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Personal tax

Car allowances disregarded for NIC

Summary – Car allowances linked to employee grade rather than business use were earnings but the payments were 'relevant motoring expenditure' and disregarded for employer NICs purposes.

Wilmott Dixon Holdings Limited is a privately owned national construction and property company with projects and customers spread across England and Wales

The company employed staff described as “job need drivers” and part of the employee’s employment contract required them to have a fit and proper vehicle available for the purpose of performing their business duties at all times. In return for this, employees were paid car allowances. However, the amount of car allowance paid was dependant on staff grade and not the number of business miles driven by an employee. Employees also received business mileage payments to reimburse them for the fuel costs of actual business miles driven.

Between 29 March 2011 and 15 October 2015, Wilmott Dixon Holdings Limited made a number of claims for repayment of Class I NICs relating to the years 2004/2005 up to and including 2014 in respect of car allowance payments paid to employees. HMRC refused the claim stating that the allowances were earnings under s3(1) Social Security Contributions and Benefits Act 1992 with none of the disregards in the Social Security (Contributions) Regulations applying. Specifically, the allowances did not qualify as relevant motoring expenditure (RME) under the paragraph 7A disregard. They were not tied to mileage, and the payments were made, at least in part, to fund the purchase of the vehicle.

Wilmott Dixon Holdings Limited appealed arguing that the car allowances were not earnings, but if they were, one or more of the disregards applied.

Decision

The First Tier Tribunal concluded that, given that the allowance paid was dependant on employee grade and not business miles driven, the payments were earnings liable to NICs.

The Tribunal moved on to consider whether the payments represented RME under the para 7A disregard. If this was the case, class 1 NICs would only be payable to the extent that the allowance exceeded the ‘qualifying amount’. The parties had agreed that the qualifying amount was the £1.5million being claimed in this case.

The Tribunal noted that this case had many similarities with the Laing O’Rourke Services Ltd [2021] case, where Judge Bowler decided that the car allowance payments were not RME and so could not be a qualifying amount and the 7A disregard could not apply. This case is being appealed to the Upper Tribunal.

Interestingly, in this appeal, the Tribunal concluded that the allowances were RMEs, and that the paragraph 7A disregard applied.

Regulation 22A(3) states that a payment is RME if—

(a) it is a mileage allowance payment within the meaning of section 229(2) of ITEPA 2003; or

(b) it would be such a payment but for the fact that it is paid to another for the benefit of the employee; or

(c) it is any other form of payment, except a payment in kind, made by or on behalf of the employer, and made to, or for the benefit of, the employee in respect of the use by the employee of a qualifying vehicle.

The First Tier Tribunal focused on point (c) of the definition stating that all the company needed to demonstrate was that the car allowances were payments in respect of the use by the employee of a qualifying vehicle. The Tribunal found that this was possible even though the payments made did not depend on actual mileage but on the grading system. Judge Popplewell found that use included expected use, potential use or availability for business use. Provided an employer could show that a payment was made and in consideration for that payment an employee was obliged to provide a vehicle for business use, then it fell within the subparagraph (c). The employment contract showed that in order to receive the car allowance, an employee was obliged to have a private vehicle available for business use. There was a clear (albeit indirect) nexus between the payments and business use.

The appeal was allowed.

Having reached a different decision to Judge Bowler in the Laing O'Rourke Services Ltd [2021] case, we now have two, contradictory interpretations of the law. It will be interesting to see what decision the Upper Tribunal reaches in the Laing O'Rourke appeal.

Willmott Dixon Holdings Limited v HMRC (TC08359)

Remuneration scheme fails

Summary - Payments made under growth *securities ownership plans were not exempt restricted securities, but rather were taxable employment income.*

In 2010, both companies entered into a growth securities ownership plan. Under their respective arrangements the companies entered into contracts with certain employees under which:

- on entering the contract the employee made an upfront payment of £10 to the employer, theoretically calculated to be equal to the then market value of the employee's rights under the contract;
- provided that the employee continued to be employed and satisfied certain conditions, the employees entered into a 'contract for differences' with:
  - the company agreeing to make a payment to the employee if the employer's future profits exceeded a stated figure; and
  - the employee agreeing to make a payment to the company if the profits were less than a lower specified figure.

The companies believed that their plans fell within Part 7 ITEPA 2003, arguing that the rights acquired at market value were restricted securities acquired under a contract for differences, making the payments exempt from income tax and national insurance on grant.

HMRC argued that the plans were artificial tax avoidance arrangements designed to allow the company to give money to employees that escaped income tax and NICs. PAYE determinations were issued accordingly.

The companies had made separate appeals but they were joined as they raised similar issues and had a number of other cases stayed pending their outcome. In HMRC's view, both companies were using the schemes to avoid paying income tax and national insurance:

- the Jones Bros appeal was representative of a number of bonus replacement appeals;

- the Britannia appeal was representative of director/shareholder profit extraction appeals.

Decision

The First Tier Tribunal found in HMRC's favour, agreeing that the plans were not contracts for differences but rather, were arrangements that were designed to produce tax free earnings. The contracts were drafted so as to appear to satisfy the requirements of a contract for differences, with the downside risk element included for employees.

From the documents that were produced marketing the schemes, it was made clear that payments could be paid to employees with significant tax savings. Further, on analysing the schemes, the downside hurdle was set so low that it was unlikely that employees would ever need to make payments. The arrangements were clearly artificial.

The First Tier Tribunal confirmed that the arrangements were a means by which the companies could make payments to employees that would otherwise have been paid as cash bonuses. The payments should be taxed as earnings from employment.

Jones Bros Ruthin (Civil Engineering) Co Ltd and Britannia Hotels Ltd v HMRC (TC 08378/V)

Payments to a remuneration trust

Summary - Payments to a remuneration trust which were loaned on to a director were not deductible. Although not earnings, the amounts were taxable as disguised remuneration.

Strategic Branding Limited operated a consulting business, advising clients on how to maximise their brand value. Mr Wilson was the sole shareholder/director and the company had no other employees.

Between 2012 and 2015, Strategic Branding Limited made contributions totalling just over £540,000 to a remuneration trust, designed by Baxendale Walker LLP. £520,000 of these funds were loaned on by the trust to Mr Wilson. The difference between the amount of the contribution and the amount loaned to Mr Wilson was the fee paid to the scheme arranger.

The company claimed corporation tax deductions for the contributions made on the basis that they were incurred wholly and exclusively for the purposes of its trade, including an additional £53,000 for fees paid to set up and run the trust. The company also believed that PAYE was not due.

HMRC disagreed and issued:

- discovery assessments to collect the corporation tax due of £109,000 relating to the disallowed contributions;

- determinations to collect PAYE and NICs of £294,000 on the basis that either the arrangements were caught by the disguised remuneration legislation (Part 7A ITEPA 2003) or they were taxable as earnings (s.62 ITEPA 2003) in line with the decision in the Rangers case.

Strategic Branding Limited appealed.

Decision

The First tier Tribunal dismissed the company's appeal confirming that:

- this was a marketed scheme seeking to gain a corporation tax deduction for the company without creating a tax liability for the director;

- the loans were inextricably linked to the contributions made, with the intention that they would benefit the director's family.

As a result, the Tribunal found that:

- the contributions were disallowed as they were not made wholly and exclusively for the purposes of the company's trade

- although the amounts lent were not earnings from an employment under s.62, the amounts lent were caught under Part 7A, as disguised remuneration and so subject to PAYE and NICs.

Strategic Branding Limited v HMRC (TC8348/V)

Second homes: Business rates or council tax

From April 2023 the government are changing the rules so that second homes that are not genuine holiday lets will result in the owners paying council tax rather than paying small business rates.

Currently, by simply declaring an intention to let their second home out to holidaymakers, second homeowners can avoid paying council tax. However, from April 2023, to be eligible to pay small business rates, second homeowners will have to prove that their properties are:

- being rented out for a minimum of 70 days a year;

- available to be rented out for 140 days a year.

Evidence is likely to take the form of a website or brochure used to advertise the property, as well as letting details and accounts.

https://www.gov.uk/government/news/gove-closes-tax-loophole-on-second-homes

Purchase of own shares – Practical issues (Lecture P1301 – 14.43 minutes)

Purchase of own shares is a useful tax planning tool for owner managed businesses where the company has cash reserves to be able to buy shares back from a shareholder.

The buy-back will be treated as an income distribution likely to be taxed at 32.5% to 38.1% unless the conditions for capital treatment are met.

Example

Consider a family company worth £2 million with significant cash reserves. Will and Grace own 30 shares each with their older children Josh and Emily each owning 20. All four are directors and work full time in the business.

Will is older than Grace and would like to retire, while Grace is happy to continue working in the business but may take more holidays going forward.

A purchase of own shares is worth consideration. The company has the cash reserves to pay Will £600,000 but he is keen to retain a small interest in the company; say 5% for sentimental reasons. He has therefore suggested £500,000 for 25 of his shares. As part of the buy-back, he will return 25 of his shares to the company and these will then be formally cancelled. He would also like to remain as a director of the company.

Capital treatment

Where the capital treatment applies, a gain will crystalise and Will is likely to qualify for 10% Business Asset Disposal Relief, often making this the preferred option.

However, the capital treatment only applies where certain conditions are met. HMRC clearance is available here and should always be sought as the difference between the capital and income treatment is significant.

HMRC has published new guidance that covers straightforward situations when an unquoted trading company purchases its own shares and explains:

- the conditions (A or B) that must be met before the payment can be treated consideration for the disposal of shares and so subject to CGT rather than as a distribution liable to income tax;

- how a company can make a clearance application in connection with the purchase of own shares legislation.

Condition A

Under this condition, the purchase of own shares must be made wholly or mainly to benefit an unquoted trading company's trade. Retirement can qualify as benefiting the trade but staying on as a director can be a problem. It is advisable that the shareholder/ director resigns his directorship.

Further:

- the seller must be a UK resident at the time the purchase is made;
- the seller must have owned the shares at least five years ending with the date of the purchase or three years if the seller acquired the shares under the will or intestacy of a former shareholder (see below);
- the shareholding interests of the seller and their associates in the company (and group, if appropriate) must be substantially reduced (See below)
- the seller and their associates must not be connected to the company after the purchase takes place; and
- the purchase must not form part of a scheme or arrangement where one of the main purposes is to enable the seller to participate in the profits of the company without receiving a dividend and/or avoiding tax.

Condition B

Here the purchase must be in connection settling an Inheritance Tax liability. This means that if the payment made is used by the seller to pay Inheritance Tax liability, the payment may not be treated as a distribution provided that:

- substantially the whole of the purchase money is applied by the seller in paying the tax liability;
- the tax was charged on a death;
- the payment received from the company is applied in the discharge of the tax liability within two years of the death;
- the tax paid could not have been paid without undue hardship;
- The payment by the company must be received by the person who is liable for the Inheritance Tax.

Owning the shares for at least five years

Where the seller has made more than one acquisition of shares of the same class that are being redeemed, repaid or sold to the company, earlier acquisitions of shares are taken into account before later acquisitions. However earlier disposals are treated as being made on a last in, first out basis. This gives the seller the longest possible period of ownership for this purpose.

If at any time during the five-year period, the shares were transferred between spouses or civil partners living together at the date of transfer, then the periods of ownership of both spouses or civil partners are aggregated.

Substantial reduction test

The substantial reduction in the seller's interest as a shareholder in the company is considered in two ways, by considering:

- the issued share capital;
- entitlement to profits.

Reduction in seller's shareholding

To test whether there's been a reduction in the seller's shareholding, the relevant proportion immediately after the sale is compared with that immediately before the purchase.

The relevant proportion is the nominal value of the shares owned by the seller divided by the issued share capital of the company. If the seller's interest immediately after the purchase is not more than 75% of their interest immediately before the purchase, it has been substantially reduced.

The calculation must take into account the fact that the number of shares in issue will have decreased after the purchase as these shares are normally cancelled by the company.

Example

A Ltd has an issued share capital of £1,000 comprising of 1,000 £1 shares. You hold 400 of those shares and sell 250 shares to the company.

This means that immediately before the sale you hold 40% of the issued share capital:

- the nominal value of your shares is 400
- the total issued share capital is 1,000

After the sale you hold 20% of the issued share capital:

- the nominal value of your shares is 150 (400 – 250)
- the total issued share capital is 750 (1000 – 250)

A 75% reduction in your shareholding would leave you with 30% of the issued share capital (75% of 40% is 30%).

After the sale you hold 20% of the issued share capital so your shareholding interest has reduced to not more than 75% of the original holding and the substantial reduction test has been met.

Reduction in seller's entitlement to share in the profits

Broadly the seller's interest as a shareholder is taken to be substantially reduced if the company were to distribute all its profits available for distribution and the seller's entitlement to a share of those profits (expressed as a fraction of the total of those profits) immediately after the purchase would be not more than 75% of the corresponding fraction immediately before the purchase.

Associates and the substantial reduction test

When applying the calculation, the interests of any persons associated with the seller are also relevant.

Associates are:

- spouses or civil partners who live together;
- children aged under 18 and their parents;
- a person connected with a company is an associate of that company and any company it controls (e.g. You are the sole shareholder of X Ltd. X Ltd has a 100% subsidiary, Y Ltd. You are an associate of both X Ltd and Y Ltd;
- a person accustomed to acting on the directions of another person in relation to the affairs of a company (both are associates of each other in relation to that company);
- companies are associated with one another if they are under the control of the same person (e.g. You are the sole shareholder of C Ltd and D Ltd. This means C Ltd is an associate of D Ltd and vice versa;

Returning to our first example with Will and Grace. Before the buy-back the couple held 60% (60/100) and after the buy-back they hold 46.67% (35/75) as 25 shares would have been cancelled as a result of the buyback. For the 75% test to be satisfied the interest must be reduced to below 45% (75% of 60%) and so, in this example, the test is breached. Note that if all his shares had been bought back by the company the company would still have 70 shares in issue with Grace holding 30 so the relevant percentage would have been 42.8% (30/70). The test would have been satisfied but this was not the case here.

Seller connected with the purchasing company immediately after the purchase

The seller must not be connected with the company, or any company in the group, following the purchase of shares. A person will be treated as connected with the company if they:

- possess, or are entitled to acquire, more than 30% of the issued ordinary share capital, loan capital or voting power, or
- are entitled to receive more than 30% of the assets on a winding up of the company.

In applying the connection test, the interests of the seller's associates are aggregated with the seller's own. In our example, even if Will sold all of his shares back to the company, Grace would still own 30 of the 70 shares in issue, which is more than 30% and so this test is breached.

(If the loan capital of the company was acquired in the ordinary course of a business carried on by the shareholder which includes the lending of money and the shareholder takes no part in the management or conduct of the company, his interest in the loan capital is disregarded in applying the 30% test.)

Solution for Will and Grace

In our example, even if Will resigned his directorship and sold back all of his shares, the buyback of shares would not satisfy the capital treatment conditions and he would be taxed under the income distribution method, which is far from ideal. To solve the problem we could discuss with the couple whether Grace would consider retiring as well or maybe gifting some of her shares to her children? Alternatively, it may be worth delaying the buyback until such time as Grace is also ready to retire. In the meantime, Will could just reduce the hours that he worked.

Making a clearance application

A company wishing to make a purchase of its own shares can get advance confirmation from HMRC that the distribution arising will be an exempt distribution. Clearance applications are the responsibility of the Clearance and Counteraction Team.

Email applications

HMRC's team are able to process an application more efficiently if companies email their application to reconstructions@hmrc.gov.uk. Companies should not include attachments larger than 3MB or self-extracting zip files as HMRC's software will block them.

Postal applications

HMRC states that it accepts no responsibility for applications lost in transit prior to receipt. Companies should use a secure delivery method such as Royal Mail recorded delivery sending their application to:

BAI Clearance
HMRC
BX9 1JL

The guidance concludes with checklists containing the information HMRC needs to reach a decision.

https://www.gov.uk/guidance/clearance-applications-and-exempt-distribution-when-a-company-purchases-its-own-shares

Profit extraction in OMBs **(Lecture P1304 – 17.38 minutes)**

It is common within the owner-managed business population to have an individual who is both director and shareholder of a company.

When considering how to extract money from the company in a tax-efficient way, we are normally thinking about the difference between salary and dividends.

There is a subsidiary issue involving loan interest (where money has been lent to the company by the individual) and rental income (where it is possible to purchase business premises outside the main company) but these are not really going to generate the main income for a household other than in a few cases.

Looking at the two options is superficially straightforward. Salary payments will be tax deductible in the company but attract tax and National Insurance for both the payer and the payee. Dividend payments are not tax deductible for the company but will only attract tax and not NICs.

The following calculations are very simplified but are really to make a general comparison between the different options. We are assuming that the personal allowance has already been used as well as the dividend allowance. We are also ignoring any employment allowance that might be available at this stage.

In reality, most director/shareholders will already be paying up to the lower earnings limit for NI purposes in order to guarantee the year qualifies for state pension purposes so we are really looking at how we top-up the main income.

Calculations – basic rate taxpayer

a) Bonus

Gross	100.00
Secondary class 1 NIC $\left[\frac{13.8}{113.8}\right]$	(12.12)
Gross salary	87.88
Income tax and NIC at 32%	(28.12)
Retained	59.76
Total tax and NI cost	40.24%

b) Dividends

For dividends, it is assumed that the dividend tax allowance has already been utilised.

Gross	100.00
Less corporation tax (19%)	(19.00)
Gross dividend	81.00
Income tax 7.5%	(6.08)
Retained	74.92
Total tax and NI cost	25.08%

The following table compares the different tax burdens:

	Basic rate taxpayer	Higher rate taxpayer	Additional rate taxpayer
Salary	40.24%	49.03%	53.42%
Dividends	25.08%	45.33%	49.86%

It is clear to see that for all taxpayers it is more beneficial to pay dividends than salary although clients are often surprised at how small the differential is between the two for higher rate or additional rate taxpayers.

What is the impact of the changes in April 2022?

These figures will go up next year with the new Health and Social Care Levy.

The calculations are exactly the same except that the rates of NIC are going up as are the dividend tax rates. Repeating the same calculations as shown above gives us the following figures:

a) Bonus

Gross	100.00
Secondary class 1 NIC $\left[\frac{13.8}{113.8}\right]$	(12.12)
Gross salary	87.88
Income tax and NIC at 32%	(28.12)
Retained	59.76
Total tax and NI cost	40.24%

b) Dividends

For dividends, it is assumed that the dividend tax allowance has already been utilised.

Gross	100.00
Less corporation tax (20%)	(19.00)
Gross dividend	81.00
Income tax 7.5%	(6.08)
Retained	74.92

	Basic rate taxpayer	Higher rate taxpayer	Additional rate taxpayer
Salary	41.98%	50.67%	55.02%
Dividends	26.09%	46.34%	50.87%

Given that the rate of NIC and the rate of dividend tax is going up by the same amount, it is unsurprising that the change affects both marginal rates of tax and there is still a similar differential between the two.

What about the changes in April 2023?

The figures then change again when the rate of corporation tax goes up in 2023 since the tax rate for dividends depends on the marginal rate of tax of the company as dividends are not tax deductible. This change will not affect the marginal ate of tax for salaries.

	Basic rate taxpayer	Higher rate taxpayer	Additional rate taxpayer
Salary	41.98%	50.67%	55.02%
Dividends			
19% CT	26.09%	46.34%	50.87%
26.5% CT	32.93%	51.31%	55.42%
25% CT	31.56%	50.31%	54.51%

This shows that once we get up to the marginal rate of tax (applying between £50,000 and £250,000 for a standalone company), the salary route is actually more tax effective due to the increased benefit of the corporation tax deduction. This was seen before when the marginal rates of tax were higher – when we had a tiered corporation tax system. In that situation you might think it would be better to take salary to bring profits down to the small profits rate and then take dividends if you wanted to take more income.

However, when the calculations are done, it is an interesting situation. You have to do the calculations as it is not easy to predict the outcome. There may not be an overall tax saving or the overall tax may be reduced by this strategy but the amount of money extracted by the individual could be less, because you are reducing the corporation tax payable, not the individual tax.

For example, if you had a standalone company with profits of £75,000 after deduction of a salary at the level of the personal allowance (set at this level to make the calculation easier!). They want to pay £50,000 gross to the individual as either dividends or salary.

Option 1: pay salary of £50,000

Employers NICs = £50,000 x 15,05% = £7,525

Corporation tax = (75,000 - £50,000 - £7,525) x 19% = £3,320.25

NIC on director: salary of £12,570 already paid, so £37,700 @ 13.25% plus £12,300 @ 3.25% = £5,241.25

Tax on director: £37,700 @ 20% plus £12,300 @ 40% = £12,460

Total tax payable = £28,546.50

Net take home for director = £32,298.75

Option 2: pay dividends of £50,000

No NICs due

Corporation tax = (£50,000 x 19%) + (£25,000 x 26.5%) = £16,125

Tax on director = (£2,000 @ nil) + (£35,700 @ 8.75%) + (£12,300 @ 33.75%) = £7,275

Total tax payable = £23,400

Net take home for director = £42,725

Option 3: pay salary to bring profits down to £50,000 and then balance as dividends

Want net deduction of £25,000 so 15.05/115.05 = £3,270.32 which then gives salary of £21,729

Balance as dividend = £50,000 - £21,729 = £28,271

Corporation tax = £50,000 x 19% = £9,500

NIC on director: £21,729 @ 13.25% = £2,879

Tax on director: (£21,729 @ 20%) + (£2,000 @ nil) + (£13,971 @ 8.75%) + (£12,300 @ 33.75%) = £9,719.51

Total tax payable = £25,368.83

Net take home for director = £37,401.49

Best outcome

In this situation, you can see that it still makes sense to pay dividends because so much of the income is being taxed at basic rate, where the difference between salary and dividends is so great. If you had the same individual who had other income so that they were being taxed at higher rates, the figures might be different. You just have to do the calculations.

Capital gains tax rates

Interesting, if no money was extracted on an annual basis but the funds were retained in the company and then extracted subsequently as a capital distribution, the following marginal rates of tax would apply:

	BADR	No BADR basic rate	No BADR higher rate
19% CT	27.1%	27.1%	35.2%
26.5% CT	33.85%	33.85%	41.2%
25% CT	32.5%	32.5%	40%

Other ways of extracting value

Payments to pension funds

Pension contributions are seen as a good way of extracting money from companies. SIPPs and SSASs are well suited to family companies as they may only be used for a small number of members. Trustees of the scheme are responsible for the management of the scheme investments subject to strict statutory requirements to prevent abuse of the funds.

Care needs to be taken since the annual allowance is £40,000 (although the availability of limited carry forward means this figure can be higher) which will limit the overall capacity of businesses to make large contributions but with beneficiaries having more freedom over how to use the money on retirement, there is likely to be increased use of pension funds. Care also needs to be taken for higher earners to make sure that the pension allowance is not tapered away. Any contributions made by a company are not a benefit and would be paid gross. It does, however, count towards the annual allowance and it is important to appreciate this point.

Family wages

The area of spouse's wages (or other family members) is a difficult area because in order to obtain a trading deduction the amount paid must be commensurate with the work done and the arms' length rate for the job. It is actually providing the evidence to support the claim that can cause the greatest problems since Inspectors tend to be sceptical if no evidence exists. However, in most cases it should be fairly easy to justify payments of up to the personal allowance for part time administrative assistance.

Renting an office

Individuals are increasingly using part of their own home for business purposes. Any payments to compensate employees or directors who use part of their home for the purposes of their employment are unlikely to have a s336 ITEPA claim agreed.

An alternative approach would be for the company to rent part of the employee's residence from the employee under a formal rental agreement. In these instances, the Revenue will normally allow a corporation tax deduction for the rent and will not regard the payment as emoluments. The rent would be taxed on the individual as property income with due relief given for costs incurred wholly and exclusively for the purposes of the property business. This is far more generous than a s336 ITEPA claim. It also has the added advantage of avoiding National Insurance. There may be some issue with PPR if there is exclusive use

There is a theoretical possibility that HMRC will argue that rent being paid for occupation of property owned by the director is more than market value. If the director is taxable at higher rate, and the company getting a deduction at 20%, this is unlikely but not impossible. It may depend on whether the director is paying tax on the rent (which might depend on the expenses being claimed). If there is an overpayment of rent (from the perspective of HMRC), it is likely that HMRC will try to tax the overpayment as remuneration. In many ways, it is likely that this will only happen where the amounts are really excessive.

Loan interest

One possibility which is often considered is the possibility of being able to extract money out of the company as interest to utilise the savings allowances where there is a credit balance on a director's loan account. The following is an example of how this might work in practice.

Harry has a director's loan account of £150,000 which arose when he incorporated his business in 2013. He draws a salary in 2022/23 of £9,100 (below the NI threshold), interest at 6% on his loan account, giving £9,000 which is tax free (£3,470 within the personal allowance, £1,000 personal savings allowance and £4,530 attracting the savings starting rate of zero) and dividends of £2,000 which are also tax free. This provides him with £20,100. Further dividends can be drawn within the basic rate band as they suffer tax of only 8.75% in addition to the corporation tax which will be paid in any event. He can take income of £50,270 at a tax cost of only £2,639.87.

The profits needed to generate dividends of £30,170 in the circumstances set out above are calculated below.

	£	**£**
Profit		55,347
Interest on loan account	9,000	
Salary	9,100	18,100
Taxable profit		37,247
Corporation tax at 19%		7,077
Net profit (= dividend)		30,170

The total tax payable is therefore £7,077 plus £2639.87 which is a marginal rate of tax of 17.5%.

Contributed by Ros Martin

Capital taxes

A 'tax nothing' (Lecture P1302 – 21.41 minutes)

'Tax nothings' occur where there is no relief for expenditure incurred by a taxpayer. They turn up in various parts of the tax system. The recent First-Tier Tribunal decision in Drake v HMRC (2022) provides a good example of this anomaly under the CGT legislation.

In July 2014, the taxpayer (D) entered into a contractual agreement under which, on completion, he was to be granted a lease of a London property – still under construction – in return for the payment of a premium of £2,200,000.

A deposit was payable by D on the date of the contract, followed by a stage payment due one year later, i.e. in July 2015. D paid the deposit, but, because of difficulties in the property market (the value of the lease was thought to be less than the agreed premium so that D had difficulty in raising the necessary finance), he was unable to make the stage payment.

This allowed the vendor to say that D had repudiated the contract, the main consequence of which was that the other party was entitled to retain D's deposit (£220,000). The contract was never completed.

In his 2015/16 tax return, D claimed relief for an allowable loss of £220,000 which HMRC refused. They said that the deposit was not an asset and so there was no disposal for CGT purposes. This was upheld on a review. D appealed to the First-Tier Tribunal.

The judge confirmed that HMRC's ruling was correct, but the real interest of this case lies in the discussion of judicial precedent. In the past, tax issues regarding forfeited deposits have come before the Courts and Tribunals on several occasions and there have been significant differences in the way in which the law has been interpreted.

Three earlier cases were cited here:

1. Hardy v HMRC (2016)

   This Upper Tribunal case dealt with an off-plan purchase of a leasehold property where a deposit was paid on entering into the contract. However, the taxpayer was unable to complete the transaction and so he lost his deposit. The benefit of the contract was not assignable.

2. Lloyd-Webber v HMRC (2019)

   The taxpayer (LW) contracted to purchase two plots of land in Barbados, together with villas to be constructed thereon. Large payments were made as the construction progressed. The developers, with whom LW dealt, suffered serious cash flow problems which ended with the building of the villas being abandoned, but not before LW was out of pocket to the tune of nearly $11,500,000. This was a First-Tier Tribunal hearing.

3. Underwood v HMRC (2009)

   The Court of Appeal had to decide whether the taxpayer (Mr Underwood) had realised an allowable loss on the disposal of land to a person (B). In the event, before completion, Mr Underwood contracted to repurchase the land and sell it to someone else (C). On completion, the land was never actually transferred to (and from) B. Instead, it was conveyed directly to C. Mr Underwood merely paid B what turned out to be the excess of the repurchase price over the sale price.

Although the facts in Drake sound similar to those in the Hardy case, a fundamental difference is that the contract in Hardy was non-assignable. The taxpayer in Hardy was not held to own an asset which he could sell and therefore the loss was disallowed), whereas, in the present case, D argued that he did have rights which he could turn to account. These were fully marketable and so, under S21 TCGA 1992, they constituted an asset for CGT purposes. D's rights were extinguished on rescission of the contract and he suffered a real monetary loss of £220,000. S24 TCGA 1992 confirms that the extinction of an asset is treated as a disposal under the CGT legislation.

D said that Hardy had failed to consider the ratio decidendi of the Underwood case (indeed, Underwood v HMRC (2009) was not mentioned in either of the Hardy hearings, despite being a Court of Appeal decision which predated Hardy by several years). The rationale was that, where a taxpayer has two contracts with the same person, one to sell and the other to repurchase an asset and settles those contracts by a payment of the excess of the repurchase price over the sale price, no allowable loss for CGT purposes can arise to the taxpayer on the sale, given that there is no disposal of the asset. This principle seems fair enough.

D then pointed out that, in Lloyd-Webber (which the taxpayer won), the Hardy decision was stated to be per incuriam, i.e. that it resulted from a judicial oversight of an important point, although no explanation was given in Lloyd-Webber as to why this was the case. However, Judge Zachary Citron in Drake v HMRC (2022) pronounced himself unable to agree that Hardy had been decided per incuriam.

He closed by saying:

> 'The principal factual difference between this case and Hardy is that the benefit of the contract in Hardy was not assignable in any circumstances, whereas, in this case, the appellant was entitled to assign the benefit of the contract after payment of the deposit and the stage payment.
>
> However, this factual difference does not justify distinguishing Hardy from this case, as:
>
> (i) the decision in Hardy expressly considered the issue of assignability and determined that it was not a significant factor, i.e. the analysis applied equally to assignable and unassignable contracts; and
> (ii) in fact, the benefit of the contract never became assignable, (given that) the stage payment was never paid.

> I conclude that Hardy is binding authority in this case and so this appeal must be dismissed, as the rescission of the contract, by reason of the taxpayer's repudiatory breach, did not constitute a disposal of an asset for capital gains purposes.'

Thus D was unsuccessful in his appeal.

As can be seen, the judge had to navigate his path through the various antecedent rulings and decide which represented binding precedents on him and which had been given per incuriam. Tax advisers dealing with legal disputes will find much to muse on in this case.

Contributed by Robert Jamieson

Main residence relief on a former hospital

Summary – Living in a large derelict building for a year was not enough to classify that property as his main residence and main residence relief was denied.

In July 1994, Mr Hussain bought the former Mansfield General Hospital (the Old Hospital). At the time, he intended to renovate the hospital, making it into a home for himself and various generations of his family

During ownership, a developer had offered him £5,000,000 for the hospital site, which he would have accepted but the deal fell through when the developer had difficulties with planning.

In 2001 a local independent school was being closed as the buildings were to be sold; Mr Hussain considered that it should be saved as it was doing well academically and so he converted the Old Hospital into a school. Unfortunately, most of the pupils had already moved to other schools and so only a small number of children attended. The project was therefore economically unviable and the school closed after a year.

Mr Hussain claimed that from 2002, after the school had closed, he began to occupy the building, moving in some furniture and sleeping there each night. He had installed a water pipe through the building, from the area previously used as a school and had moved a portable heater from room to room as required. He stated that he moved out some time in 2003, when another developer expressed interest in the site.

In 2005, Mr Hussain applied for planning permission to convert the site into 133 apartments but argued that he never intended to undertake the development and did not intend to sell the site. His claimed that he was trying to deflect the council from forcing him to sell to developers.

Later, yet another developer offered him £7,000,000 for the site paying Mr Hussain a non-refundable deposit. The deal fell through, with Mr Hussain keeping the deposit. He did not use any of the funds for refurbishment of the Old Hospital.

In 2013, he eventually sold the Old Hospital to the council because he believed they would force the sale via a compulsory purchase order if he did not accept their offer. He had used the funds to buy another property in central Nottingham and a country property which he said was now used as the family seat and a hotel.

Throughout his period of ownership, he owned a number of other properties, one of which was the White House, his main residence which he occupied both before and after the period in which Mr Hussain stated that he occupied the Old Hospital. He made no election under s222(5)(a) TCGA 1992 to elect which property was his main residence.

He claimed principal private residence relief on the gain arising on sale of the Old Hospital for a period of four years, consisting of his one year of actual occupation as well as deemed occupation for the last three years of ownership (as was the rule at the time – it is now 9 months).

HMRC refused the claim and Mr Hussain appealed.

Decision

The First Tier Tribunal found that the Old Hospital was a derelict building, "not habitable as a dwelling". At best, it was a 'basic shelter'. The limited renovation that Mr Hussain had undertaken was to enable the property to be used as a school, not his main residence. Indeed "no work had been done to convert the property to residential use; old medical equipment remained in place".

Mr Hussain had not shown any intention to occupy the property as his long-term residence. His wife had never been to the property and did not know of his plans for it to become the family home. There was insufficient evidence provided to support his case. Mr Hussain stated that he had not notified any change of address for banking or insurance purposes. Further, he had not notified his car insurers that the car was kept at the Old Hospital overnight during the period for which relief was claimed.

The Tribunal concluded:

> "Taking into account the nature, quality, length and circumstances of Mr Hussain's occupation of the Old Hospital, we do not consider that such occupation was sufficient to amount to 'living in' the Old Hospital".

The Tribunal found that the Old Hospital was not at any time Mr Hussain's 'only or main residence'. The CGT assessment and penalties for carelessness were upheld.

Mumtaz Hussain v HMRC (TC08366)

Obligation to reinstate land

Summary – The trust was not entitled to a CGT deduction for the value of it releasing its tenant from an obligation to reinstate land on the surrender of its lease.

In 1972, the Wakelyn Trust leased an area of land to Brown & Root-Wimpey Highland Fabricators Limited (B&R) for 30 years. The company built a dock and fabrication yard partly on this land, partly on its own adjacent land and partly on former seabed acquired from the Crown Estate. The lease required the company, if so requested by the Trust not less than five years prior to the expiry date to remove all building and structures on the leased land and fill in at its own expense to enable it to support buildings for light industrial purposes.

In December 1996 the lease was extended for a further 30 years.

In October 2011, B&R agreed to sell the yard to another company, Global Energy Nigg Limited (GE). B&R surrendered the lease back to the trust and the trust granted a new lease to GE.

The Trust's 2011/12 tax return included a capital loss of £1,367,000.

Later, it was agreed that the disposal should have been treated as part disposal of an interest in land (s42 TCGA92), with the loss of £1,367,000 previously claimed amended to a gain of £625,000.

HMRC challenged this gain on the basis that the trust had claimed a deduction for enhancement expenditure. The trust argued that the release of a tenant's reinstatement obligation was deductible expenditure unders.38(1)(b) TCGA 1992. HMRC disagreed and issued a closure notice showing a revised gain, indicating that no such deduction was allowable as no expenditure had been incurred. HMRC stated that "even if the trustees had incurred expenditure, the expenditure was neither incurred to acquire the asset held by the trustees (the freehold) nor was it an incidental cost of acquisition or disposal so it is not allowable under either s38(1)(a) or s38(1)(c)."

Decision

The Tribunal stated that they needed to consider whether the term "expenditure" in s 38(1)(b) included the release of a valuable right?

Rejecting the trust's argument, the First Tier Tribunal found that the value of releasing the lessee from their reinstatement obligation was not 'expenditure'. Expenditure can include money and money's worth but a notional cost or value of release from the obligation was not expenditure.

The value of the release was not an 'expense' for CGT purposes.

The Wakelyn Trust v HMRC TC/2019/01108/V (Released 17 January 2022)

IHT: BPR – Company issues in practice **(Lecture P1303 – 10.22 minutes)**

Background

Business property relief (BPR) offers inheritance tax (IHT) relief at rates of 100% or 50% to the extent that a transfer of value is attributable to relevant business property.

AIM listed shares

'Relevant business property' includes an interest in an unincorporated business and unquoted shares in a company, broadly where the unincorporated business or company's business does not consist wholly or mainly of dealing in securities, stocks or shares, land or buildings or making or holding investments (IHTA 1984, s 105(3)).

'Unquoted shares' are defined as shares not listed on a recognised stock exchange. However, shares that are listed, but only on the Alternative Investment Market (or AIM, for short) are regarded as unquoted for BPR purposes.

It is important that individuals investing in AIM shares for BPR purposes recognise that some AIM listed companies have secondary listings on other stock exchanges, which may be recognised stock exchanges, thus depriving the shares of BPR status. Good practice would therefore involve monitoring the company and its activities.

Single company or company with subsidiary?

Another potential BPR pitfall for company shareholders concerns an anomaly in the way that the legislation treats single companies compared to companies with subsidiaries.

Broadly speaking, shares in a group holding company are eligible for BPR if the company's business consists wholly or mainly of holding shares in one or more companies carrying on a business activity that is not wholly or mainly investment (IHTA 1984, s 105(4)(b)).

Even if the shares in the holding company qualify for BPR, there is a restriction in relief if the business of any subsidiaries is wholly or mainly investment. In those circumstances, BPR is only available based on what the value of the holding company shares would have been if the non-qualifying subsidiary or subsidiaries were excluded from the group (IHTA 1984, s 111).

The anomaly in the BPR rules is that shares in a company with no subsidiaries, which is mainly trading but carries on a minor investment business qualifies for BPR in full, whereas if the investment business was carried on by a subsidiary of a trading company and the investment business was the subsidiary's principal activity, BPR would be restricted. HMRC is aware of this anomaly (see HMRC's Shares and Assets Valuation manual, at SVM111190), but seems to consider that Parliament intended the relief to operate in this way. Nevertheless, it is a point worth bearing in mind when considering a group structure.

Ending or reorganising the company

If a company is no longer required, its owners may decide to liquidate or voluntarily wind up the company. As a general rule, the company's shares are excluded from BPR if there is a transfer of value of the shares, and at the time of the transfer of value a winding-up order has been made, or a voluntary winding-up resolution has been passed, or the company is otherwise in the process of liquidation.

However, there is an exception to this general rule if the company's business is going to continue after a reconstruction or amalgamation. This applies if the reconstruction or amalgamation is either the purpose of the winding-up or liquidation, or if it takes place no later than one year after the transfer of value of the shares (IHTA 1984, s 105(5)).

The key requirement for this exception is the continuation of the company's business. If the company has ceased trading and is then being wound up, it is likely that BPR would cease to be available simply because the company is no longer carrying on a business (IHTA 1984, s 103(3)).

Gift followed by a share sale

Another point to watch out for is a gift of shares followed shortly afterwards by a sale of the company.

An anti-avoidance provision that sometimes gets overlooked concerns 'binding contracts. As a general rule, BPR is denied on a transfer of value of the shares if a binding contract for their sale has been entered into at the time of the transfer. However, there are certain exceptions to this general rule. One such exception relates to transfers of shares or securities where the later sale is made for the purpose of a company reconstruction or amalgamation (IHTA 1984, s 113(b)).

Care is needed on a straightforward sale of the shares. For example, if a chargeable lifetime gift of shares (e.g., a gift of shares into a family discretionary trust) is made on which BPR is claimed and this is followed shortly afterwards by a sale of the company, HMRC might check the position carefully to establish whether there was a binding contract for the sale when the gift was made. HMRC's inheritance tax manual (at IHTM25291) advises its officers to investigate such circumstances to ensure that BPR is properly due.

Surplus cash

Another BPR anti-avoidance rule concerns 'excepted assets' (IHTA 1984, s 112). An asset is 'excepted' broadly if it was neither used wholly or mainly for the purposes of the business in question throughout the two years (or any shorter period the company owned the asset) immediately preceding the transfer of value, nor required at the time of the transfer of value for future use for the purposes of the business. Note that both incorporated and unincorporated businesses are potentially affected.

If 'caught' by the excepted asset rule, BPR is broadly restricted by the value attributable to the excepted asset. Only that part of a transfer of value which relates to 'relevant business property' is reduced by BPR; the other part relating to the excepted asset is not reduced by BPR and is chargeable to IHT as normal.

Surplus cash which is excessive for the present and future needs of a trading company will normally be regarded as an 'excepted asset'. In those circumstances, steps should be considered to mitigate the effect of any BPR restriction. For example, the cash might be used to pay business creditors. Another possibility might be to invest the surplus cash to acquire assets that will constitute a business activity, such as a portfolio of shares or investment properties, provided (most importantly) that the company's trading activity remains the dominant activity of the company. BPR should be available on both the trading and investment business activities in those circumstances.

Control of the company

Transfers of shares in unquoted trading companies can generally obtain 100% relief, regardless of the size of the donor's shareholding.

By contrast, if an individual holds shares in a company which constitute relevant business property, and also owns land or buildings, machinery and plant used wholly or mainly by the company, a gift of that asset can obtain BPR at the 50% rate, but only if the shareholder then had control of the company (IHTA 1984, s 105(1)(d)).

A person has 'control' of a company for these purposes broadly if they have voting control on all matters affecting the company as a whole, which if exercised would yield a majority of the votes capable of being exercised.

Helpfully, in determining whether a person is deemed to control a company, any shares that are 'related property' are taken into account (IHTA 1984, s 269(2)). 'Related property' includes property comprised in the estate of a spouse (or civil partner).

On some occasions, the order of gifts may be very important. For example, a gift of shares that reduces the donor's shareholding to less than 50% may result in the loss of BPR on a subsequent gift of the business premises, unless control is retained for BPR purposes taking into account a spouse's shareholding.

However, even if BPR is lost due to making gifts in the 'wrong' order, it is not necessarily a disaster for IHT purposes if the qualifying asset was gifted to another individual, because the gift is a potentially exempt transfer which becomes exempt after seven years in any event. Consideration could be given to taking out insurance against the risk of the transferor's death within that period.

Contributed by Mark McLaughlin

SDLT - grant of call option

Summary – A call option granted by the taxpayer was not an 'other transaction' falling within s.45(1)(b) FA 2003 as that section applied at the time of the transaction. The option holder obtained no entitlement to a conveyance and the scheme failed.

Mr Fanning acquired a residential property in 2011 from an unrelated vendor for £5m via a sub-sale scheme. At the same time as the contract for the acquisition of the property was completed, Mr Fanning granted a call option to San Leon Energy plc (San Leon) for £100 under which San Leon could buy the property for a market value consideration at a later date.

The First Tier Tribunal found that the scheme failed because the grant of the option (the secondary contract for the purposes of s.45(1)(b) FA 2003) was not substantially performed at the same time as the original contract.

Decision

The Upper Tribunal agreed with the First Tier Tribunal that the scheme failed, but for different reasons.

In order for the option to fall within s 45(1)(b) it had to constitute an 'other transaction' as a result of which another person becomes entitled to call for a conveyance of the property. The Upper Tribunal found that San Leon (the option holder) had no entitlement to a conveyance until it exercised the option.

It was not entitled to exercise the option on completion—the option period commenced five years later. As San Leon had no entitlement to a conveyance, the option could not be the secondary contract for the purposes of s 45(1)(b). The Upper Tribunal held that a contingent future entitlement to a conveyance was not sufficient.

The Upper Tribunal analysed the interaction of s.44 FA2003 (contract and conveyance) and s.45. It found that s.44 refers to an entitlement that is definite rather than contingent when it refers to a contract that is to be completed by a conveyance. It considered that s.45(1)(b) had to involve a similar entitlement. The entitlement that San Leon obtained was contingent in nature and did not confer the entitlement for s 45(1)(b) to apply.

The Upper Tribunal disagreed with the taxpayer's suggestion that Vardy Properties and another v HMRC [2012] SFTD 1398 was authority for the option falling within s 45(1)(b).

The Upper Tribunal also commented that HMRC were entitled to revive an argument that failed before the First Tier Tribunal in its respondent's notice without seeking permission to appeal. This was because HMRC were not seeking a different decision to that made at the First Tier Tribunal (and follows the case of HMRC v SSE Generation Ltd [2021] EWCA Civ 105).

As part of the appeal, HMRC were entitled to rely on arguments that had failed at the First Tier Tribunal as the First Tier Tribunal had decided the matter entirely in HMRC's favour (even if the particular argument had been rejected). The position would have been different if the First Tier Tribunal decision had not been entirely in HMRC's favour, as happened in SSE Generation. In that case, the First Tier Tribunal decided that some expenditure qualified for capital allowances and HMRC appealed; by its respondent's notice, SSE asked the Upper Tribunal to hold that all the expenditure was allowable. The Court of Appeal held that it could not do this by way of a respondent's notice but had required permission to appeal. It suggested that appellants wishing to challenge arguments in a respondent's notice should raise them either in a reply to a respondent's notice or an interlocutory application so that the issue can be resolved in advance of the hearing.

Oisin Fanning v HMRC [2022] UKUT 00021 (TCC)

Adapted from the case summary in Tax Journal (4 February. 2022)

IHT stocks and shares valuation

On 1 February 2022, HMRC published new guidance on how to value stocks and shares on death for inheritance tax purposes.

The guidance explains how to value both listed and unlisted shares.

For those needing help with unlisted shares, the guidance provides contact details for HMRC's Shares and Assets Valuation team.

https://www.gov.uk/guidance/valuing-stocks-and-shares-for-inheritance-tax

No repayment of Additional dwelling supplement

Summary – The repayment of Additional Dwelling Supplement was not allowed on the sale of his first property as the owner had never occupied the property as their residence in the 18 months before sale. It made no difference that overseas military service had been the reason for not occupying it.

Dr Christie was a doctor in the British Army. Whilst serving in Cyprus, his wife bought a property with the intention of the family living there when they returned to the UK.

However, from August 2015 to December 2019, he was posted to Canada where the family lived in army accommodation and so the property was rented out.

From January 2020, he was posted to Scotland. Prior to this, in September 2019, the couple had purchased a second property in Scotland submitting a Land and Buildings Transaction Tax return and paying the Land and Buildings Transaction Tax, including the Additional Dwelling Supplement that was due of £22,000.

However, in February 2021, the first property was sold and Dr Christie submitted a claim for repayment for the £22,000. He included a letter explaining that the first property had been their only property and the only reason that they had been unable to reside in it was because of the posting overseas. He pointed out that the Armed Forces Covenant states that

serving personnel should 'face no disadvantage' due to military service and 'the taxation system may be adapted to reflect their circumstances'.

Revenue Scotland rejected the claim on the grounds that the first property had not been his main residence at any point in the 18 months before purchase of the second property.

Dr Christie appealed.

Decision

The First Tier Tribunal sympathised with Dr Christie, acknowledging that he had no choice as to when and where he was posted. Further, the Tribunal acknowledged that the only reason that he did not occupy his first property was due to being posted abroad.

Further, the Tribunal accepted that the Armed Forces Covenant stated that military personnel should receive fair treatment and experience no disadvantage compared with civilians However, the Tribunal found that the Land and Buildings Transaction Tax Act was very clear as to when repayment of the Additional Dwelling Supplement was permitted. The Act did not contain any exceptions for members of the armed forces.

Dr Christie's appeal was dismissed.

Dr Andrew Christie v Revenue Scotland ([2022] FTSTC 2)

Administration

Carelessness by accountant

Summary – HMRC's discovery assessment was valid as a tax adviser was careless in completing the taxpayer's return when he completed it based on advice from the scheme promoter without understanding the tax scheme or seeking advice from someone who did.

During 2008/09, Jason Callen participated in a tax avoidance scheme known as the Montpelier Section 730 Dividend Strip Scheme. Under the scheme he sought to set off losses against income from his trade in that year and then carry forward the balance to the next year.

Following an enquiry into Jason Callen's affairs, HMRC raised Discovery Assessments for 2008/09 and 2009/10 totalling approximately £800,000.

Acknowledging the Upper Tribunal's decision in Clavis Liberty 1 LP v HMRC [2017] STC 2392, Jason Callen accepted that the Montpelier scheme did not work. The issue in this case was whether his inaccurate tax return was due to careless behaviour by either himself or his tax adviser. He sought to overturn the assessment by arguing that the assessments were out of time, as reasonable care had been taken.

His adviser, who was an accountant, simply accepted that the scheme worked and submitted the returns on that basis. He had little experience of tax avoidance schemes, and simply "copied the entries provided to him by Montpelier in a spreadsheet with little or no thought as to whether they were correct."

Decision

The First Tier Tribunal stated that Jason Callen's tax adviser should be judged by the standard of a reasonably competent tax adviser.

The Tribunal found that the adviser had not advised Jason Callen that he lacked the necessary expertise to correctly complete his returns; nor did he seek the advice of a third party with the required expertise. He had simply copied the data provided by the scheme promoter into the return and did not question whether the amounts were deductible. He made no attempt at any independent assessment of the correct tax position.

The First Tier Tribunal found that the tax adviser had carelessly prepared and submitted the returns and the discovery assessment was therefore upheld. Having found his adviser to be careless, the tribunal stated that it did not need to make similar findings of Jason Callen or the scheme promoter.

Jason Callen v HMRC (TC 08392/V)

Penalty mitigation – reasonable excuse **(Lecture P1305 – 14.08 minutes)**

The issue of penalty mitigation is an important one for advisers. This session will consider the principle of reasonable excuse and includes practical considerations for advisers dealing with a case where it is, or may be, relevant.

Overview of reasonable excuse

A reasonable excuse may provide a defence for a person against penalties imposed by HMRC for certain compliance failures, including the following:

- Late filing of returns, Schedule 55, FA 2009;
- Failing to make a payment on time, Schedule 56, FA 2009;
- Failing to notify chargeability, Schedule 41, FA 2008;
- Failing to notify under the Requirement to Correct provisions, Section 67 and Schedule 18, Finance (No. 2) Act 2017.

It is important to recognise that the term "reasonable excuse" is not defined in statute. The phrase takes its normal meaning. This means that each case must be determined by its own facts and merits, and the circumstances of the person.

The onus is on the tax taxpayer to demonstrate that they had a reasonable excuse for the failure giving rise to the penalty. Consideration of how this might be done is covered later in this article. It is important to recognise that there are two stages to a reasonable excuse defence. It is not sufficient that the client had a reasonable excuse – they must also have addressed the relevant failure without unreasonable delay (not defined) after the reasonable excuse has ceased to apply.

Reasonable excuse is not the same as reasonable care, although there may be an overlap between the two concepts.

What is a reasonable excuse?

As noted above, there isn't a statutory definition of reasonable excuse. The following might be a reasonable excuse:

- Coronavirus;
- Mental health;
- Physical illness;
- Bereavement;
- Ignorance of the law;
- Reliance on another person (which might include an HMRC officer);
- Service issues with HMRC's Online Service;
- Delay caused by HMRC.

There may be a combination of factors which contribute to the reasonable excuse. Each case must be considered on its own facts, and by reference to the person's abilities and circumstances. What constitutes a reasonable excuse for one person might not apply to another person.

What is not a reasonable excuse?

Although there isn't a statutory definition of what is a reasonable excuse, statute provides that an insufficiency of funds or reliance on a third person does not constitute a reasonable excuse. However, there are exceptions to this provision.

In addition to the statutory provisions, there are various situations that, on their own, HMRC will not normally accept, as a reasonable excuse, including the following:

- Pressure of work;
- Lack of information;
- Lack of a reminder from HMRC;

What is HMRC's view on reasonable excuse?

HMRC's guidance on reasonable excuse is contained in the Compliance Handbook (CH160100 to CH160950). The guidance has recently (January 2022) been updated, and HMRC now recognises that the "law does not require that a reasonable excuse is based on an unforeseeable or inescapable event". This is a welcome change and reflects a shift from the position previously taken by HMRC. The guidance also states that a reasonable excuse is "something that stops a person from meeting a tax obligation despite them having taken reasonable care to meet the obligation". Advisers should point HMRC officers to their own guidance manual if they are not familiar with the updated HMRC view of reasonable excuse.

The test for reasonable excuse

It is difficult for advisers to refer to tribunal decisions for relevant examples of reasonable excuse, as it is unlikely that the facts and circumstances of a case will exactly mirror their client's position. The upper tribunal decision of Perrin v HMRC [2018] UKUT 156 [TC] is a case worth referring to, as it sets out a four-step process, summarised below, for determining if there is a reasonable excuse:

1. Establish what facts the taxpayer asserts give rise to a reasonable excuse;
2. Decide which of those facts are proven, based on the evidence available;
3. Decide whether, viewed objectively, those facts amount to an objectively reasonable excuse for the default and the time when that objectively reasonable excuse ceased;
4. Decide whether the taxpayer remedied the failure without unreasonable delay after the reasonable excuse ceased (unless they had already done so before the reasonable excuse stopped).

The evidence needs to be considered on the balance of probabilities. In the Perrin case, the tribunal also made the point that, before any question of reasonable excuse is considered, it is important to remember that the initial burden lies on HMRC to establish that events have occurred as a result of which a penalty is due.

Practical considerations

The first point for the adviser to consider is the last one made in the preceding paragraph – if there has not been a failure which is subject to a penalty, you do not need to consider reasonable excuse. Where there has been a failure, you need to establish all relevant facts, including timings. I have assisted numerous advisers and their clients over the years on this area.

In many cases, even where the adviser has considered that there might be a reasonable excuse, there has been an absence of fact-finding, and exploring all potential avenues to build a defence. This process includes collating supporting documentation, the detail of which will depend on the circumstances of the case. Advisers should follow the four-stage test, noted above, and, where they consider there is a reasonable excuse, ensure that the facts are presented to HMRC, together with appropriate supporting documentation.

Where advisers are unsure whether their client has a reasonable excuse, they should consider seeking specialist advice, which may extend to assistance in presenting the facts to HMRC.

Other considerations

If the HMRC officer does not accept that there is a reasonable excuse, the adviser has other options:

- Seeking a statutory review of the officer's decision;
- Alternative Dispute Resolution;
- Appeal to the tribunal.

Another option for advisers to consider is whether there are special circumstances, such that the penalty can be reduced under the provisions relating to special reduction.

Contributed by Phil Berwick (Director, Berwick Tax)

Year-end payroll procedures **(Lecture B1304 – 18.39 minutes)**

This article provides a useful summary of the payroll tasks that need to be undertaken by the employer when transitioning from 2021/22 through into 2022/23.

Running the final payroll for 2021/22

For monthly paid employees, this will be the March payroll but remember there will be a 53, 54 or 56-week run where employees are paid weekly, two weekly or four weekly respectively.

A word of warning for directors. Remember their national insurance contributions are calculated on a cumulative basis so the employer will need to check at the year-end that they have paid the correct amount for the year.

File final full payment submission (FPS) report

Having run the payroll for last pay day in tax year, we must file the final FPS report for the tax year and this must be done on or before pay day. When filing this last report it is important to remember to insert 'YES" in the "final submission for year" field.

The filing deadline for the final FPS is 19 April 2022 which means that the report filed on or before the final pay day can be corrected up until this date.

File final employer payment summary (EPS)

Where an adjustment is needed to the FPS, the employer must submit an EPS. This could be because the final FPS needed changing due to an SMP reclaim or a number of other reasons. Maybe the employer did not have any employees to pay in the final payroll period and so no FPS was submitted or simply be due to the employer omitting "YES" in the "final submission for year" field.

Final Payroll Checklist:

Here is a list of the steps that should have been undertaken by 19 April 2022:

- Do PAYE/NIC payments made to HMRC agree with payroll deductions? If not, check and reconcile and amend
- Do CIS deductions made agree to CIS paid to HMRC?
- Have claims been made on EPS to recover:
  - SMP/SAP?
  - SSP rebate re COVID-19?
  - Employment allowance?
  - CIS suffered if limited company?

If not submit final EPS and make final payment to HMRC by 19/22 April 2022

Errors found after 19 April 2022

If an error is found after 19 April and after submission of the final FPS or EPS:

From April 2020 onwards any correction to 2020/21 and future years must be made on an FPS. This means that corrections for the 2021/22 tax year filing will be made on an FPS in the 2022/23 tax year. In this situation, the FPS reports the current payroll run as usual. The employer would then run a second FPS to show the amendments to the payroll in the prior tax year using the "late reporting" submission (option H- correction to earlier submission), enabling HMRC to pick it up as being a change to a prior tax year.

Issue P60s for 2021/22

The employer must issue 2021/22 form P60s to employees by 31 May 2022.

These are only issued to employees still working for the employer at the tax year end. Remember, leavers during the tax year will already have been issued a P45.

The P60 shows:

- gross taxable pay;
- tax paid – total, in this employment and prior;
- national insurance contributions;
- Statutory payments – SMP, SAP, SSP etc;
- Student and post graduate loan deductions;
- NI number and tax code;
- Employer PAYE reference.

Update payroll software for 2022/23

Employers must download updates from the software provider for 2022/23 and ensure that it is using:

- Correct allowances for 2022/23;
- Correct UK and Scottish tax bands;
- UK tax rates – 20%, 40% and 45%;
- Scottish tax rates – 19%, 20%, 21%, 41% and 46%;
- Updated thresholds for national insurance;
- 2022/23 rates for statutory payments – SMP, SAP, SSP etc.

Update payroll records for 2022/23

The basic tax code usually changes from one tax year to the next, after the budget. However, for 2022/23, the standard tax code remains unchanged at 1257L

When an employee with a week1/ month 1 tax code moves into the new tax year, this week1/month1 indicator can be removed from 6 April 2022.

Where HMRC want to vary a tax code for an employee, they will issue a P9T form indicating that this is the case.

Expenses and benefits

The filing deadline for the 2021/22 P11D forms is 6 July 2022 and the related Class 1A employer NIC is payable by 19/22 July 2022.

If a PAYE Settlement Agreement (PSA) is in place the calculations must be submitted to HMRC by 31 July 2022 and the related Class1B employer NIC paid by 31 October 2022

Checklist for start of new tax year

And finally, here is a checklist for the start of 2022/23:

- Have new tax codes from HMRC been entered for employees?
- Have 2021/22 week 1/month 1 indicators been removed?
- Check criteria for claiming employment allowance and claim it on first EPS;
- Note new rates for SMP/SAP/ShPP/OSP - £156.66 weekly from 3/4/22;
- Note new rates for SSP - £99.35 weekly from 6/4/22;
- Ensure pay rates comply with both the National Minimum Wage and National Living Wage. from first full pay period after 1 April 2022.

Created from the seminar recorded by Alexandra Durrant

Deadlines

1 March 2022

- SME Corporation tax for periods ended 31 May 2021, not paying by instalments

2 March 2022

- 5% penalty from today for unpaid 2020/21 income tax/class 4 NICs

7 March 2022

- VAT returns and payment for 31 January 2022 quarter (electronic payment)

14 March 2022

- Quarterly corporation tax instalment for large companies depending on year end

19 March 2022

- PAYE, NICs, CIS and student loan liabilities for month to 5 March 2022 (non-electronic payment
- File monthly CIS return

21 March 2022

- File online monthly EC sales list – Only Northern Ireland businesses selling goods
- Supplementary intrastat declarations for February 2022
    - arrivals and despatch for a business in Northern Ireland

22 March 2022

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

31 March 2022

- Companies House should have received accounts:
    - private companies with 30 June 2021 year ends
    - public limited companies with 30 September 2021 year ends
- S.455 reclaim deadline for loans repaid during the year ended 31 March 2018
- CTSA returns for companies with accounting periods ended 31 March 2021

News

HMRC interest rates increase

On 2 February 2022, the Bank of England Monetary Policy Committee to increase the Bank of England base rate to 0.50% from 0.25%.

As HMRC interest rates are linked to the Bank of England base rate, the rate applied:

- to the main taxes became 3% from 21 February 2022 for non-quarterly instalments payments;
- on underpaid quarterly instalment payments became 1.5% from 14 February 2022.

The rate of interest on repayments from HMRC remains unchanged at 0.5%.

https://www.gov.uk/government/news/hmrc-late-payment-interest-rates-to-be-revised-after-bank-of-england-increases-base-rate--2

Business Taxation

Adrian Chiles - IR35 did not apply (Lecture B1301 – 16.48 minutes)

Summary – Although mutuality of obligation and control existed, Adrian Chiles was found to be operating his own hypothetical business that included working under contracts for both ITV and BBC. The IR35 rules did not apply.

In 1996, the BBC required Adrian Chiles to cease employment with them but to continue providing his services through his personal service company, Basic Broadcasting Ltd. This case concerns the tax years 2012/13 to 2016/17 during which time Basic Broadcasting Ltd provided Adrian Chiles's services for contracts with both the BBC and ITV as well as some other parties.

HMRC argued that during this time the intermediaries legislation applied to both the BBC and ITV contracts and issued determinations for income tax and national insurance contributions of £1,249,433 and £460,739 respectively. The determinations were made on the basis that hypothetical contracts between the BBC/ ITV and Adrian Chiles would have been contracts of service (employment) rather than contracts for services (self-employment).

Basic Broadcasting Limited argued that Adrian Chiles was a self-employed contractor, with no further liability on the part of his personal service company. In November 2021, Basic Broadcasting Limited made an application for disclosure of material in relation to IR35 decisions concerning television and radio presenters currently on appeal to the Upper Tribunal and the Court of Appeal. However, the First Tier Tribunal refused both of these applications.

Decision

The Tribunal stated that it was common ground that there was mutuality of obligation in relation to the BBC Contracts and found that mutuality of obligation also applied to the ITV contracts. Although there was no obligation on ITV to offer work, it was anticipated that ITV would offer work and that payment would be made for the work. ITV did call on Adrian Chiles to provide his services throughout the ITV contracts.

The Tribunal moved on to consider whether each of the contracts involved a sufficient framework of control to constitute contracts of employment by considering who controlled what, where, when and how his work was to be done. The Tribunal stated that in their view editorial control of the programme, including adherence to Ofcom rules and the BBC Standards and Editorial Guidelines, the form and content of the programme, the requirement to interview a particular guest or to require the presenter to move to a commercial break, was a relevant and important element of control. On balance, the Tribunal concluded that under both the ITV and BBC hypothetical contracts there was a sufficient framework of control to constitute Adrian Chiles being treated as an employee. Despite this conclusion, the Tribunal did not consider that the extent of either ITV or the BBC's control was in either case is a compelling factor.

The First Tier Tribunal considered whether there were other provisions of the contracts or other factors which resulted in the hypothetical contracts being contracts for services. In the Tribunal's view the most significant other factor to consider was whether Adrian Chiles

would have been in business on his own account, with the hypothetical contracts being seen as part of that business.

Adrian Chiles had contracted with nearly 100 different third parties and had undertaken a significant amount of other work in relation to projects which had not 'borne fruit'. He had also turned down a significant number of appearances on television. Further he had appointed both a managing agent to promote and further his career and reputation in the entertainment industry and a personal assistant to manage day-to-day affairs at significant cost to him. The Tribunal concluded that it was clear that Adrian Chiles, through his personal service company, was building a business and his agent was helping him to build that business.

But were the hypothetical contracts separate contracts of employment with ITV and BBC, or were they part of this busines? The Tribunal noted that the contracts involved Adrian Chiles working for the competing broadcasters at the same time as a TV presenter for ITV and a radio presenter for the BBC. Considerable research and preparation for both was undertaken when and where he chose. He provided some of the tools and resources required for the better performance of his duties. All of these were matters pointing towards both the ITV and BBC contracts being part of his business.

Although the contracts prohibited a substitute presenter, the Tribunal considered that this reflected the nature of the industry in which he worked. He was not in the business of supplying presenters, but rather supplying his own services as a presenter.

The income generated from his work with both ITV and the BBC was significant, but the Tribunal acknowledged that it is not uncommon for a business to have individual clients contributing a large proportion of turnover. The services provided for both ITV and BBC 'fell fairly and squarely within the scope of his existing business activities'.

Looking at the big picture, the Tribunal concluded that the hypothetical contracts formed 'part and parcel' of his own business and that IR35 did not apply.

The appeal was allowed.

Basic Broadcasting Limited v HMRC (TC08400)

Compensation and Consumer Redress **(Lecture B1301 – 16.48 minutes)**

Summary – Compensation and Consumer Redress payments were not incurred wholly and exclusively for the purposes of the trade and Redress payments did not qualify as charitable donations.

The companies were licensed non-domestic energy suppliers, one supplying electricity and the other supplying gas. Between them they had some 40,000 customers, most of which were small businesses.

Following an investigation by the Gas and Electricity Markets Authority, the companies admitted seven regulatory breaches and a Settlement Agreement was signed. This required the companies to pay compensation to affected customers (Compensation Arrangements) and make a charitable donation to the Money Advice Trust (Consumer Redress).

The companies reduced their profits chargeable to corporation tax by the total value of the payments relating to the Compensation Arrangements and the Consumer Redress.

HMRC argued that the settlement agreed was a penalty, as the Settlement Agreement was entered into to avoid higher penalties being levied by Ofgem. A total of £980,000 between the two companies should not be deductible. They did, however, allow deductions for the payments in excess of that, and also in the following year since they were not included in the Settlement Agreement.

The companies appealed, arguing that the payments were incurred wholly and exclusively for the purposes of their trades, making them deductible from their trading profits. If this was not the case, the Consumer Redress payments qualified for relief as charitable donations.

Decision

All parties agreed that the leading authority on the scope of entitlement to deduct expenses relating to disciplinary or regulatory proceedings was the House of Lords judgment given by Lord Hoffman in McKnight v Sheppard. In this case it was decided that penalties were not incurred to enable the company to generate profits but rather "they were unfortunate incidents which followed after the profits had been earned", making them non-deductible.

In this case, the reason for the Settlement Agreement payments was that Ofgem required this as an alternative to levying a more substantial penalty. As a result, applying the principle in *McKnight* the payments were not deductible as they were made in order to punish the companies. It did not matter that the package of payments was a penalty to be paid to third parties rather than HMRC. To be incurred wholly and exclusively for the purposes of the trade payments must be made for the purpose of earning profits. In this case payments were made to reduce the total potential financial burden and to settle the enquiry. Referring to *McLaren Racing Ltd v HMRC*, it was stated that:

> "A deliberate activity which is contrary to ... the rules and regulations governing the conduct of the trade, which is not an unavoidable consequence of carrying on a trade and which could lead to the destruction of the trade is not an activity carried on in the course of that trade ...".

The Tribunal found that the companies had made a deliberate decision not to invest in their complaints handling processes and it was this that caused the breaches that were made, resulting in the penalties being imposed. Consequently, the Tribunal held that the payments were not incurred wholly and exclusively for the purposes of the taxpayers' trade.

Finally, could the Consumer Redress payments be treated as charitable donations? "Qualifying charitable donations" are defined by s.190(1)(a) CTA 2010 as "payments which are qualifying payments for the purposes of Chapter 2". They can only qualify if Conditions A to F set out in S.191 CTA 2010 are met. In this case, HMRC agreed that Conditions A-E were met but challenged Condition F (that the payment is not disqualified under S.195 (associated benefits received by the company). Agreeing with HMRC, the Tribunal found that agreeing to make the Consumer Redress payments gave the companies the right to pay a lower sum overall which was a valuable benefit. The Tribunal found that the Settlement Agreement made it clear that if the sums were not paid, the penalty would be higher. With the

Consumer Redress providing for a 'lesser outlay', the payments did not qualify for charitable donations relief.

The companies' appeal was dismissed.

BES Commercial Electricity Ltd and Business Energy Solutions Ltd v HMRC (TC08340)

Farming loss relief denied (Lecture B1301 – 16.48 minutes)

Summary - The farming taxpayer was not entitled to sideways relief for any of the five years of claimed losses as the reasonable expectation of profit test was not met.

In 1995 Mr Naghshineh bought a working farm together with 75 acres of agricultural land. Realising that he could obtain premium prices for organic farm produce compared to conventional produce, he decided to convert the farm to organic production. To make the farm economically viable he acquired a further land in the years that followed so that in total he was managing 438 acres. Further, he decided to work towards ways of direct selling to the public, which he thought would enable him to achieve significantly higher prices than conventional routes.

He was a businessman and had no experience of running a farm, he never lived in the farmhouse and, in 2007, he employed a general manager but had to make him redundant in 2010.

He operated on an organic basis until 2009/10, but for a number of reasons decided to revert to farming on a conventional basis. Over the years he carried on various different agricultural and non-agricultural activities on the farm, with activities often changing from year to year but broadly falling into three categories:

1. arable, comprising crop, vegetable, and fruit production;

2. livestock, comprising the rearing of cattle and sheep;

3. egg production.

Additional business ventures included a direct delivery box scheme, a farm shop, renting out of property on his land, a micro-brewery and a mustard business.

At all material times Mr Naghshineh intended that the farm should operate on a commercial basis and should realise profits. However, he made losses from 1994/95 until 2011/12, finally becoming profitable from 2012/13, 18 tax years from when he started.

Mr Naghshineh claimed sideways loss relief for the five-year period to 2011/2012 but HMRC denied the relief on the grounds that there was no expectation of profit before 2010. (s.67 ITA 2007: sideways loss relief is denied where losses have arisen for each of the previous five tax years unless the taxpayer can meet the reasonable expectation of profits test in s 68).

The First Tier Tribunal allowed the appeal but this was overturned by the Upper Tribunal. The case moved to the Court of Appeal.

Decision

The Court of Appeal agreed with the Upper Tribunal and effectively confirmed that s.68(3) ITA 2007 allowed the five-year rule to be extended where farming activities were expected reasonably to be profitable. In looking at this time frame, s.68(3)(b) did not state that it was appropriate to consider the competence of the farmer (as the First Tier Tribunal had done). The legislation stated that in considering the extension, the farmer was a competent person.

Based on the expert's evidence presented in this case, there was a reasonable expectation that a competent person would make a profit from the activities undertaken well before it actually did.

With the business not run on a commercial basis, sideways loss relief was not available and the appeal was dismissed.

Ardeshir Naghshineh v HMRC [2022] EWCA Civ 19

Denial of R&D tax credit

Summary – HMRC were correct to deny an R&D tax credit claim on the grounds that the company was in liquidation.

Incorporated in 2009, Megablue Technologies Ltd developed and provided telecommunications equipment. The changing technology needed to move from 2G through to 4G meant that the company required continual development of its offering.

The company successfully claimed and received R&D tax credits for the periods to 31 March and 30 June 2017.

However, its claim in November 2018 for the period to 30 June 2018 was challenged by HMRC when they opened an enquiry into the claim, 81 days after it was submitted.

In June 2019, the company entered voluntary liquidation.

Two months later, HMRC issued a closure notice disallowing the claim on the grounds that the company was in liquidation, which meant that the going concern condition in s.105(2) CTA 2009 was not met.

The Directors' report in the Liquidator's Report to Creditors attributed the company's failure to four factors:

1. an acrimonious trade dispute;
2. the delay in the receipt of the R&D tax credit
3. lack of orders; and
4. the failure to obtain an export licence.

The company appealed arguing that HMRC had treated the company 'unfairly and unreasonably'. Given that the company's previous claims had been paid in accordance with HMRC's Guidance the company had a legitimate expectation that HMRC would comply with it in relation to subsequent claims.

Further, HMRC had failed to comply with their Guidance by not making payment within 28 days and not opening their enquiry before the expiration of 60 days. The company argued that the delay had caused the company's insolvency and liquidation

Decision

The First Tier Tribunal stated that even if they agreed that HMRC had acted unreasonably, they were limited to deciding whether HMRC had acted within the law.

The company had not argued that the conclusions reached by HMRC and the consequent amendments were not in accordance with the law, and, even if they had, based on the facts, HMRC's decision was in accordance with the law.

The judge concluded by stating that although an action for judicial review of HMRC's actions could succeed, given the caveats in the Guidance this would be difficult. There could be scope for the company to use HMRC's complaints procedure in relation to the delay in opening the enquiry and failing to make payment but this was wholly outside the Tribunal's remit.

The appeal was dismissed.

Megablue Technologies Ltd (In Liquidation) v HMRC (TC8376/V)

SME R&D relief - subsidised expenditure (Lecture B1302 – 12.07 minutes)

In computing their taxable profits, small and medium-sized companies are able to claim a special enhanced deduction in respect of their qualifying revenue R&D expenditure (S1044 CTA 2009). With effect from 1 April 2015, this allowable deduction (often referred to as a 'super-deduction') has been set at 230% of the relevant expenditure. For a company paying corporation tax at 19%, it represents an effective tax relief of 43.7%.

In order for a company to be classified as an SME, it must have:

- fewer than 500 employees (see Illustration below); and
- either:
  - a turnover not exceeding €100,000,000; or
  - a gross assets total in its balance sheet not exceeding €86,000,000.

Clearly, such companies may still be very substantial enterprises.

Illustration

For its year ended 31 December 2021, Brandon Industries Ltd employed the following staff:

- 440 full-time employees;
- 80 part-time staff (50 working 3 days a week and 30 working 4 days a week);
- 5 employees who joined the company on 1 June 2021;
- 3 employees who left the company on 31 March 2021;
- 10 apprentices who were employed for the whole year; and
- 2 employees who went on parental leave from 1 August 2021.

The employee headcount for Brandon Industries Ltd is calculated as follows:

Full- time		440.00
Part-time	(50 x 0.6) + (30 x 0.8)	54.00
New joiners	5 x 214/365	2.93
Leavers	3 x 90/365	0.74
Parental leave	2 x 212/365	1.16
		498,83

This is below the 500-employee limit and so Brandon Industries Ltd meets the headcount requirement for being an SME.

Apprentices and students with vocational training contracts are not included in the headcount.

A company cannot claim R&D relief for expenditure which is subsidised (S1052(6) CTA 2009). The definition of 'subsidised' is set out in S1138 CTA 2009 and particular note should be taken of S1138(1)(c) CTA 2009 which states that there is deemed to be a subsidy where the expenditure 'is met directly or indirectly by a person other than the company'. The rationale for this stipulation is clear: if the company is not incurring the relevant costs, it should not be supported by the tax system.

Judgment in the case of Quinn (London) Ltd v HMRC (2021) has recently been published by the First-Tier Tribunal. The taxpayer company (Quinn) carried on a trade of providing construction and refurbishment works to a range of clients in return for an agreed price. HMRC accepted that Quinn was an SME and had expended sums on R&D which it was entitled to deduct in computing its taxable profits. However, HMRC contended that the company was not entitled to the enhanced R&D relief claimed on the basis that the relevant expenditure was 'subsidised' within the meaning of S1138(1)(c) CTA 2009.

What is subsidised expenditure? No-one doubts that, if a company receives a grant for a particular project, then this will represent a subsidy. But, in this case, Quinn, which HMRC accepted was carrying out appropriate R&D work, factored the cost of its R&D activities into the overall price which the company charged under the various contracts with its clients. Did that constitute subsidised expenditure? In an important decision, the First-Tier Tribunal judge (Judge Harriet Morgan) ruled that it did not. Judge Harriet Morgan's key conclusion in Para 47(5) deserves to be quoted in full:

> 'It would be wholly out of kilter with the overall SME scheme if an SME were to be denied enhanced R&D relief solely because, in doing what is envisaged by the legislation (namely, utilising the relevant R&D for the purposes of its trade), as is usual and to be expected of an entity carrying out a trade on a commercial basis, it seeks to recover some or all of the relevant costs of the R&D under its commercial contracts with its clients entered into in the course of its ordinary trading activities. Indeed, if HMRC's approach were to be adopted, the circumstances in which an SME could claim enhanced R&D relief would seem to be confined to those where it has no prospect of exploiting the R&D for commercial gain.'

It is difficult for the speaker to see why HMRC took this case because, as Judge Harriet Morgan implied, HMRC's arguments – taken to their logical conclusion – would have severely curtailed the scope for companies to obtain tax credits for genuine R&D activities.

All tax advisers involved with R&D claims will have breathed a sigh of relief that the judge's finding went the way that it did.

Contributed by Robert Jamieson

What is plant?

Summary - The First Tier Tribunal's decision denying plant and machinery capital allowances on expenditure on the construction of a nuclear deconversion facility had included several errors of law. The case was remitted back to the First Tier Tribunal to remake the decision.

The company spent £1bn constructing a 'tails management facility' for the processing of depleted uranium tails. The treatment for capital allowances of most of the expenditure was agreed but £192m was disputed by HMRC. The First Tier Tribunal dismissed the company's appeal. It held, firstly, that some of the disputed assets were merely part of the setting in which plant and machinery functioned and so were not themselves plant. However, all of the assets were excluded by s.21 CAA 2001 as buildings or items incorporated in or connected with buildings. None of the expenditure was saved from that exclusion by inclusion in list C in s.23 CAA 2001. The company appealed.

Decision

The Upper Tribunal identified the following errors of law made by the First Tier Tribunal:

- In applying the 'functional' test, the First Tier Tribunal had decided that a safety function was not relevant to whether an asset performs a function in the trade. The Upper Tribunal said that where, as in the case of the nuclear industry, the trade itself was 'shaped and determined' by the regulatory environment, that environment must be relevant to assessing functionality. The First Tier Tribunal had stated that, without the safety structures, the processes concerned could still have been carried out efficiently, but in fact, they could not have been carried out at all.

- The First Tier Tribunal had misdirected itself in concluding that the walls and slab of the vaporisation facility were not plant because they performed a premises like function. The Upper Tribunal held that the correct principles were that, where there is an item of plant, expenditure may qualify as being 'on the provision' of that plant if it is incurred on acquiring title, delivery or transport or installation. If the result is a physical item, it is not relevant whether that item itself functions as plant or premises.

- In determining whether the assets were buildings within s.21, the First Tier Tribunal took as its starting point the ordinary everyday meaning of the term but failed to consider the various potential meanings and to consider which would best fit. It also focused on the appearance or characteristics of the assets rather than on function.

The Upper Tribunal considered that it was wrong to adopt an approach in which physical characteristics are predominant and the actual functions are subsidiary. The Upper Tribunal dismissed the company's appeals relating to the application of list C but remitted the remaining issues to be reconsidered by the First Tier Tribunal, applying the correct legal tests as identified by the Upper Tribunal.

Urenco Chemplants Limited and Urenco UK Limited v HMRC [2022] UKUT 00022 (TCC)

Adapted from the case summary in Tax Journal (11 February 2022)

Deferred tax – dealing with tax rate changes (Lecture B1303 – 17.13 minutes)

FRS 102 and IFRS (IAS 12) state that we must use the rates of tax enacted or substantively enacted by the balance sheet date which are expected to apply when timing differences reverse in calculating deferred tax assets and liabilities.

'Substantially enacted" in the UK is usually taken to be after the third reading of the Finance Bill in the House of Commons.

However, occasionally a tax rate change is presented as part of the Budget Resolution after the post-Budget debate as it was when the Chancellor cancelled the legislated reduction in corporation tax rate from 19% to 17% in 2020.

The increase in the corporation tax rate from 19% to 25% from 1 April 2023 for companies with augmented profits above the upper profit limit of £250,000 was substantively enacted on 24 May 2021, so must be used for accounting periods ending on or after that date.

It is important to establish in which chargeable accounting periods the timing differences are expected to reverse then apply the appropriate rate of tax for those periods.

Some tax software will automatically calculate deferred tax at 25% at the moment unless the reversals are specifically scheduled and calculated for each future period.

Example – deferred bonus

A company with a December year-end accrued a December 2021 deferred bonus of £70,000 (leaving it with a profit of £300,000).

This will be paid in mid-January 2024 when it will become tax-deductible.

Assuming a tax rate of 19% throughout, prepare a summary P&L:

1. Using FRS 105 (where no deferred tax can be recognised), and

2. Using FRS 102 (where deferred tax must be booked)

Analysis

	FRS 105	FRS 102
Profit before tax	**300,000**	**300,000**
Current tax expense (19% on £370,000)	70,300	70,300
Deferred tax (timing difference £70,000 @ 19%)	N/A	(13,300)
Total tax expense	**70,300**	**57,000**
Profit after tax	229,700	243,000
Effective tax rate	**23.4%**	**19%**

Analysis using enacted tax rates:

	FRS 105	FRS 102
Profit before tax	**300,000**	**300,000**
Current tax expense (**19%** on £370,000)	70,300	70,300
Deferred tax (timing difference £70,000 @ **25%**)	N/A	(17,500)
Total tax expense	**70,300**	**52,800**
Profit after tax	229,700	247,200
Effective tax rate	**23.4%**	**17.6%**

Mini tax reconciliation:

Profit before tax multiplied by statutory rate for year (300,000 x 19%)	57,000
Effect of change in tax rate on DT asset 70,000 x (19% - 25%)	(4,200)
Total tax expense	£52,800

Deferred tax and capital allowances

The timing difference is the difference between:

1. Net book value ("NBV") of qualifying assets, and
2. Tax written down value ("TWDV")

This will gradually reversal over a long period of time when the future depreciation will exceed the future capital allowances.

When tax rates change, we need to estimate reversals year by year and tax rates that will therefore apply to them.

Estimate future depreciation and capital allowances for the qualifying assets up to the periods affected by rate changes, then the balance will reverse at 25%.

Example – single asset

A company acquired a fixed asset on 1 January 2021 at a cost of £80,000. The company's depreciation policy is to depreciate on a straight-line basis over 5 years to a zero residual value.

The company will make accounting profits after depreciation of £100,000 in each of the next 5 years.

Assume that the expenditure qualifies for 100% AIA.

Prepare the P&L summary for each accounting period from 2021 to 2025.

Current tax

	2021	2022	2023	2024	2025
Profit before tax	**100,000**	**100,000**	**100,000**	**100,000**	**100,000**
+ Depreciation	16,000	16,000	16,000	16,000	16,000
- AIA	(80,000)	nil	nil	nil	nil
Taxable profit	36,000	116,000	116,000	116,000	116,000
Tax: 19%	**6,840**	**22,040**			
23.5%			**27,260**		
25%				**29,000**	**29,000**
Profit after tax	**91,160**	**77,960**	**72,740**	**72,740**	**72,740**
Effective tax rate	6.84%	22.04%	27.26%	29%	29%

Deferred tax

	2021	2022	2023	2024	2025
Book value	64,000	48,000	32,000	16,000	Nil
Tax WDV	Nil	Nil	Nil	Nil	Nil
Timing difference	64,000	48,000	32,000	16,000	Nil

Reversal of TD:	2021	2022	2023	2024	2025
2022: 16,000 @ 19%	3,040*				
2023: 16,000 @ 23.5%	3,760*	3,760			
2024: 16,000 @ 25%	4,000*	4,000	4,000		
2025: 16,000 @ 25%	4,000*	4,000	4,000	4,000	
DT liability 31 Dec	**14,800**	**11,760**	**8,000**	**4,000**	**Nil**

Total

	2021	2022	2023	2024	2025
Profit before tax	**100,000**	**100,000**	**100,000**	**100,000**	**100,000**
Current tax	6,840	22,040	27,260	29,000	29,000
Deferred tax	14,800	(3,040)	(3,760)	(4,000)	(4,000)
Tax expense	**21,640**	**19,000**	**23,500**	**25,000**	**25,000**
Profit after tax	**78,360**	**81,000**	**76,500**	**75,000**	**75,000**
Effective tax rate	21.64%	19%	23.5%	25%	25%

Mini tax reconciliation:

Profit before tax multiplied by statutory rate (100,000 x 19%)			19,000
Effect of future tax rates on DT			
2022	16,000 x (19% – 19%)	-	
2023	16,000 x (19% - 23.5%)	720	
2024	16,000 x (19% - 25%)	960	
2025	16,000 x (19% - 25%)	960	
			2,640
Total tax expense			21,640

Contributed by Malcolm Greenbaum

VAT and indirect taxes

Church of England spiritual retreat (Lecture B1301 – 16.48 minutes)

Summary - The provision of spiritual retreats supervised by the Church of England were not exempt welfare services organised by a state-regulated body.

Reverend Jane Taylor is an active priest in the Church of England, who conducts services in the Exeter diocese, but her primary work was as director of the retreat centre, Mill House Retreats.

She is a "self-supporting minister", which means that she is not in receipt of a stipend from the Church of England. Although she is self-supporting, she remains subject to the same quality of training and supervision as a paid member of the Church of England clergy.

Through the Church of England, she received training in spiritual direction and provided spiritual welfare through activities at Mill House Retreat

She claimed that Mill House Retreat was state-regulated by the Church of England and that the activities provided were VAT exempt as welfare services organised by a state-regulated body under Item 9 Group 7 (Health and Welfare), Schedule 9 VATA1994

HMRC disagreed stating that the activities were standard rated.

Reverend Jane Taylor appealed.

Decision

Note (6) to Group 7 provides that 'welfare services' includes the provision of spiritual welfare as part of a course of instruction or retreat. There was no dispute that the provision of spiritual welfare provided in this case was of the kind described in Note (6) to Group 7.

The main issue was whether the retreats were state regulated.

To qualify as state-regulated, the services must be linked or controlled by a government minister or act of parliament. Supervision by the Bishop of Exeter, minister for the Church of England, was not supervision by a government minister.

The Tribunal agreed that Mill Hill Retreat was regulated by the state but found that it was not 'state-regulated'.

The appeal was dismissed.

In its conclusion, the First Tier Tribunal took the unusual step of suggesting that the retreat might be registered as a charity within the Church of England. The Tribunal acknowledged that this could be difficult as the retreat was also her home but suggested that "she might benefit from specialist legal advice as to whether it might be possible to reorganise her affairs in a way that would make registration feasible."

Reverend Jane Taylor Trading as Mill House Retreats v HMRC (TC08315/V)

Share sale professional fees (Lecture B1301 – 16.48 minutes)

Summary – VAT suffered on professional fees incurred disposing of shares in a subsidiary was recoverable. The share proceeds were used to fund the development of a new hotel, making them directly and immediately linked to the parent company's future trading activities.

Hotel La Tour Ltd was the 100% holding company of Hotel La Tour Birmingham Ltd to whom it provided management services. The companies were in a VAT group.

In 2015, the parent company decided to develop a new hotel in Milton Keynes that would cost approximately £34,500,000. Having considered a number of financing options, the parent decided to sell Hotel La Tour Birmingham Ltd, whose business had plateaued and could grow no further. The shortfall would be borrowed from a bank.

The sale went ahead in 2017, with the parent company incurring professional fees of £383,000. The company sought to reclaim £77,000 VAT but this was disallowed by HMRC on the basis that the sale of shares was an exempt supply.

Hotel La Tour Ltd appealed to the First Tier Tribunal on the grounds that the professional fees were incurred as part of the sales process used to raise funds for the new Milton Keynes development. Consequently, there was a direct and immediate link between the sale and the intention to make taxable supplies from the new hotel development.

Decision

The First Tier Tribunal confirmed that a sale share is an exempt supply.

However, following the Supreme Court decision in HMRC v Frank A Smart & Son Ltd [2019] UKSC 39 and the CJEU decision in Skatteverket v AB SKF (Case C-29/08), the VAT incurred when selling the shares could be recovered provided that the purpose of the sale was to generate money to fund general overheads or specific taxable activities of the business making the sale. The Tribunal found that the shares were sold to fund the new hotel's taxable activity and the costs incurred when selling the shares were paid for out of the proceeds. Hence these costs reduced the amount available for the new taxable hotel activity and so were a cost of that activity. With a direct and immediate link between the share sale and the Milton Keynes hotel development activity, VAT on the professional fees was reclaimable.

There was a late argument submitted that the parent's management services to the Birmingham subsidiary should be disregarded, as they were in a VAT group. This meant that there was no economic activity and so the sale of shares was outside the scope of VAT rather than exempt. The first time that this argument was raised was in further written submissions after the hearing. The First Tier Tribunal found that there was no good reason for the failure to apply to introduce this argument earlier and the late submission was refused. However, the Tribunal then stated that even if they had allowed the late argument, it would have been dismissed as a VAT grouping does not mean that transactions are ignored, but rather are simply allocated to the representative member.

The First Tier Tribunal also dismissed the claim that the share sale should be treated as a transfer as a going concern as there was no transfer of the parent's management of its Birmingham subsidiary and the subsidiary held all of their relevant assets.

Ultimately, the First Tier Tribunal allowed the appeal on the basis of a direct and immediate link between the sale of the shares and the new Milton Keynes taxable activities.

Hotel La Tour Ltd v HMRC (TC08335)

Reclaiming VAT when not invoiced (Lecture B1301 – 16.48 minutes)

Summary – The taxpayer was not entitled to reclaim VAT on a standard rated supply, treated as exempt at the time of supply, as no additional VAT was actually charged by the supplier.

You may remember, this is a test case in respect of supplies of services by Royal Mail that were wrongly treated as exempt.

Zipvit Ltd supplies vitamins and minerals by mail order. Between 1 January 2006 and 31 March 2010, Royal Mail supplied postal services to Zipvit Ltd under contracts which all parties, including HMRC, believed were exempt under Group 3 Schedule 9 VATA 1994. However, following the CJEU decision in R (oao TNT Post UK Ltd) v HMRC (Case C357/07), it was confirmed that postal services for which the price is individually negotiated is a standard rated supply. Group 3 Schedule 9 VATA 1994 was subsequently revised in 2011.

Royal Mail did not attempt to recover the VAT from Zipvit Ltd and other customers and HMRC did not issue claims against Royal Mail for the VAT, as it considered that Royal Mail had grounds for a defence based on legitimate expectation.

Zipvit Ltd took the view that previous payments made to Royal Mail should be regarded retrospectively as including VAT and submitted two applications for deduction of input VAT relating to the supplies for a total £415,746, together with interest.

HMRC dismissed both applications arguing that the supplies had not been subject to VAT and that Zipvit Ltd had not paid any tax.

The issue progressed through up to the Supreme Court, who referred the matter to CJEU.

Decision

The CJEU decided that under Article 168(a) of the Principal VAT Directive, VAT could not be regarded as being due or paid when:

- the customer and supplier have mistakenly assumed supplies were exempt due to an incorrect interpretation of EU law by the national authorities;
- consequently, the invoices issued did not refer to VAT;
- the contract between the customer and supplier stated that if VAT were due, the customer should bear the cost of it; and
- no steps to recover the VAT were taken in good time, so that any action to recover the unpaid VAT was time barred.

VAT was irrecoverable as none of it was regarded as due or paid on the Royal Mail supplies.

Zipvit Ltd v HMRC Case C-156/20

Record keeping requirements for bad debt relief

Summary – The taxpayer was not entitled to VAT bad debt relief as the company had not maintained a bad debt relief account that satisfied record keeping requirements.

Regency Factors Plc provides invoice factoring services using a Factoring Current Accounts that maintain a running account for each client. Invoices are posted to the account and then funds advanced to its clients based on a proportion of the invoice value. The company collects the invoice value from the clients' customers, with any balance due paid over to the client. Where Regency Factors Plc is unable to collect an amount either from a customer or failing that, the client, it claimed bad debt relief.

This system does not allocate funds against specific invoices but instead calculates its claim by reference to the balance on the Factoring Current Account owed by the client to Regency.

HMRC denied the company's claim for bad debt relief, stating that Regency Factors Plc did not comply with the requirements reg.168(3) SI 1995/2518 to keep records in a single account to be known as the "refunds for bad debts account"."

It was common ground that the company did not keep a single account the company argued that it retained records as required by reg 168(2), just not in a single account.

The First Tier and Upper Tribunal had dismissed the company's appeal who then appealed to the Court of Appeal.

Decision

The Court of Appeal found that by failing to keep the single account, the audit trail provided did not provide a trail that HMRC could easily check.

The judge stated:

> "The keeping of a single bad debt relief account would undoubtedly have served a legitimate and useful purpose, namely that of ensuring that the particular supply which qualified for bad debt relief was properly identified; and in consequence that the correct amount of VAT was collected."

The Court of Appeal stated that although the company had failed to comply with reg 168(3), HMRC did have discretion to permit other forms of proof, but the Court had no power to require HMRC to invoke such discretion.

The Court concluded by saying:

> "Regency had the opportunity to prove its claim for bad debt relief in the FTT (just as SCT [(Case C-146/19)] allows) but it failed to do so. It is not entitled to a second opportunity."

The company's appeal was dismissed.

Regency Factors Plc v HMRC [2022] EWCA Civ 103

Revenue & Customs Brief 2(2022)

Previous HMRC guidance stated that when customers are charged to withdraw from agreements to receive goods or services, these charges were not generally for a supply and were outside the scope of VAT.

Following the CJEU judgments in Meo (C-295/17) and Vodafone Portugal (C-43/19), it was evident that some of these charges are additional consideration for the supply of goods or services. Most early termination fees and some cancellation fees are therefore liable for VAT if the goods or services for which the fees have been paid are liable for VAT, even if they are described as compensation or damages.

Following representations from industry, HMRC is adopting a revised policy on early termination payments and compensation payments which will take effect from 1 April 2022.

Under the revised policy fees charged when customers terminate a contract early will be regarded as further consideration for the contracted supply. For example, where a customer is charged a fee for exiting a mobile phone contract early it will be liable for VAT.

All businesses must adopt the revised treatment by this date, even if they previously had a specific ruling from HMRC stating that such fees are outside the scope of VAT.

https://www.gov.uk/government/publications/revenue-and-customs-brief-2-2022-vat-early-termination-fees-and-compensation-payments

VAT penalty reform

HMRC has produced a table, published via the CIOT, showing the first affected accounting period affected by the penalty reform under a range of filing frequencies, and the corresponding dates on which the earliest possible late submission penalties, late payment penalties and interest could be applied.

The CIOT states that there will be a one year 'period of familiarisation'. In the first year, from 1 January 2023, where a taxpayer is doing their best to comply, HMRC will not assess the first penalty at 2% after 15 days, allowing taxpayers 30 days to approach HMRC before a penalty is charged.

HMRC has also confirmed that the current 'default surcharge' regime will continue as normal throughout 2022.

Accounting Periods which straddle 1 January 2023 will be subject to the current default surcharge regime.

https://www.tax.org.uk/penalty-reform-for-vat

E-Commerce (Lecture B1305 – 18.39 minutes)

E-commerce from GB - 1 January 2021 to 30 June 2021

Where consignments of goods valued up to €22 were sold to a customer in an EU country, the GB supplier treated that as a zero-rated export. As the goods were classed as a low value consignment, there was no import VAT payable in the EU country of destination. No Duty was payable as the goods were under the €150 duty threshold.

Where consignments were valued at greater than €22, there was still no UK VAT but import VAT was payable in the destination country. This was normally accounted for by the customer via the postal import system. The customer would also settle any duty where the goods were over €150 and not of UK origin.

On their website, the GB supplier would normally be advertising their goods net of VAT with a note that the customer is responsible for settling any import VAT and duty in their country. However, some e-commerce suppliers were giving their customers the option of paying gross, meaning that the local VAT (and duty where applicable) is added to the sales price at check-out. This VAT (and duty) would then be paid to the transport company on the customers behalf so that the goods can be cleared at the border.

E-commerce from GB - from 1 July 2021

From 1 July 2021 the EU e-commerce directive came into force and the €22 import VAT exemption for small consignments was removed. This means all goods imported in the EU will now be subject to VAT but the way that it is collected has changed. The duty limit remains unchanged at €150.

Where goods are imported with a value of up to €150, the seller could have continued with the postal import system if they wanted to.

Alternatively, they could charge the destination country's VAT rate at the point of sale. This means that the seller should be advertising the goods net of VAT and then adding the correct country's VAT at the point of sale. The VAT charged is called "supply VAT" rather than import VAT.

The payment of the supply VAT to the destination authority will be facilitated through the EU's new Import One Stop Shop.

Where the supplier sells via an online marketplace (OMP), then the OMP can take on these responsibilities.

Import One Stop Shop (IOSS)

E-commerce suppliers wanting to use the IOSS simplification would have registered for IOSS in an EU member state of their choice by 1 July 2021. Having registered, the supplier will receive an IOSS registration number that must be communicated to the transport company responsible for delivery of any goods sold. This should ensure that goods pass through Customs with minimal interruption. The IOSS number should be evidence that VAT has been accounted for at point of sale and there is no duty for consignments up to €150.

To facilitate this, the GB supplier will need to appoint a local representative to prepare their monthly IOSS returns. Monthly payments will be due via the registration portal of the

member state chosen to register in. The returns will only include EU output VAT for each country where the supplier has traded, on a line-by-line basis.

Consignments over €150

Where such goods are sold to an EU customer, the GB supplier will continue to have a zero-rated export but the EU import VAT due will be payable through the relevant country's postal import system.

Where the goods are of 'UK origin', no duty will be payable. However, in cases where the origin rules are not satisfied, duty will also be payable.

E-commerce into GB from 1 January 2021

The UK introduced a similar system to the EU for consignments up to £135 but six months earlier.

Where a non-UK company sells goods valued up to £135 to a GB customer, no duty will be payable. However, UK supply VAT is due at the point of sale, meaning that the overseas supplier must charge UK VAT at the point of sale and must register for VAT in the UK.

If that supplier was selling through an online marketplace, the online marketplace must be registered for UK VAT and account for the point-of-sale UK VAT.

Selling to a business

Most e-commerce transactions are B2C supplies. However, where a non-UK company sells goods to a GB business for an amount up to £135, provided that the overseas company obtains the GB company's VAT number, the GB company must reverse charge the supply. The same will apply where a GB company sells to an EU business.

Goods stored in GB by overseas supplier

If goods valued at up to £135 are in GB at point of sale, then the overseas supplier will already be UK registered as the goods have been imported into the UK.

If the goods are then sold to unregistered customers via an online marketplace the:

- overseas supplier has a zero-rated supply to the online marketplace;
- point of sale VAT is accounted for by the online marketplace.

If the goods are sold to a VAT registered customer, the supplier must charge VAT, with the online marketplace simply providing the supplier with the sales information.

Consignments into GB greater than £135

These will be treated as a zero-rated export in the country of dispatch but import VAT, rather than supply VAT, will be due in the UK. There will be an import declaration at time of arrival. If the supplier is the importer of record, the supplier will register in the UK and use the UK postal import system.

Contributed by Dean Wootten