

For the three years in question, HMRC issued penalty notices totalling just over £43,000 for failure to take corrective action. The penalties were calculated as 50% of the denied tax advantage which is, broadly, the Income Tax and NICs purportedly 'saved' by the Scheme.

Michael Bentley appealed these penalties arguing that he did not understand what corrective action was required and was confused by the notices.

Decision

The First Tier Tribunal did not accept that it was reasonable for Michael Bentley to take no corrective action because, as non-tax expert, the notices confused him. If he was capable of investigating a potential scheme to mitigate his taxes, he was capable of reading the letters that he had received with the follower notices. The Tribunal stated that:

> "Given the significant financial consequences of having to pay penalties of up to 50% of the tax saved, the reasonable taxpayer in Mr Bentley's position would have investigated further (and a great deal of information is available online)".

The Tribunal found that the letters that accompanied the follower notices were clear, confirming the taxes they covered, the action that was needed by the recipient as well as what would happen if he failed to take the appropriate action. It was unreasonable for him not to have taken corrective action by the due date and in principle, the penalties were upheld.

The First Tier Tribunal went on to consider whether the amount of the penalties was excessive. The penalties were calculated as 50% of the denied tax advantage which as the Tribunal stated is “basically the Income Tax and NICs purportedly ‘saved’ by the Scheme.”

The case summary in Tax Journal (29 January 2021) neatly sums up the First Tier Tribunal approach:

> “Having upheld the penalties in principle, the FTT went on to consider their amount. The maximum penalty was 50% of the denied advantage and this could be reduced for cooperation, but not below a minimum of 10%. The FTT followed the approach in an unpublished case, *Barlow v HMRC*, defining two categories of cooperation; quantifying the advantage and counteracting it. A maximum reduction of 20% of the denied advantage was then to be applied to each category depending on the timing, nature and extent of the cooperation.
>
> However, the judge departed from that decision in holding that the need for the penalty regime to apply proportionately required consideration not only of what a taxpayer did or failed to do, but also of why they did or did not do it. Applying these considerations to the appellant's circumstances the judge reduced the penalties to 24%.”

The taxpayer's appealed was dismissed.

Michael Bentley v HMRC (TC07989)

Legitimate interest in penalties procedure (Lecture P1241 -17.18 minutes)

Summary – A barrister was allowed access to an email contained in the bundle of documents presented in evidence by HMRC in an earlier case.

Keith Gordon, a barrister, applied to the First Tier Tribunal for a copy of an e-mail referred to in the Tribunal’s decision in the case Fastklean Limited v HMRC (TC07773). In the decision it was recorded that the email referred to HMRC’s current internal procedure for issuing penalties.

Keith Gordon was not a party to the appeal nor did he represent any party. He sought the document requested as a barrister practising frequently in the Tribunal with a particular interest in the operation of the Taxes Management Act. The Tribunal stated that legitimate interest did not require a 'direct personal or professional interest in the outcome of proceedings and that an interest in other related litigation, whether actual or in contemplation, is sufficient'.

Neither the Appellant in the case nor HMRC had any representations to make on the issue and, having considered the Tribunal’s power to allow access to the document they decided that he had a legitimate interest in seeing the email. and allowed access to the document.

Fastklean Ltd, HMRC and K Gordon (TC07981)

Late filing on paper but no penalties?

Summary – The taxpayer had a reasonable excuse because he could not file his return online for reasons outside of his control. Further, by advising that he should submit a paper return instead, HMRC did not explain the late filing penalties that would arise.

John Brocklesby was a singer/songwriter. He did not possess a computer or mobile phone and his income for the year was only £3,500. He had been filing Self Assessment returns since 1996, and until his local HMRC office closed in 2014, HMRC had been assisting him each year.

With the HMRC office now closed, he attempted to deal with his returns himself. He had managed to file his 2015/16 return online but had had some technical difficulties in doing so. When he went to file his 2016/17 return, he discovered that he was no longer registered for online Self Assessment services. Clearly, he would only have discovered this when he tried to file his return which was towards the end of January 2018. Trying to submit his return, he had repeatedly phoned HMRC, who eventually advised him to file a paper return and not to worry about the penalties. Unable to download a paper return, HMRC posted one to him.

He eventually managed to file a completed paper return on 30 October 2018, almost a year late. John Brocklesby appealed against the late filing penalties that resulted.

Decision

The Tribunal noted that no evidence was provided as to why John Brocklesby was no longer enrolled for Self Assessment online, nor any evidence that he had been advised that he was no longer enrolled. Having filed online in 2015/16, the Tribunal concluded that it would be reasonable for John Brocklesby to assume that he would be able to do so for the 2016/2017 tax year. The Tribunal stated that there is no obligation to file returns early and so it was not unreasonable for a taxpayer to believe that they will be able to continue to file online when they have not been advised otherwise by HMRC.

The First Tier Tribunal stated that it was regrettable that HMRC had advised John Brocklesby in spring 2018 to complete a paper return for 2016/2017, without explaining that he would be immediately liable to a six-month late filing penalty as well as daily penalties.

Given that he could not file his return online for reasons outside his control and also the incomplete advice as to the penalty position of filing a paper return, the Tribunal concluded that he should be treated as having filed an online return for the purposes of determining whether he had a reasonable excuse for late filing penalties. The Tribunal concluded that HMRC had contributed significantly to the delays in the filing of the return, taking some 14 weeks to follow up an incomplete return and then an unsigned return.

Further, the Tribunal disagreed with HMRC's suggestion that if the taxpayer had instructed an agent, these problems would not have arisen. The Tribunal stated that an agent should not be needed in a case where taxable income was only £3,500.

The appeal was allowed.

John Brocklesby v HMRC (TC07970)

Retrospective notice and ATED penalties (Lecture B1241 – 21.35 minutes)

Summary – As notice of daily late filing penalties was given after the period for which the penalties applied the penalties were void.

D & G Thames Ditton Limited was incorporated on 28 August 2014 and on 10 October that year the company bought a property in Thames Ditton, Surrey. The Stamp Duty Land Tax return showed that the price paid was £650,000. The filing date for the ATED return for the year ending 31 March 2019 was 30 April 2018 but it was not until 21 March 2019 that the company filed a Relief Declaration Return. Although 325 days late, no tax was due.

HMRC issued the following penalty assessments in respect of the late filing:

- 9 December 2019 Automatic £100 fixed penalty for the initial failure;
- 23 January 2020 Daily penalties for return three months late (£900);
- 23 January 2020 Automatic £300 fixed penalty for filing six months late.

D & G Thames Ditton Limited appealed against all of these penalties, arguing that they were unaware of the obligation to file an ATED return and in any event, there was no liability to tax.

Decision

The First Tier Tribunal held that both the £100 and £300 automatic penalties were valid as the company had not shown a reasonable excuse for their late filing. There were no special circumstances which might have allowed a reduction in the penalties.

Para. 4 Sch. 55 FA 2009 states that, if after a period of 3 months beginning with the penalty date the return remains outstanding, daily penalties of £10 per day up to a total of £900 are payable. However, to be valid, Para 4(1)(c) states that HMRC must give prior notice to the taxpayer, specifying the date from which the penalty will be payable. In this case, HMRC had not given notice of daily penalties until January 2020, so after the period to which they related.

As notice had been given retrospectively, the daily penalties were therefore cancelled.

D & G Thames Ditton Limited v HMRC (TC07961)

Code of Practice 9 investigations (Lecture P1245 – 12.58 minutes)

What is Code of Practice 9?

Where HMRC suspect tax fraud they may conduct either a criminal or civil investigation, and they maintain complete discretion as to which route they will use. Criminal investigation is usually reserved for cases where only a criminal sanction is considered appropriate, or where HMRC considers that it needs to send a deterrent message. Code of Practice 9 is HMRC's process for the civil investigation of suspected fraud cases. HMRC do not have the resources to conduct criminal investigations in all cases of suspected fraud, hence Code of Practice 9 provides an option for dealing with those cases.

The basic premise is that Code of Practice 9 provides taxpayers with immunity from prosecution for tax offences, in return for a full and complete disclosure.

The Contractual Disclosure Facility

The latest incarnation of Code of Practice 9 is the Contractual Disclosure Facility, which was introduced on 31 January 2012. There was a revision to the terms of the Contractual Disclosure Facility from June 2014, and that is the version that remains in use today.

The process is usually initiated by HMRC, with the taxpayer receiving a letter offering them a contract under the Contractual Disclosure Facility. The taxpayer is given two options:

1. Accept that there has been a loss of tax due to his fraud, and agree to participate in the Contractual Disclosure Facility;
2. Reject HMRC's offer to participate in the process.

The taxpayer has 60-days to respond to the HMRC offer and decide which option he is going to take. The 60-day period can only be extended in exceptional circumstances, although HMRC are currently giving a longer period to respond, due to the pandemic.

HMRC will not disclose what their suspicions are and will not communicate with the taxpayer or adviser during the 60-day period, except in very limited circumstances. This is to avoid prejudicing any subsequent criminal investigation.

If the taxpayer wants to choose the second option, they can sign the Rejection Letter and return it to HMRC within the 60-day period. HMRC will start its own investigation, which can be a criminal investigation. The Rejection Letter may be used in court or tribunal proceedings as evidence.

If the taxpayer does not respond within the 60-day period, HMRC will treat that as a rejection, and will start its own investigation, which can be a criminal investigation.

The disclosure process

If the taxpayer decides to take the first option, he must confirm his acceptance, and provide an Outline Disclosure of the relevant offences within the 60-day period. The taxpayer must ensure that sufficient disclosure is made to ensure that they receive the immunity offered. There is, usually, a significant amount of work to undertake, and it is important to start on receipt of the HMRC letter.

If HMRC accept the Outline Disclosure, the taxpayer is invited to a meeting where they will be questioned about their disclosure. They are then required to submit a formal disclosure report, necessitating further detailed investigation of their business and personal tax affairs, for up to the last 20 years. A timetable is agreed with HMRC for the submission of the report.

Typically, HMRC want the report within six months of the meeting with the taxpayer, although that is seldom sufficient time, and the matter should be discussed with the investigator. The report must contain full details of all irregularities, including those arising from non-deliberate behaviour. Full computations must be submitted, covering tax, interest and penalties, together with various certified documents.

The investigator will review the report and make such further enquiries as are considered necessary. At the end of the review, any additional liabilities established by HMRC will be agreed, and settlement will, usually be by a contract settlement (although any VAT liabilities will be recovered by assessment). If agreement cannot be reached the taxpayer has the usual right of appeal against any assessments issued by HMRC.

If HMRC consider that a full disclosure has not been made, they may start a criminal investigation. The risk of criminal investigation also applies if a false statement is provided to HMRC.

Voluntary request for inclusion

Although most Code of Practice 9 investigations are instigated by HMRC, it is possible for a taxpayer to seek inclusion in the process. This is sensible where the facts and circumstances of the case are such that the taxpayer has a disclosure to make and is at risk of criminal investigation. Where the case falls within HMRC's criminal investigation policy, or where the amounts of tax at risk are significant, and that tax has been lost due to the taxpayer's deliberate behaviour, consideration should be given to obtaining the protection afforded by Code of Practice 9. Advisers should note that the criminal investigation policy does not have a materiality limit.

HMRC do not guarantee that they will offer a taxpayer a contract under the Contractual Disclosure Facility when one is requested. For example, HMRC will not offer a contract where the taxpayer is already involved in a criminal investigation.

Use of specialist adviser

Accountants and other agents need to be very aware of their competences and capabilities when it comes to Code of Practice 9 investigations. If a client is not properly advised, the repercussions may not just be financial, and could end with the client being prosecuted. There are various ongoing obligations that the client must meet to avoid putting themselves at risk of criminal investigation.

HMRC use specialist investigators when conducting Code of Practice 9 investigations, and it is essential for a satisfactory outcome for the client to be represented by an adviser with specialist knowledge of the investigation process. HMRC recognise this in the Code of Practice, stating "many people find it helpful to appoint a specialist who is familiar with COP9, as well as their regular adviser". I am frequently asked to work alongside an accountant or other agent, providing specialist input. The appointment of a specialist adviser helps to protect not only the client, but also the regular adviser from claims of professional negligence.

Contributed by Phil Berwick (Director, Berwick Tax)

Deadlines

1 March 2021

- CIS domestic reverse charge applies for specified construction and building services
- Pay CT liabilities for periods ended 31 May 2020 where not paying by instalments
- Review HMRC car mileage fuel rates

2 March 2021

- Unpaid income tax/class 4 NIC for 2019/200 liable to automatic 5% penalty

7 March 2021

- Online VAT returns and payment for 31 January 2021 quarter

14 March 2021

- Quarterly CT instalment for large companies.
- File paper monthly EC sales list —only Northern Ireland businesses selling goods

15 March 20201

- Submit February Coronavirus Job Retention Scheme claims

19 March 2021

- PAYE, NIC, CIS and student loan liabilities for month to 5 March 2021 by cheque
- File monthly CIS return

21 March 2021

- File online monthly EC sales list — only Northern Ireland businesses selling goods
- Supplementary intrastat declarations for February 2021
  - arrivals only for a GB business/ arrivals and despatch for Northern Ireland

22 March 2021

- PAYE, NIC and student loan liabilities must clear HMRC's bank account.

31 March 2021

- VAT deferred from 2020 should be paid (if not being paid by instalments)
- Accounts to Companies House
  - private companies with 30 June 2020 year ends
  - public limited companies with 30 September 2020 year ends
- Reclaim s455 tax on loan to participator if loan repaid in year to 30 June 2020

- CTSA returns filed for companies with periods ended 31 March 2020

News

COVID-19 and the 5% late payment penalty

The payment deadline for Self Assessment is 31 January , with interest charged from 1 February where any amounts are outstanding on that date. This has not changed.

Normally, a 5% late payment penalty is also charged on any unpaid tax that is still outstanding on 3 March. However, on 22 February, HMRC announced that Self Assessment taxpayers will not be charged a 5% late payment penalty provided hey pay their tax or set up a monthly payment plan by 1 April 2021.

https://www.gov.uk/government/news/more-help-for-self-assessment-taxpayers

Paying Self Assessment, including Class 2 (Lecture P1241 -17.18 minutes)

Taxpayers who deferred their second payment on account for 2019/20 due by 31 July 2020 will have had the following payments falling due on 31 January 2021:

- deferred July 2020 payment on account;
- balancing amount due for 2019/2020 including Class 2 NIC;
- their first 2020/2021 payment on account.

Those who had difficulty in making all 3 payments at once may have set up a Time to Pay instalment arrangement with HMRC.

HMRC has confirmed that, in order to minimise the interest that will be charged, deferred July 2020 payment on account will be cleared first. However, this could result in the 2019/20 Class 2 NIC being paid after their due date of 31 January 2021, which can have a detrimental effect on certain contributory benefits claimed.

HMRC are advising that such taxpayers should contact them for help, as they may be able to allocate monies already paid for 2019/20 against the Class 2 owed. This may result in a small amount of interest, but this will protect any contributory benefit claim.

The guidance also highlights that for Self Assessment payments due on 31 January 2021, taxpayers can avoid the first late payment penalty if they set up a Time to Pay arrangement by 2 March 2021 and the 6 month and 12-month late payment penalties can be avoided if taxpayers pay all the tax owing under that arrangement on time.

https://www.gov.uk/guidance/defer-your-self-assessment-payment-on-account-due-to-coronavirus-covid-19

Income tax limits and allowances

The Income Tax (Indexation) Order, SI 2021/111, sets out the following indexed income tax limits and allowances for the tax year 2021/22:

- Basic rate limit to £37,700;
- Personal allowance is £12,570;
- Blind person's allowance to £2,520;
- Minimum amount for tax reductions for married couples and civil partners to £3,530;
- Amount by which the married couple's allowance is calculated to £9,125;
- Adjusted net income limit for the married couple's allowance to £30,400.

https://www.legislation.gov.uk/en/uksi/2021/111/contents/made

Scottish taxes

Income tax rates and bands

The Scottish budget announced that:

- income tax rates will remain unchanged;
- starter, basic rate bands and higher rate threshold will increase by CPI inflation (0.5%);
- top rate threshold will remain at £150,000

Land and Buildings Transaction Tax (LBTT)

- from 1 April 2021 the ceiling of the nil rate band for residential LBTT returns to £145,000;
- first-time buyers will continue to be able to claim the first-time buyer relief, effectively increasing the nil rate band to £175,000;
- the existing non-residential LBTT rates and bands are unchanged

https://www.gov.scot/publications/scottish-budget-2021-22/

CPI increase for van and fuel benefits

In a statement made on 4 February 2021 by the Treasury, we now know that the van benefit and fuel benefit charges for cars and vans will be increased from 6 April 2021 as follows:

- Van Benefit Charge will uprate from £3,490 to £3,500;
- Car Fuel Benefit Charge multiplier will uprate from £24,500 to £24,600;
- Van Fuel Benefit Charge will uprate from £666 to £669.

This measure was announced outside of the normal fiscal process to ensure employers and HMRC are given enough time to prepare for the uprate, ahead of the 2021/22 tax year.

The Government will lay the statutory instrument to uprate these charges before the House on 9 March 2021.

https://questions-statements.parliament.uk/written-statements/detail/2021-02-04/hcws763

HMRC agent update: Brexit edition

In this agent update special edition, the government has provided a summary of the key areas linked to Brexit that tax agents should be aware of, including:

- new rules for trading with Europe, for business travellers and on social security coordination;
- cash declaration rules;
- postponed VAT accounting for importers

https://www.gov.uk/government/publications/agent-update-january-2021-brexit-edition

Off-payroll working rules for private sector (Lecture B1241 – 21.35 minutes)

From 6 April 2021 off-payroll working rules will apply to:

- public sector authorities engaging contractors who work through their own limited company or other intermediary;
- medium and large-sized private sector organisations engaging contractors who work through their own limited company or other intermediary;
- employment agencies and third parties which supply contractors.

HMRC has published "HMRC issue briefing: supporting organisations to comply with changes to the off-payroll working rules (IR35)" that explains its IR35 compliance strategy for the changes to the off-payroll working rules from 6 April 2021.

HMRC has confirmed it will adopt a light touch approach to penalties. Consequently, there will be no penalties for inaccuracies relating to the off-payroll working rules in the first 12 months, unless there is evidence of deliberate non-compliance. However, where HMRC believe contractors are adopting artificial, contrived arrangements claiming to avoid the application of the off-payroll working rules or result in customers paying less tax than should be the case, HMRC will take action.

HMRC has also confirmed that they will not use information acquired as a result of the changes to the off-payroll working rules to open a new compliance enquiry into returns for tax years before 2021/22, unless there is reason to suspect fraud or criminal behaviour.

The briefing document explains the taxpayers' responsibilities under the off- payroll rules and provides a series of case studies to show how the rules apply.

https://www.gov.uk/government/publications/hmrc-issue-briefing-supporting-organisations-to-comply-with-changes-to-the-off-payroll-working-rules-ir35

Uber drivers are not self-employed (Lecture B1241 – 21.35 minutes)

The Supreme Court has ruled that the 35 drivers that took the case back in 2016 were indeed employees of Uber and as such were entitled to employment rights such as minimum wage and holiday pay.

It should be noted that employment law cases do not automatically apply to tax but HMRC may choose to take this further. If the passenger income belongs to Uber rather than an unregistered driver the VAT due is likely to be significant.

Business Taxation

Taxi driver's assessments reduced (Lecture B1241 – 21.35 minutes)

Summary – Three discovery assessments relating to a taxi-driver's failure to declare income were valid but the tax payable was reduced as the assessments were overstated.

Mark Turner was a self-employed taxi driver who had been within the Self Assessment regime since February 2006.

In January 2012, as a result of receiving information from Gloucester County Council indicating he had undertaken driving work for them, HMRC notified Mark Turner that they intended to visit him and discuss his business records.

Following a meeting in June 2012, Mark Turner agreed he would provide HMRC with his business records but failed to do so, despite information notices being issued.

In 2014, after having received information from another client, HMRC wrote to Mark Turner telling him that they would be raising determinations for three tax years increasing his net profits as follows:

- 2009/10 From £10,026 to £23,696;
- 2010/11 From £5,326.48 to £26,513;
- 2011/12 From£2,940.24 to £20,721.

Out of time to raise assessments, HMRC raised discovery assessments for the three tax years in question. Expenses were based on national trends for similar businesses and calculated as 37% of turnover.

In the summer of 2016, following assistance from HMRC's "Needs Extra Support" ("NES") Team, Mark Turner submitted tax returns for 2007/08 to 2015/16.

HMRC invited Mark Turner to make a late appeal, which he did in November 2017.

Decision

On appeal, Mark Turner stated that he was now in a position to produce evidence to support his appeals against the three discovery assessments. The Tribunal directed that, by no later than 30 June 2020, he should provide HMRC with details and supporting evidence of his business expense claims for these years. Having supplied this information, HMRC withdrew the late filing penalties which they had previously assessed.

On appeal, the First Tier Tribunal accepted HMRC's income figures for contract work but, based on Mark Turner's evidence, included additional income for parcel delivery. Further, the Tribunal included cash income of just £10 per week based on the evidence there was little cash trade where he worked.

The only evidence supplied regarding wages was information contained in Mark Turner's Halifax statements for the 2011/12. The Tribunal used this figure to substantially reduce the figures claimed by Mark Turner in all three years. The Tribunal stated that:

> "by approaching the analysis this way, there is no need for us to speculate about significant amounts of additional cash which the appellant might or might not have obtained from his operations."

By extrapolating evidence provided on fuel purchased for a three-month period in 2011, the Tribunal were satisfied that Mark Turner's expense figure was reasonable, accepting this higher figure.

Other expenses in his tax returns were allowed as the Tribunal concluded that the NES must have been given documents to justify the expenses claimed, despite that evidence not being available to the Tribunal.

In conclusion, the Tribunal directed HMRC to adjust the assessments to reflect these revised profit figures.

Mark Turner v HMRC (TC07982)

Group relief denial

Summary – The UK's restriction on claiming group loss relief for the losses of a UK permanent establishment of a Dutch company was an unlawful restriction on the EU principle of freedom of establishment.

The VolkerWessels group is involved in construction projects in the Netherlands, UK, Germany, Canada and America. The appeals in this case concerned the denial of group loss relief claims by the UK permanent establishment of a Dutch resident company within the group.

With losses of some £36.5 million sitting within the UK permanent establishment, group loss relief was claimed against the UK liabilities of other UK resident companies within the group, and a claim had also been made for most of those losses to be relieved in the Netherlands against the Dutch tax liabilities of the group.

At the time, s.403D(1)(c) ICTA 1988 applied. However, under this provision, no group relief was available in the UK where any part of the losses of a non-UK resident company carrying on trade in the UK through a UK resident permanent establishment was relievable in another jurisdiction. As the losses were deductible in the Netherlands, the UK companies were prevented from claiming group relief in the UK. On this basis, HMRC denied the claim.

However, following the CJEU decision in *HMRC v Philips Electronics UK Ltd* (Case C-18/11) (*Philips*), a very similar case, the UK companies concerned argued that limiting group relief in this way was an unlawful restriction on the freedom of establishment under EU law. Consequently, the UK provision should be disapplied, allowing loss relief to be claimed in both Netherlands and the UK.

HMRC argued that a later decision in *NN A/S v Skatteministeriet* (Case C-28/17) applied, meaning that the Philips Electronics UK Ltd decision was no longer binding.

Decision

The First Tier Tribunal concluded that the facts of the Philips Electronics UK Ltd case were more closely aligned to the VolkerWessels group case than the *NN A/S* case.

On that basis it was clear that s403D(1)(c) ICTA 1988 did restrict the freedom of establishment and the group relief restriction should be disapplied with the result, perhaps somewhat surprisingly, the group was able to claim a double deduction for the losses incurred.

VolkerRail Plant Limited and others v HMRC (TC07950)

No EIS relief on shares with excluded preferential dividend rights

Summary – Despite obtaining non-statutory advanced assurance from HMRC, changing the company's articles of association, meant that HMRC were right not to issue compliance certificates allowing EIS relief on B shares issued by the company.

Foojit Limited had raised finance by issuing A and B shares. It had expected the issue of the B shares to qualify for EIS tax reliefs. However, when Foojit Limited submitted its compliance statement (EIS 1) to HMRC, HMRC refused to issue the authorisation to Foojit Limited to issue the necessary forms for investors to claim relief.

In order to be eligible for EIS relief, S173 ITA 2007 states that qualifying shares must be ordinary shares that do not carry any present or future preferential right to dividends as detailed in subsection 2A. It was common ground that the B shares carried a preferential right to a dividend, the question was whether that preferential right fell within s173 (2A)(a) ITA 2007. i.e. whether the amount payable or the date on which the dividends were payable depended 'to any extent, on a decision of the company, the holder of the share or any other person'.

The First Tier Tribunal dismissed the company's appeal against HMRC's refusal, concluding that the preferential dividend depended on the decision to declare a dividend, and so HMRC's refusal had been correct.

Foojit Limited appealed to the Upper Tribunal, arguing that the company's articles of association provide for the dividends to be payable mandatorily, without the need for any declaration by the directors or the company in general meeting, once the accounts show that there are sufficient profits for dividends to be paid.

HMRC argued that the articles simply provide for the B shares to have a priority entitlement to dividends if declared so that, if (and only if) the company resolves to pay a dividend, the first 44% of profits must be paid by way of dividend on the B shares.

Decision

The Upper Tribunal agreed with HMRC. The decision was based on the interpretation of the articles of association, specifically the interaction between:

- the article that set out the B share rights to preferential dividends (B share article) in the specific new articles introduced at the time of the share issue, with the expectation that they would establish appropriate rights for EIS relief to be available; and

- the article that provided the general procedures of the company for declaring dividends (dividend article) in the model articles, which had been in place since incorporation of the company, but which were specifically retained as forming a joint set of articles with the specific new articles.

The Upper Tribunal found that:

- the two sets of articles had to be looked at as a whole, and the new specific articles did not take precedence;

- the dividend article set out the two ways in which a dividend could be paid: an ordinary resolution of shareholders; and, for interim dividends only, a directors' resolution;

- the B share article did not contain any express terms dealing with the date on which the dividends would be payable; and

Therefore, the articles provided that all dividends, whether the preferential B share or ordinary dividends, could only become 'payable' following the routes in the dividend article, which, unambiguously, involve 'decisions' of the company, its shareholders and directors.

The appeal was dismissed.

Foojit Limited v HMRC [2021] UKUT 0014 (TCC)

Adapted from the case summary in Tax Journal (5 February 2021)

Lack of evidence supporting R&D claims (Lecture B1241 – 21.35 minutes)

Summary – A company failed to provide sufficient written evidence to support its claim that it was undertaking work to resolve a scientific or technological uncertainty or to advance overall scientific knowledge

Hadee Engineering Co Ltd was an engineering company which submitted claims for 2009 and 2010 for R&D relief under s.1044 CTA 2009 totalling approximately £300,000.

The claims were formulated and submitted by a specialist R&D advisor, but the advisor did not assist the company with HMRC's enquiries. In support of the claims, the company submitted a report compiled by the advisor which itemised the amounts claimed under seven separate projects.

HMRC concluded that the company had not met the burden of proof that any of the expenditure had satisfied the tests to be classed as R&D. The company appealed.

Decision

The First Tier Tribunal considered that the company had to demonstrate that there was a clear methodology behind its activities which 'identified the uncertainty it sought to resolve and in doing so attempted to produce ... a material change or improvement which added to or extended knowledge in a field of science or technology which was not publicly available or could be worked out by a competent professional in that field without difficulty'.

The First Tier Tribunal treated the adviser's report with caution as no evidence was provided from its author and its contents were therefore untested. There was no evidence to show what source documents were used in its compilation.

The First Tier Tribunal dismissed the company's appeal in relation to six of the seven projects but allowed the appeal in respect of the seventh, subject to the parties agreeing the correct amount of the claim.

Hadee Engineering Co Ltd v HMRC [2020] TC07969

Adapted from the case summary in Tax Journal (22 January 2021)

Corporate interest restriction – Part 3 (Lecture B1242 – 25.32 minutes)

Group ratio calculation – blended rate

The group ratio (QNGIE ÷ Worldwide Group EBITDA) can potentially be enhanced if there are related party investors with a higher group ratio.

Related parties were defined in an earlier Part of this topic review, but are broadly defined as

1. a party which would be required to be included in a consolidation of the group, or
2. there is common participation in the management, control or capital (based on definitions in transfer pricing rules), or
3. There is common 25% participation between or by a third party in the parties (votes, disposal proceeds, assets, or income)

For each investor, take the highest of

1. 30%;
2. The actual GRR for this group; and
3. The investor's own GRR.

Multiply that by the investor's share in the group and add the results together.

Example

Z Ltd heads a worldwide group of ten companies with a group ratio rate of 35%.

Its shareholders are:

	Shareholding	Investor's Group Ratio
A Ltd	25%	28%

B Inc	40%	55%
C Ltd	30%	40%
D Ltd	5%	45%

Assume that none of the investors satisfies the participation condition, nor the consolidation condition so we only consider if their investment is at least 25%.

D Ltd is not a related party and is ignored. For A, B and C we take their percentage of the highest of 30%, their own group ratio, or Z's group ratio.

The blended rate is therefore:

A Ltd: 25% x 35% (Z's ratio being the highest)	8.75%
B Ltd: 40% x 55% (B's ratio being the highest)	22.00%
C Ltd: 30% x 40% (C's ratio being the highest)	12.00%
	42.75%

Z Ltd is therefore able to use a group ratio of 42.75% instead of its own ratio of 35% in calculating the interest allowance under the group ratio method.

Public infrastructure exemption (PIE)

Where the PIE applies to a qualifying infrastructure company (QIC), tax-interest expenses on non-related party borrowing are excluded from the CIR regime, subject to a requirement that the recourse of the creditor is limited to income, assets or shares in or loans issued by the QIC.

Any tax-interest income of the QIC is also excluded from the CIR regime.

Tax-interest expenses on related party borrowings are not generally exempted under the PIE (although some debt may be grandfathered), unless the lender is also a QIC. Where the PIE applies, the QIC's tax-EBITDA is also reduced to zero.

As a result, where the QIC forms a single company CIR group, it is unlikely to be worthwhile electing into the PIE regime where the QIC is wholly or substantially funded by (non-grandfathered) related party debt.

Where the QIC forms part of a wider CIR group and elects into the PIE regime, it may be possible to access some relief for its interest costs on (non-grandfathered) related party debt but this will depend upon the group's wider CIR position.

A joint infrastructure election can be made to include one or more group companies such that the rules apply to them collectively.

Conditions for the exemption to apply

The company must elect for the exemption to apply - such an election must be made before the end of the accounting period to which it is to have effect.

The election can be revoked before the start of the accounting period for which revocation cannot have effect in relation to any accounting period which begins less than five years after the first day of the first accounting period in which the election to be a QIC had effect.

Once revoked, no new election can be made for a further 5 years.

Example

A company makes an election on 31 December 2018 to be a QIC. It meets the other conditions necessary, so the election has effect for the 12 month accounting period ended 31 December 2019. It subsequently brings forward its balance sheet date to 30 June 2020.

On 1 January 2023 the company revokes its election. This cannot have effect for the 12 month accounting period ended 30 June 2024, as this began (on 1 July 2023) less than five years after the existing election had begun to have effect (1 January 2019).

The revocation must be prospective; as such the earliest it can have effect is the 12 month accounting period ended 30 June 2025.

The earliest another election to be a QIC could have effect would be for the 12 month accounting period ended 31 June 2030, if the election was made prior to 1 July 2029.

Qualifying infrastructure activities

To qualify, the QIC should derive its income/value of its assets from qualifying infrastructure activities (QIA).

A company carries on a QIA if it provides a public infrastructure asset or carries on any other activity that is ancillary to, or facilitates the provision of, a public infrastructure asset.

A building or part of a building, is a public infrastructure asset if the company or another member of the worldwide group carries on a UK property rental business; and

- The building, or part, is or is to be let (or sub-let) on a short-term basis (a lease term of 50 years or less) to parties unrelated to the company or group member;

- The expected economic life of the building is at least 10 years; and

- The building or part is recognised on the balance sheet of the PIE company or an associated company, which itself must be subject to UK corporation tax on all sources of income.

Key points to note and practical implications

A PIE election may be beneficial in some circumstances, such as for groups with significant third-party debt and low tax-EBITDA at UK group level, and a low group ratio at group level.

For many groups with significant related party lending, the fixed ratio method or the group ratio method (where the wider group has a high gearing ratio) may provide better relief than the PIE treatment.

Even where there is significant third-party debt, the group ratio method could provide similar deductions to PIE treatment and should be modelled to compare the benefit.

Grandfathering of related party debt is unlikely to apply to the majority of real estate type structures but there can be arguments to support grandfathering for some type of property businesses such as student accommodation, hospitals, health, etc., and so each case should be considered separately.

The PIE election is irrevocable for at least five years so the impact of future plans should be considered before making the election.

Where only some group companies make the election, any cross guarantees or financial assistance provided by non-QICs within the worldwide group to the lenders of the QIC can taint the third party debt as related party debt (reducing Qualifying net-group interest expense “QNGIE”– see later)

A PIE election can simplify the compliance burden significantly.

Income generated from activities that are ancillary to or facilitate the provision of qualifying infrastructure activities (required for the exemption to apply) also qualify but what constitutes ‘ancillary’ or ‘facilitates the provision’ is not clearly defined and is subject to interpretation.

Excess debt cap brought forward

This can arise where there is an interest disallowance in a period and the debt cap (i.e. ANGIE or QNGIE depending on which method is used) is not the limiting factor in computing a group's basic interest allowance for a period.

Excess debt cap can arise if either the fixed ratio method or the group ratio method is applied.

Where the fixed ratio method applies, excess debt cap for a period of account is the fixed ratio debt cap as calculated by reference to the group's adjusted net group-interest expense - (ANGIE) less the fixed ratio, 30%, of aggregate tax-EBITDA.

Where the group ratio method applies, excess debt cap for a period of account is the group ratio debt cap as calculated by reference to the group's qualifying net group-interest expense (QNGIE), less the group ratio percentage of aggregate net tax-interest expense.

Unlike interest allowance, which can be carried forward up to five years, excess debt cap can only carry forward from one period to the next period. However, the debt cap brought forward from the immediately preceding period may have the effect of increasing the amount that can be carried forward to the following period. As such, an amount of excess debt cap can, in effect, be carried forward indefinitely.

There is a limit on the amount of excess debt cap that can be carried forward “the carried forward limit”.

This is the sum of the total disallowed amount for that period, plus excess debt cap, if any, from the period immediately before the period of account. This therefore limits the increase in the excess debt cap that arises in a period to the amount of the disallowance that has arisen in the period.

The excess debt cap carry-forward is of practical significance for a group where the factor limiting interest allowance sometimes the fixed ratio or group ratio percentage of aggregate tax-EBITDA, and sometimes the debt cap.

The excess debt cap is available in the next period even if the group switches from applying the fixed ratio method to the group ratio method, or vice versa; there is no need to recalculate the figure on a different basis when this happens.

Example 1

Year end 31 March 2020

Aggregate UK tax-EBITDA = £10 million

Aggregate UK net tax-interest expense = £3.15 million

ANGIE = £3.2 million

QNGIE = £2.85 million (due to £350,000 interest payable to related parties)

Group ratio = 33%

Interest allowance based on either

1. Fixed ratio = smaller of 30% x aggregate UK tax-EBITDA = £3.0m, or ANGIE £3.2m (i.e. £3.0m)

2. Group ratio = smaller of 33% x UK tax-EBITDA = £3.3m or QNGIE £2.85m (i.e. £2.85m)

No election is made for group ratio and the interest allowance is £3.0m. £150,000 of net UK tax-interest expense is disallowed and is carried forward indefinitely for deduction in future periods.

As the fixed ratio was used, the excess debt cap is:

1.	ANGIE	£3.2 million, minus
2.	30% x UK tax-EBIDA	£3.0 million
	i.e.	£0.2 million, or £200,000

There is a cap on the amount carried forward, being:

1.	The interest disallowed for the period	£150,000, plus
2.	Debt cap b/fwd from the prior period	Nil
	i.e.	£150,000

This is carried forward and can increase interest allowance in the year ended 31 March 2019.

So there are now two amounts carried forward:

1.	Interest disallowed	£150,000
2.	Excess debt cap	£150,000

Year ended 31 March 2021

Aggregate UK tax-EBITDA = £9 million

Aggregate UK net tax-interest expense = £2.73 million

ANGIE = £2.65 million

QNGIE = £2.41 million (due to £240,000 interest payable to related parties)

Group ratio = 25%

Interest allowance based on either:

1. Fixed ratio = smaller of 30% x aggregate UK tax-EBITDA = £2.7m, or ANGIE £2.65m (i.e. £2.65m)

2. Group ratio = smaller of 25% x UK tax-EBITDA = £2.25m or QNGIE £2.41m (i.e. £2.41m)

No election is made for group ratio.

Without any excess debt cap brought forward, the interest allowance would be £2.65m and £80,000 of net UK tax-interest expense would potentially be disallowed.

As the fixed ratio was used, the debt cap is:

1.	ANGIE	£2.65 million, plus
2.	Excess debt cap b/fwd	<u>£0.15</u> million
	i.e.	<u>£2.80</u> million

The actual interest allowance is the smaller of the debt cap (£2.80 million) and the 30% of the aggregate UK tax-EBITDA (£2.70m), i.e. £2.70 million, so the actual interest disallowed is £2.73m minus £2.70 million, i.e. £30,000.

The excess debt cap brought forward has allowed a further (80,000 – 30,000) £50,000 interest to be deducted in the year ended 31 March 2019.

The excess debt cap (before considering any carry forward limit) is:

Debt cap	£2.80 million, minus
Interest allowance	<u>£2.70 million</u>
i.e.	<u>£0.10 million</u>, or £100,000

Debt cap carry forward limit

Excess debt cap b/fwd	£150,000
Disallowed interest this period	<u>£30,000</u>
	<u>£180,000</u>

Excess debt cap c/fwd is the smaller of:

1. Carry forward limit £180,000 or
2. Excess debt cap £100,000

   i.e. £100,000

This looks complicated, but in reality, all that has happened is that £50,000 of debt cap brought forward has been used up in the period to 31 March 2019. As £150,000 was brought forward from the previous year, there is a balance of £100,000 to carry forward.

Corporate interest restriction and lease accounting under FRS 101/IFRS 16

The CIR rules operate to limit interest and other financing costs that are deductible for corporation tax purposes. Under IAS 17 (and FRS 102), for leases classified as finance leases for tax purposes, any finance charges in the accounts are tax-interest amounts for CIR. For leases classified as operating leases for tax purposes, any finance charges in the accounts are not tax-interest amounts for CIR.

Where a lessee has a right-of-use asset under IFRS 16, the legislation requires the company to determine whether they would have accounted for the lease as a finance lease if they were required to determine whether the lease was a finance lease or not for accounting purposes.

Therefore, lessees will not suffer any interest restriction on amounts paid in respect of operating leases. This means effectively that this change in the legislation will not have any impact for the purposes of CIR, but it will mean an adjustment to the accounting figures for CIR purposes, disallowing any depreciation and interest on IFRS 16 leases that would have been operating leases under IAS 17 and instead deducting a rental expense figure (therefore reducing EBITDA).

Contributed by Malcolm Greenbaum

Companies in difficulty (Lecture B1243 – 15.18 minutes)

When a company encounters difficulties there are lots of different things which need to be considered. However, we will first consider the formal issues procedures which might affect such a company.

Creditors' voluntary liquidation

The unsecured creditors of a company decide that the company is insolvent and appoint a liquidator on the basis that every £1 owed is a vote.

In order to have a vote registered, each creditor must have submitted their statement of claim or proof of debt form to confirm the amount they are claiming from the company. A proposed liquidator will have to give, prior to their appointment, a written undertaking to the creditors that they are independent and that there is no conflict of interest in their accepting the appointment.

Only the unsecured creditors vote on the appointment and if secured creditors vote then they lose the benefit of their security against the assets.

Insolvency is judged with on the basis that a business cannot meet its liabilities and the liabilities of the business are greater than the assets. The liquidator takes possession of all company property and confirms the assets of the company as well as notifying HMRC of his appointment.

Within a Creditors' Voluntary Liquidation, there is a prescribed order in which creditors are paid. This is obviously important for the company in liquidation but also for the creditors, particularly those small businesses who might be owed a debt which might determine the validity of their own business.

The order is:

- Fixed charge/mortgage holders: including any person who has any kind of fixed charge security including HP providers, debts subject to factoring agreements. If there is more than one fixed charge holder in respect of the same property, they are discharged in order of their creation. Any supplier who has a retention of title clause within their terms of sales or supply and whose goods can be identified is entitled to have them returned on making a claim. Their debt would be reduced by the value so returned;

- Preferential creditor claims: in the UK the main category here is employee pay claims including back pay and holiday pay (and also pay to directors) although the amount is capped;

- Floating charge claims: these would be debts relating to anyone that has a fixed charge over the business assets;

- Unsecured creditors.

The tax implications of liquidation

The following applies:

- The liquidator must notify HMRC immediately;

- The company's accounting period comes to an end and a new accounting period begins. The new accounting period will last 12 months or to the end of the final accounting period, whichever occurs first;

- Post-appointment CT liabilities are disbursements of the liquidator;

- The group structure is broken as the parent loses beneficial ownership of its subsidiaries when it goes into liquidation;

- It is unlikely that the company will continue trading and so terminal loss relief becomes available. If the trade continues after appointment but then ceases, the cessation will not end the accounting period;

- Post-cessation receipts incurred within six years of cessation can be treated as recovered in the final period;

- Expenses incurred after the trade has ceased are ring-fenced and only available for offset against post-cessation receipts as they would be in a normal company;

- Release of loan relationship liabilities will not normally result in a taxable credit;

- It is not possible to hive down a trade into a new company as the liquidation results in loss of beneficial ownership of the assets (including shares in the subsidiary). This would have to be done prior to the liquidation to get the benefits of s944 et al.

- Group relief ceases to be available so that losses can no longer be transferred between group companies;

- There is no deemed disposal for CG purposes but there may be clawback of some reliefs;

- The company is still part of a CG group so assets could be transferred at no gain/no loss but these would be unusual given that the assets are part of the funds available for the creditors;

- Any capital gains are subject to tax with the original cost being the base cost (i.e. no rebasing to date of liquidation);

- Substantial shareholdings exemption should continue to be available for disposal of subsidiary company shares as for these purposes the group relationship is not lost. However, if those shares are sold at a loss that loss would not be allowable;

- If the company is the representative member of a VAT group, the group treatment ceases and all solvent members of the group are de-registered and re-registered. Where another member of the VAT group becomes insolvent, group treatment can continue although degrouping would normally occur to limit debts for which the insolvent member may be liable;

- The liquidator has any responsibilities relating to PAYE and CIS.

Compulsory/Court liquidation

A creditor can petition the Court to have the company put into liquidation with the Official Receiver handling the initial liquidation. This process could also be undertaken by the company directors or shareholders. This would be the approach taken by HMRC if they wished to force a company into liquidation to collect tax debts.

Any creditor who is owed more than £750 can petition for a winding up. The creditor issues a statutory demand for payment requesting payment of the debt within 21 days. Non-payment of the statutory demand would then be presented to Court as evidence that the company is insolvent. The petition is advertised in the London Gazette.

The Official Receiver reviews the position of the company and decides whether to call a meeting of creditors to appoint a liquidator. A formal liquidator would only be appointed if there are assets in the company.

The tax implications of this type of liquidation are exactly the same as outlined above.

Receivership and administration

A receiver can be appointed by someone who has security over an asset and their main role is to realise the asset or assets for the benefit of the charge holder. They have no general duty to any other creditor.

Administration is a formal process where a person is appointed to manage the business and get a better return for the creditors. The assumption is that they will try to rescue the company although it is clear that this is not always possible. If they cannot rescue the company it is likely to proceed to liquidation fairly quickly.

The tax implications are very straightforward because nothing really changes. There is no cessation of the accounting periods in a receivership but there is in an administration. There is no breaking of the group structure. Tax is due as normal.

Company Voluntary Arrangements

A company that can show that it is insolvent may enter into a Company Voluntary Arrangement (CVA). This could be proposed by the director or an administrator (if the company is administration). Very occasionally, if you have a company in liquidation where the petition to wind up has not been challenged, the liquidator might apply for a CVA. A nominee (who must be a licensed insolvency practitioner) prepares a proposal to be considered by the creditors and there is a formal process by which would then be considered. Each £1 owed represents a vote and more than 75% of the votes in relation to unsecured creditors must approve and accept the CVA. It is binding on the unsecured creditors once in place. It would be usual to have the support of any secured creditors too. Arrangements can last for any period of time but are typically between three and five years.

There is a Voluntary Arrangements Team within HMRC and they must be notified by the supervisor within 21 days (although the likelihood that HMRC are not a creditor will be fairly low).

Crown preference

Up until recently there was no Crown preference in respect of insolvency proceedings and all tax claims were non-preferential unsecured debts and as such had no special priority over other debts. For insolvencies that start on or after 1 December 2020, HMRC has become a secondary preferential creditor in relation to taxes held by any insolvent entity. This will only apply to those taxes which are collected and held by businesses on behalf of other taxpayers such as VAT, PAYE, NICs, student loan deductions and CIS deductions.

At the same time, directors and others connected to a company who misuse company insolvency, become joint and severally liable for specified debts owed to HMRC by the company. The measure also applies to members of LLPs.

HMRC will be able to issue a joint liability notice to an individual where these three conditions are satisfied:

1. A corporate tax liability arises or is expected to arise from:

   – Tax avoidance or evasion;

   – Repeated insolvencies where tax debts are repeatedly accumulated but never paid ;or

   – Penalties for facilitating tax avoidance or evasion.

2. The company starts insolvency proceedings (or is expected to do so) so that HMRC will not be able to collect some or all of the tax liability.

3. The individual (in relation to each of the above offences in order):

   – Was responsible for the company entering into the avoidance or evasion:

   – Directly or indirectly managed to some extent, the old and new companies:

   – Was a director of the company or a participator at the time the event causing the penalty occurred or the proceedings for the penalty were started.

'Tax-avoidance arrangements' means in this context:

- arrangements in respect of which a notice of HMRC's final decision, after considering opinion of GAAR Advisory Panel, that a tax advantage is to be counteracted under the general anti-abuse rule;

- arrangements in respect of which a follower notice has been given;

- DOTAS arrangements for circumstances in which an accelerated payment notice may be given, being:

  a) notifiable arrangements to which HMRC has allocated a reference number;

  b) notifiable arrangements implementing a notifiable proposal where HMRC has allocated a reference number under that section to the proposed notifiable arrangements; or

  c) arrangements in respect of which the promoter must provide prescribed information by reason of the arrangements being substantially the same as notifiable arrangements;

- arrangements to which HMRC have allocated a reference number under the DOTAS for VAT and other indirect taxes or in respect of which the promoter must provide prescribed information;

- arrangements in relation to which a relevant tribunal order has been made, where a 'relevant tribunal order' is made;

- arrangements that:

  – are substantially the same as arrangements in relation to which a relevant tribunal order has been made (whether involving the same or different parties), and

  – have as their promoter the person specified as the promoter in the application for the order.

'Tax-evasive conduct' means:

- giving any deliberately false return, claim, document or information to HMRC;
- deliberately withholding information from a person, or providing a person with deliberately false information, with the intention of the person giving any false return, claim, document or information to HMRC;
- deliberately failing to comply with an obligation to notify liability to tax as specified in the table in FA 2008, Sch. 41, para. 1.

Something is 'false' if:

- it is false, inaccurate or misleading;
- it contains anything that is false, inaccurate or misleading; or
- it is incomplete to any significant extent.

A notice must include:

1) The company to which it relates;
2) Why the officer thinks conditions are met;
3) The effect of the notice;
4) An offer to review the officer's decision to issue the notice and the effect of a review;
5) The right of appeal;
6) The amount of the relevant tax liability, if the existence and amount of that liability have been established, or if not, an indication that the amount will be specified in a further notice (once the amount is established a further notice must be issued to the same individual as the original notice specifying the amount and the items specified in 4) and 5)).

An individual has a right of appeal to the First-tier Tribunal (FTT) against a joint liability notice. Unless HMRC agree a longer period or the FTT gives permission, the appeal must be made within 30 days of when the notice was issued or, if HMRC has carried out a review, within 30 days of HMRC issuing their review conclusion.

When can HMRC get other taxes from individuals?

The above commentary demonstrates that it is not easy for HMRC to collect business debts from individuals, even when they are involved in the business. But there are some cases where this might be possible.

Corporation tax

There is no automatic right to collect corporation tax from directors or shareholders, subject to the legislation to be introduced as described above. However, what HMRC might try to do is argue that illegal payments have been made to participators in the company, usually as an illegal dividend. An illegal dividend is a loan to the shareholders so money can be recovered by the company (often by appointing a liquidator for an insolvent company) from those shareholders which becomes available to pay the tax.

What is an illegal dividend? The question whether a dividend is unlawful or not is not a tax issue. It is rather the application of company law to the particular facts, and the tax consequences flow from those facts.

There is a significant difference in the treatment of improperly paid dividends dependent upon the position of the recipient. Company law provides that a recipient member who knows or has reasonable grounds to believe that a distribution or part of it is unlawful is liable to repay it or that part of it to the company but not if they did not.

HMRC do not often need to consider this point as they are usually dealing with close companies where there is a strong likelihood that all shareholders are fully aware of the position.

Where a dividend is paid and it is unlawful in whole or in part and the recipient knew or had reasonable grounds to believe that it was unlawful then that shareholder holds the dividend (or part) as constructive trustee in accordance with the principles stated by Dillon L J in Precision Dippings Ltd v Precision Dippings Marketing Ltd [1986] 1 Ch at page 457.

Such a dividend (or part) is void for the purposes of the IT charge on distributions.

The company has not made a distribution as a matter of company law, and so the dividend does not form part of the recipient's income for tax purposes. The company has not parted with title to the sum that it purported to distribute, which as a consequence remains part of its assets under a constructive trust (see also Ridge Securities Ltd v CIR (1964) 44TC373).

Where the company concerned is a close company, it is regarded as having made a loan to the shareholder within s455, thereby triggering a charge. Relief would however be available where the dividend is repaid to the company.

The most likely reason that a dividend will be illegal is the absence of the necessary distributable reserves. The question might arise as to when that judgement is made. If it can be shown that events after the dividend was voted have contributed to a negative balance sheet, then the dividend may not be illegal. But this can be a very difficult argument to make.

PAYE

Unpaid PAYE is the liability of the employer. There are, however, situations where HMRC will seek to collect the tax from the employee or director by means of a direction. This is only ever going to be the tax relating to payments made to the individual who is then pursued.

Reg 72(5) allows HMRC to do this in 2 circumstances:

- where HMRC are of the opinion that the employer took reasonable care and the error was made in good faith (condition A);
- where HMRC are of the opinion that the employee received employment income knowing that the employer has wilfully failed to deduct the tax (condition B).

Condition A is an interesting one as the question of whether the employer has taken reasonable care or not will be a matter of fact. However, the interpretation of the facts might be different depending on your perspective. There is a feeling that HMRC are too willing to accept this as they feel the employee is likely to be a softer target that the employer.

Condition B will normally be applied in close company cases as it becomes straightforward for HMRC to argue that the person knew that tax was not being correctly deducted on payments made to them. HMRC will only adopt this route if there is a good likelihood of the director or employee paying the tax. They acknowledge that there must be firm evidence to support their view. There is obviously less of a risk with employees as opposed to director but an employee who is an officer of an unincorporated club or an individual who is a wage clerk or financial manager might well be seen to have the ability to do this.

Directions under these regulations must be made before formal directions have been issued to the company. However, if a Reg 80 determination has been made to a company but remains unpaid, then HMRC might again seek to transfer the liability to the employee. In those cases, a Reg 81 determination would be issued to the employee but only where one of the following two conditions are met:

- Condition A is that HMRC are of the opinion that the employee in respect of whose relevant payments the determination was made has received those payments knowing that the employer has wilfully failed to deduct the amount of tax which should have been deducted from those payments;
- Condition B is that the unpaid tax represents an amount for which the employer was required to account under reg 62(5) in relation to notional payments to the employee.

NICs

The situation with National Insurance Contributions owed by an employer is slightly wider. HMRC has the power to issue Personal Liability Notices (PLNs) to an individual where:

- A body corporate has failed to pay contributions due; and
- That failure is (in the opinion of HMRC) attributable to the fraud or neglect of one or more individual who, at the time of the fraud or neglect, were officers of the company (referred to as culpable officers).

The liability can cover primary and secondary Class 1 NICs, Class 1A and 1B NICs plus interest and penalties.

The relevant legislation defines an officer as ‘any director, manager, secretary or other similar officer of the body corporate or any person purporting to act as such; and in a case where the affairs of the body corporate are managed by its members, any member of the body corporate exercising functions of management with respect to it or purporting to do so.’ This is typically going to be the director or company secretary but it can be wider than that and would include shadow directors.

HMRC do potentially have to demonstrate that the officer in question has some culpability in relation to the failure to remit the NICs to them. It may be that an officer can argue that they were not involved in this aspect of the business in order to avoid paying the additional duties.

The legislation talks about neglect or fraud.

Neglect is not defined in law but has been considered in case law. In the Upper Tribunal case of *HMRC v CM O'Rorke,* this was found to involve an objective test as to whether there has been a departure from the standard of care in dealing with affairs that would be expected of a reasonable man. In the HMRC guidance on this legislation the following factors are indicated as potentially showing that neglect has occurred:

- *no payments of PAYE or NICs for the full period of trading; or non-payment over a prolonged period of time;*
- *at the time of the failure to pay the contributions due the body corporate was making payments to, or for the benefit of, one or more officers of the body corporate, connected persons or associated businesses;*
- *where the contributions due to HMRC were knowingly and deliberately withheld;*
- *where one or more officers of the body corporate have been associated with other businesses that have failed to comply with their statutory PAYE and NIC obligations;*
- *where we are dealing with a phoenix company;*
- *at the time of the failure to pay the contributions due the company continued to make payments to other creditors;*
- *where the evidence points to the PAYE and NICs that should have been remitted to HMRC being used to fund the company activities and boost cash flow;*
- *where we are dealing with an action that placed a significant NICs liability on the body corporate at a time that the officer would or should have known that there was no reasonable prospect of the body corporate being able to satisfy the resulting NICs liability. For example, the clearing of an overdrawn director's loan account through the declaration of a salary, just prior to liquidation.*

Contributed by Ros Martin

VAT and Duties

VAT deferred under COVID-19 (Lecture B1241 – 21.35 minutes)

As a part of the government's COVID-19 support package, businesses were able to defer VAT due between 20 March and 30 June 2020. Unless a business opts to pay by instalments under the VAT deferral new payment scheme, this VAT is payable by 31 March 2021.

VAT deferral new payment scheme

The scheme is open to join between 23 February and 21 June 2021 inclusive. Taxpayers must join the scheme themselves; their agent cannot do this for them.

Providing a taxpayer is up to date with their VAT returns, rather than paying their deferred VAT by 31 March 2021, they can choose to join this scheme, and further delay payment by opting to pay in equal instalments, interest free.

The number of instalments

Taxpayers will be able to choose the number of monthly instalments, up to a maximum, over which to settle their liability:

Join by	Maximum instalments available
19 March 2021	11
21 April 2021	10
19 May 2021	9
21 June 2021	8

The first instalment is payable on joining the scheme, with remaining instalments then settled by Direct Debit.

Unable to use the online service

Where a taxpayer is unable to join the new online service, perhaps because they do not have a UK bank account, they should contact the COVID-19 helpline when the scheme opens by phoning 0800 024 1222.

Errors in VAT returns

At the end of January 2021, HMRC updated its guidance to include what to do if a business has made errors in the VAT returns that are covered by the deferral period.

Businesses should:

- complete Form VAT652;
- send it to the VAT Error Correction Team.

Where any extra VAT is payable as a result of the error, this must be paid by March 2021 unless the taxpayer has contacted the COVID-19 helpline (tel: 0800 024 1222) to discuss including the additional amounts due in the deferred balance at the time of joining the VAT deferral new payment scheme. Further, a taxpayer cannot include correction payments in their instalments, where notified to HMRC after 31 March 2021.

https://www.gov.uk/guidance/deferral-of-vat-payments-due-to-coronavirus-covid-19

Online newspapers (Lecture B1241 – 21.35 minutes)

Summary – *Digital news services were not 'newspapers' and so online newspapers were not eligible for zero-rating until new legislation was introduced from 1 May 2020.*

This case concerned whether or not "newspapers" as defined by Item 2 Group 3 Schedule 8 VATA 1994 should include digital newspapers, making them zero rated.

The digital newspaper editions relevant to this case were The Times, The Sunday Times and The Sun, including The Sun on Sunday. News Corp UK & Ireland Limited argued that these were 'newspapers' and so should be zero rated.

The First Tier Tribunal concluded that, although the content of the digital and printed editions was fundamentally the same, the digital editions provided digital services rather than goods. The legislation relating to zero rating was confined solely to goods.

On appeal, the decision was overturned, with the Upper Tribunal finding that zero rating applied. Tribunal had reached its decision on the basis of the 'always speaking' principle, in that the law should be interpreted in a way that kept pace with developments. They concluded that when the legislation was drafted, digital newspapers did not exist but such products now carry out the same or very similar functions as a printed version and so were 'newspapers' with zero rating applying.

HMRC appealed the decision arguing that the First Tier Tribunal had been correct. They argued that the Upper Tribunal had misinterpreted or misapplied the "always speaking" principle and had failed to apply a strict interpretation of the zero-rating legislation.

Decision

The Court of Appeal stated that the general rule is that VAT is applied at the standard rate to all supplies unless the legislation states otherwise. When deviating from this rule the language used to identify specific, items and not others, indicates a narrow Parliamentary intention, and not a broad, permissive one.

The requirement of strict interpretation of legislation does not exclude the "always speaking" principle from operation, but they must be applied concurrently. However, where there is a new development that does not fit with Parliament's original intention, the court must not fill any gap to make the legislation fit. It is not appropriate to allow a wider policy than statutory language permitted, which they said the Upper Tribunal had done when concluding that purpose of the legislation was to 'promote literacy, the dissemination of knowledge and democratic accountability by having informed public debate'. If that were true, digital newspapers serve the same purpose as a "rolling news" service but as the Court stated: "nobody suggests that a rolling news service is a newspaper."

When enacted in 1972 it was intended that only tangible matter be included within Group 3. The fact that the zero-rating in respect of music was limited to music in printed form (and not audio recording) was a good indicator of their intention. The Court of Appeal overturned the Upper Tribunal's decision finding that there was a need for a strict approach to be taken when interpreting the zero-rating provisions and that the word "newspapers" in Item 2 Group 3 could not be read as including intangible digital news services.

Note: Since the Upper Tribunal decision, new legislation has been introduced effective from 1 May 2020 extending zero-rating to all electronic newspaper publications, but this legislation does not apply retrospectively. Hence the Court of Appeal's decision here only affects supplies prior to that date, including any protective claims made.

News Corp UK & Ireland Limited v HMRC [2021] EWCA Civ 91

Ceroc dancing tuition (Lecture B1241 – 21.35 minutes)

Summary –Teaching Ceroc dancing in dance classes was not the supply of private tuition in a subject ordinarily taught in a school or university and so did not qualify for zero rating.

Anna Cook ran Ceroc dancing classes for the public under a franchise agreement. She had not registered for VAT as she believed that she was supplying private tuition, in a subject ordinarily taught in a school or university. When supplied by an individual teacher acting independently of an employer this was exempt under Item 2, Group 6, Schedule 9 VATA 1994.

The First Tier Tribunal concluded that Ceroc included elements of various types of dance and so represented the teaching of 'dance', rather than a specific style of dance. Consequently, the Tribunal concluded that the Ceroc classes run by Anna Cook did fall under Item 2, Group 6, Schedule 9 VATA 1994 as a subject ordinarily taught in schools or universities.

HMRC appealed.

Decision

The Upper Tribunal found that the First tier Tribunal had erred in law.

Ceroc is a style of dance, performed in pairs, that includes elements of other dance styles, including jive and salsa. However, the Tribunal concluded that, despite this, Ceroc was a specific style of dance and could not be treated as the generic subject 'dance' ordinarily taught in schools or universities.

HMRC's appeal was allowed meaning that the supplies were standard rated.

HMRC v Anna Cook [2021] UKUT 0015 (TCC)

Insurance services or services of an insurance intermediary?

Summary – The company made exempt supplies of insurance rather than insurance intermediary services and so the related input tax was irrecoverable.

Safestore Ltd provides storage facilities to both business and domestic customers.

The company required its domestic customers to insure their goods under a policy that was provided by Assay Insurance Services Limited, an affiliated company incorporated in Guernsey.

Safestore Ltd collected the insurance premiums from its domestic customers and then quarterly in arrears, the company would remit 70% of the net premium to its sister company in Guernsey.

Safestore Ltd argued that the arrangement resulted in it making exempt supplies of insurance intermediary services to its sister company. As its sister company was not part of the UK for VAT purposes, it was entitled to recover input tax on the associated costs under VATA 1994, s 26(2)(c) and VAT (Input Tax) (Specified Supplies) Order SI 1991/3121.

By contrast, HMRC argued that Safestore Ltd was making an exempt supply of insurance to its UK customers, so the related input tax was not recoverable.

Basing much of its decision on *Card Protection Plan v CCE* (Case C-349/96), the First Tier Tribunal dismissed the appeal and Safestore Ltd appealed to the Upper Tribunal.

Decision

The skeleton argument contained submissions that the First Tier Tribunal should have concluded that Safestore Ltd was making a single, standard-rated, composite supply of storage services. However, this argument was never pursued at the hearing.

The Upper Tribunal concluded that the First Tier Tribunal were correct to conclude that there was an exempt supply of insurance by Safestore Ltd, making the related input tax irrecoverable. Safestore Ltd procured insurance cover for its customers, in return for payment, in its own name and for its own account.

The appeal was dismissed.

Safestore Ltd v HMRC [2020] UKUT 0322 (TCC)

Factoring bad debts

Summary – The company was not entitled to bad debt relief on the fees charged for its factoring services as it did not maintain a single account for bad debts.

Regency Factors Plc provided a factoring service to its clients in return for a fee on which they charged VAT. The factoring service agreed to was “with recourse”, meaning that Regency Factors Plc was entitled to recover from its clients any sums paid to those clients in relation to invoice debts that Regency Factors Plc was ultimately unable to collect.

Under the factoring arrangement, a client would submit a schedule of invoices for factoring, with Regency Factors Plc approving the invoices that it agreed to factor. A Factoring Current Account was then maintained for each client showing the funds available to drawdown at any point in time.

At appeal, the tribunal used a single approved invoice to demonstrate how the numbers worked. Once approved for factoring, typically 80% of the invoice value was available to draw down, less the factoring fees (+ VAT) that would be payable to Regency Factors Plc, once the customer settled the invoice in full.

For an invoice totalling £1,000, funds would be available to drawdown as follows:

	£
80% of invoice value (80% x 1,000)	800
LESS:	
Fees charged (3% x 1,000)	30
VAT on fees at 20% (30 x 20%)	6
Funds available to drawdown	764

The Factoring Current Account would show £764 as the Initial Advance and £36 of fees including VAT due, so £800 was payable in total. Assuming that £1,000 was later collected in full by Regency Factors Plc, the available funds shown in the Factoring Current Account would then stand at minus £200; the first £800 from the customer was used to cover both the advance and VAT inclusive fees, and the balance of £200 would be due to the client.

	£	£
Initial Advance	764	
VAT inclusive fees	36	
Balance on account		800
Funds collected from customers		1,000
Balance due to the client		(200)

When invoices were settled, there was no allocation of funds against particular invoices in the Factoring Current Account; instead it was operated on a running account balance basis with Regency Factors Plc issuing monthly statements to its clients called a "Client Statement and VAT Invoice".

It was common ground that these monthly statements were valid VAT invoices with the date on which the statements were issued being the time of supply or tax point for VAT purposes.

The appeal in this case related to the situation where debts were not collected in full, either directly or by virtue of the right of recourse. Regency Factors Plc claimed bad debt relief for the VAT on its fees that it treated as unpaid, as these only fell due once the customers settled their invoices. The company claimed VAT bad debt relief, calculated by reference to the balance in the Factoring Current Account owed by the client.

Agreeing with HMRC, the First Tier Tribunal held that no bad debt relief was available as the client had paid for its services at the time that the company had made its Initial Advance to clients, when its fee was deducted to arrive at the drawdown amount available. There was no bad debt to write off. Further, the Tribunal concluded that Regency Factors Plc had not kept sufficient records to comply with reg 168 VAT Regulations 1995, as it did not maintain a single account for bad debts.

Regency Factors Plc appealed to the Upper Tribunal.

Decision

The Upper Tribunal concluded that the First Tier Tribunal had erred by concluding that the consideration for the fees due was received when the Initial Advance to clients was made. Although the fee was deducted at that time, the funds were not freely available to use. The factoring fees were only paid once the debts had been collected and the amounts collected exceeded the amount of the Initial Advance.

However, the Upper Tribunal stated that Regulation 168 clearly provides that a trader who makes a claim for bad debt relief must keep a record of the information required by regulation 168(2) and Regulation 168(3) requires that information to be kept in a single account to be known as a "refunds for bad debts account". This was to enable HMRC to check any bad debt claim. Maintaining such an account was not onerous. Further, the Tribunal noted that Regulation 172(2) provides that the time when consideration is taken to have been written off is when an entry is made in that account. It was common ground that the information required to be kept had not been kept in a single record or spreadsheet. The company was obliged to keep such records in a single account and had not done so and so the bad debt relief claim was denied.

Regency Factors Plc v HMRC [2020] UKUT 0357 (TCC)

Provision of state funded education (Lecture B1241 – 21.35 minutes)

Summary – Free education/vocational training funded by government agencies was a supply of services for consideration. However, HMRC were allowed to bring into account input tax previously reclaimed under the Lennartz principle, despite being outside the four-year time limit.

Colchester Institute Corporation is a further education corporation providing further and higher education and vocational training programmes to over 11,000 students.

In 2008, Colchester Institute Corporation started a major building project. At that time, it was agreed that the provision of education and vocational training, when funded by a relevant funding body, was not a "business" activity within the scope of VAT.

Colchester Institute Corporation was granted permission to deduct the VAT incurred on the building project under to the rule in *Lennartz,* whereby the input tax could be deducted up front, provided it accounted for deemed output tax on its non-business education and vocational training. By 07/10, total input tax repaid to Colchester Institute Corporation under *Lennartz* was £2,225,806. Thereafter, it continued to account for output tax on deemed supplies.

By 2014, Colchester Institute Corporation had changed its mind and claimed that its provision of education and vocational training to students was, after all, a business activity (making it exempt) and so there was never any need to have accounted for the deemed output VAT under the *Lennartz* principle. In April 2014, it claimed a repayment of the output tax accounted for in the previous four years. However, Colchester Institute Corporation did not net off the input tax claimed under the earlier building project as this was outside the four-year cap imposed by s80 VATA 1994. Colchester Institute Corporation believed that this prevented HMRC from making such a recovery assessment.

HMRC denied the claim stating that the provision of education and vocational training did not amount to the making of supplies for consideration. They maintained that it was a non-business activity and that output tax had been correctly accounted for. Alternatively, if they were wrong, HMRC argued that s81(3A) VATA 1994 allowed it to reduce the overpayment claim to nil by offsetting the input tax initially recovered, despite the four-year capping provisions.

The First Tier Tribunal held that the Colchester Institute Corporation's provision of education was a non-business activity and dismissed the appeal.

Colchester Institute Corporation appealed to the Upper Tribunal.

Decision

The Upper Tribunal disagreed with the First Tier Tribunal. Despite the fact that the state funding was not specific to any particular course and not every student would necessarily benefit from the funding, there was a link between the funding and the provision of education. There was third party consideration for a supply of education (*Rayon d'Or SARL v Ministre de L'Économie et des Finances* (Case C151/13)). Consequently, Colchester Institute Corporation was making exempt supplies of education and it was entitled to reclaim the output tax previously accounted for.

The Upper Tribunal moved on to consider HMRC's alternative argument, referring to *Birmingham Hippodrome(2014) EWCA Civ 684.* Here, the Court of Appeal had explained that, when correcting a mistake, s.81(3A) VATA 1994 allowed <u>all</u> of the consequences of a mistake to be taken into account. Here, the Lennartz principle had been incorrectly applied as there were no non-business supplies. To correct this, the deemed output tax should be repaid but so too should the input tax from more than four years ago.

Colchester Institute Corporation v HMRC [2020] UKUT 0368 (TCC)

Import/export grant to help SMEs (Lecture B1241 – 21.35 minutes)

HMRC has announced a new SME Brexit Support Fund providing up to £2,000 to seek advice and training on:

- how to complete customs declarations;
- how to manage customs processes and use customs software and systems;
- specific import and export related aspects including VAT, excise and rules of origin.

PwC will administer the grants for HMRC and online applications for the grants will open soon.

Qualifying businesses

To be eligible a business must:

- have no more than 500 employees;

- have no more than £100 million turnover;
- have been established in the UK for at least 12 months before submitting the application, or hold Authorised Economic Operator status;
- not have previously failed to meet its tax or customs obligations;
- import or export goods between Great Britain and the EU or moves goods between Great Britain and Northern Ireland.

Further, the business must either:

- complete or intend to complete import or export declarations internally for its goods;
- use someone else to complete declarations but needs extra help internally.

https://www.gov.uk/guidance/grants-to-help-small-and-medium-sized-businesses-new-to-importing-or-exporting

Meeting the new origin rules **(Lecture B1244 – 12.46 minutes)**

For tariff free trading under the UK-EU Trade and Cooperation Agreement, traders must meet the new preferential rules of origin. Under these rules, preferential tariffs only apply to goods that originate in the UK (or the EU); goods that do not meet the origin rules will have duty applied.

This article takes a more detailed look at how we meet the new origin rules when trading with the EU from 1 January 2021.

When considering the origin of a product, the general rules contained within the Trade and Cooperation Agreement must be considered alongside the product specific rules for each product.

Wholly obtained

A product is said to be an originating product if it was wholly obtained or produced in one country's territory, without using materials from any other country. Wholly obtained products are products obtained entirely in the territory of a party without the addition of any non-originating materials. These automatically qualify for preferential treatment when trading with the EU, with no duty payable.

Some examples of wholly obtained products includes:

- plants, vegetables, fruit grown and harvested in the UK
- livestock, meat and dairy provided that the animal was born and reared continuously in UK
    - for meat it needs to be born, raised and slaughtered in the UK
    - milk must come from cows raised in the UK

Substantially transformed

Under bilateral cumulation, EU materials used in UK production are regarded as being of UK origin where the goods have been sufficiently transformed in the UK.

For example, ‘simple painting and polishing operations’ or ‘peeling, stoning and shelling, of fruits, nuts and vegetables’ will not confer originating status by themselves and the trader would need to rely on a product specific rule.

Let’s have a look at a couple of examples.

HS Code 0406.20 – Grated cheese

For grated cheese to qualify as originating in the UK, all of the dairy produce (Chapter 4) used must be wholly obtained, and the total weight of non-originating materials of headings 17.01 and 17.02 (sugars) must not exceed 20% of the weight of the product.

What if the cheese is imported from the EU and grated in the UK? Is that a sufficient transformation for bilateral cumulation? If this is classed as ”simple cutting” then it will not qualify as this is a process listed within Article: Orig 7 as being ’Insufficient Production’. However, if the grating required special skills or a machine produced or installed for the processing, the grated cheese may be treated as originating in the UK.

HS Code 081190 – Frozen nuts

For frozen nuts to qualify as originating in the UK, the edible nuts (Chapter 8) used must be wholly obtained in the UK and the total weight of non-originating materials of headings 17.01 and 17.02 (sugars) must not exceed 20% of the weight of the product.

Nuts originating from the EU would be treated as of UK origin if the processing went beyond ‘Insufficient Production”. However, the shelling of nuts is considered an insufficient transformation under Article: Orig 7, even if machinery is used for the processing. bilateral cumulation is not available.

Tolerance

If a product does not meet its product-specific rules, it can still be originating if only a limited amount of non-originating materials are used in the production of that product. This is known as tolerance.

However, tolerance can only be applied to certain types of product-specific rules.

If the rule is “wholly obtained”, tolerance may allow a small amount of those materials to be not wholly obtained. If using “change in tariff heading” rule, an element of same tariff heading can be allowed

Specific tolerance rules

The Trade and Cooperation Agreement allows a tolerance of:

- 15% by weight of the final product for agri-food goods; and

- 10% by value of the value the final product for manufactured goods.

Textile and clothing products classified under HS50-63 are subject to specific tolerance thresholds that are detailed in Notes 7 and 8 of Annex ORIG-1.

To clarify what we mean by tolerance, let's have a look at a couple of examples.

HS Code 1509 – Olive oil

Olive oil production requires that all the vegetable materials used are wholly obtained in the country of origin. This means that the olives used in making the olive oil must be grown and harvested in the UK (or EU by cumulation).

The tolerance rule permits the use of non-originating olives if the total weight of non-originating olives does not exceed 15% of the net weight of the product. So if olives are imported from Mexico amounted to 5% of the net weight of the exported olive oil, tolerance would allow the olive oil to obtain originating status.

HS Code 9503 – Dolls

Under the rule for dolls, non-originating material used in the production of a doll must be from a different tariff heading than the doll. Doll's eyes fall into the same heading as a doll which breaches this rule.

However, the non-originating doll's eyes constitute 10% or less of the ex-works price of the doll, and so under the tolerance rule, the final doll would be considered as originating.

Accounting segregation

Accounting segregation can be used to record originating and non-originating fungible materials, allowing them to be stored together, prior to production.

Fungible materials that are of the same kind and commercial quality, with the same technical and physical characteristics, and which cannot be distinguished from one another for origin purposes.

A good example is sugar. Originating and non-originating sugar can be stored together while accounting segregation enables the relative quantities of originating and non-originating sugar to be recorded using accounting methods.

Fungible products may be exported without any further processing, provided the stock of originating materials is sufficient to cover the quantity of product exported.

For example, UK manufacturers of ethylene (HS2901) can store originating and non-originating ethylene in the same tank before exporting it to the EU provided an accounting segregation method is used. The supplier must ensure that the amount of originating materials does not exceed the amount that would receive originating status if stored separately. Clearly a very good inventory management system would be needed.

Prepared from the seminar by Dean Wootten, Wootten Consultants

Product specific origin rules (Lecture B1245 – 14.17 minutes)

When establishing whether a product is of UK origin, free trade agreements have product-specific rules (PSRs) that must be met to ensure a traded product qualifies for preferential tariff treatment. Satisfying these origin rules means that no duty is payable.

It is important that businesses determine the correct product specific tariff code for their exported product so that they can establish the relevant rule(s) within the UK-EU Trade and Cooperation Agreement product-specific rules list. These rules are set out in ANNEX ORIG-2 of the Trade and Cooperation Agreement, with definitions within ANNEX ORIG-1. Each of these rules describes the nature or value of processing that must be carried out on any non-originating materials so that the final product meets the origin requirements.

Types of rule

There are four types of rule that a product may be required to meet in order to confer origin

1. Wholly obtained
2. Change of tariff code
3. Value added/percentage rule; and
4. Specified processes

The product specific code may require one or more of these rules to apply.

Wholly obtained

This was covered in detail in the last article so here are just a couple of examples to confirm our understanding.

- Meat has an HS code of 0203 and so falls within Chapter 2. Within ANNEX ORIG-2, all materials of Chapters 1 and 2 used must be wholly obtained to qualify for preferential tariff treatment. This states that if meat is produced from animals born, raised and slaughtered in the UK, then the product is wholly obtained, so originating in the UK and qualifies for preferential tariff treatment.

- Barley has an HS code of 10 and so falls within Chapter 10. Within ANNEX ORIG-2, all materials of Chapters 10 used must be wholly obtained to qualify for preferential tariff treatment. Barley would satisfy this rule is it was grown and harvested in the UK and qualify for preferential tariff treatment.

Change in tariff classification (HS Code)

Where non-originating material is used to make a product, some product-specific rules of origin require a change of classification to take place before preferential tariff treatment applies. There are no limits on the amount of non-originating materials used but any non-originating material used in the production of the product must be classified in a chapter, heading or subheading other than that of the final product:

- Chapter or "CC" classification change: This means that the first 2-digits of the Harmonized System must change;

- Heading or "CTH" classification change: This means that the reclassification must take place at the 4-digit level of the Harmonized System; or

- Subheading or "CTSH" classification change: This means that the reclassification must take place at the 6-digit level of the Harmonized System.

These abbreviations (CC, CTH and CTSH) are referred to throughout the Trade and Cooperation Agreement. Each product specific code will indicate which, if any, of the abive reclassifications is required.

Change of Chapter (CC)

Let us consider an example where the specific product rule states that the CC must change.

Manufactured yachts (HS code of 8903) fall within Chapter 89 (Ships, boats…). The product rule specifies CC or MaxNOM 40% EXW. Remember, it is possible that a product specific rule may state more than one rule. We will return to the 'MaxNOM 40% EXW' later in this article. For now, let's focus on the CC.

The rule is fulfilled if the yacht is manufactured in the UK from non-originating parts from chapters <u>other than</u> Chapter 89. This means that unlimited non-originating parts of steel (HS Chapters 72 and 73) or glass (HS Chapter 70) could be used, regardless of their value.

This is a relatively generous provision and is allowed in this way as they want to encourage the manufacture of yachts. Using materials obtained outside the UK is fine provided the materials are form a different chapter heading.

Compare this with the position where the yacht was imported and then fitted out before being exported . Here, the CC rule would be breached, as the imported yacht would also be Chapter 89.

Change of Tariff Sub-Heading (CTSH)

Let us move on and consider a product specific rule that requires a change in the sub-heading.

Sunflower-seed oil (HS code of 151219) is in Chapter 15 (Animal or vegetable fats…) and within this Chapter, HS code 151219 is classified as CTSH. To satisfy the rule, the final product must be made from a product that has a different CTSH or 6-digit HS code. So if the sunflower seed oil is manufactured from non-originating crude sunflower oil (HS 152111), the rule is satisfied. It does not matter how much of the crude sunflower oil is imported for this test.

Same heading

If a product-specific rule of origin allows production from non-originating materials of <u>any heading</u>, the product can include non-originating materials of the same heading. This means that a change of heading does not need to take place.

However, to qualify, processing of non-originating materials does need to be more than insufficient. You may remember that we covered 'insufficient production' this last month's article.

Let's consider an example.

Crushed or ground pepper (HS code 090412). This falls in Chapter 9 (Coffee, tea, maté, spices….). The rule specifies "Production from non-originating materials of any heading". Provided the source material is sufficiently processed in the UK, it can be imported and the final product will obtain preferential tariff treatment.

Pepper has the same heading as ground pepper. By crushing and grinding the pepper, sufficient processing has taken place in the UK and the product specific rule has been satisfied. Although the pepper was imported, by processing in this way in the UK, it qualifies for preferential tariff treatment.

Value and weight limit percentage

If the use of an ingredient, material or component is limited by value and/or weight, the rule concerning tolerance (discussed in the previous article) <u>cannot</u> be used.

Under a value limitation rule, the value of non-UK or non-EU originating materials may not exceed a given percentage of the ex-works price. The product specific rule will stipulate what that percentage is.

HS Code 920120 – Grand pianos

Grand pianos (HS code 920120) fall in Chapter 92 (Musical instruments…) and the product specific rule states "MaxNOM 50% (EXW).

MaxNOM means the maximum value of non-originating materials expressed as a percentage, calculated as:

VNM/EXW x 100

VNM, the value of the non-originating material, is its customs value at time of importation including freight and insurance. Let's say £400.

EXW is normally the price charged to the customer, excluding freight and insurance. Let's say £1,000 in our example.

In our example, the value of our non-originating materials expressed as a percentage is 40%, calculated as £400/£1,000. This is less than the 50% stated in the product specific rule and so the origin rule is met. No duty will be payable on the piano when it is exported to the EU.

HS Code 17049030 – White chocolate

White chocolate (HS code 17049030) falls in Chapter 17 (Sugar and sugar confectionary). The product specific rule for this code is CTH, provided that:

a) all the materials of Chapter 4 (Dairy produce) used are wholly obtained <u>and</u>

b) either:

i) the total weight of non-originating materials of headings 17.01 and 17.02 (sugars) used does not exceed 40% of the weight of the product, **or**

ii) the total value of non-originating materials of 17.01 and 17.02 (sugars) does not exceed 30% of the ex-works price of the product.

When checking to see whether white chocolate qualifies for preferential tariff treatment, all of the dairy content must be wholly obtained in the UK, but we must check that the percentage of any non- originating sugar added is not too high. Note that this product specific rule only requires one of the percentage tests, weight or value, to be satisfied.

Let's assume that 22.2g of non-originating sugar is used in making each 60g bar of white chocolate. As 37% (22.2/60) is less than 40%, the weight percentage rule above is satisfied. As this rule is satisfied, we don't actually need to check the value percentage. The white chocolate is treated as originating, with no duty payable when it is moved to the EU.

However, so that we are clear on how the value percentage calculation would work, if 20p of non-originating sugar is included in an 80p bar of white chocolate, the value test is also satisfied. 25% (20/80) is less than the maximum 30% stated in the product specific rule.

Specific process

Our last example considers a product that requires specific processes to be carried out.

As an example, for cotton men's shirts (HS Code 620520) to be treated as UK originating requires 'weaving and making-up' of the shirts to be carried out in the UK.

However, with bilateral cumulation of processing, these processes can be divided between the UK and EU. For example, the weaving of the fabric could be done in the EU, whilst the making-up of the shirt could be done in the UK. The final product can then be exported back to the EU tariff-free as an 'originating' product.

Conclusion

The rules that we have discussed over our three sessions are complex. We must not lose sight of the fact that to qualify for UK-EU Trade and Cooperation Agreement preferential zero rate tariff, the relevant product-specific rules must be satisfied so that goods are treated as being of UK origin.

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