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CONTENTS

Personal tax

Gold bullion was earnings (Lecture P1361 – 16.29 minutes)

Summary – Gold bullion paid for by directors was found to be taxable earnings, with no deduction available for the company.

Wired Orthodontics Limited was a close company that provided dental products and supplies. The company had two directors, Susan Bessant and Ian Hutchinson, who were both participators and employees of the company.

In October 2014, under a scheme devised by Qubic Tax Ltd, the company established The Wired Orthodontics Limited Employee Trust 2014, for the benefit of the company's employees and office holders. The company awarded the two directors £300,000 of gold bullion, which was paid for by its immediate sale by the directors, creating credits on the directors' loan accounts. The directors subsequently extracted this value as cash drawings but with agreements in place under which the directors undertook to pay the £300,000 (plus an RPI uplift) to the Trust (an employee benefits trust) ten years later in 2024.

HMRC referred the arrangements to the GAAR advisory panel who found the arrangements to be 'abnormal and contrived' designed to exploit a loophole in anti-avoidance legislation contained in Part 7A ITEPA 2003 and stated:

> "The most likely comparable commercial transaction, without the overlay of contrived or abnormal steps, would be a funding by the Company of the EBT followed by a loan from the trustees of the Trust to the Directors".

The panel went on to state that this "would give rise to a charge to income tax under Part 7A and the associated PAYE and NICs charge with no reduction being available under section 544Z8. The time of the corporation tax deduction would be linked to the time when the Directors suffer tax on the reward."

HMRC raised assessments on the basis that:

- the directors were taxable on the £300,000 as earnings, despite their obligation to fund the trust at a later date. They were liable for tax on a benefit as they had not made good the PAYE and NIC that should have been withheld by the company;

- the company was not entitled to a corporation tax deduction as the costs were not incurred wholly and exclusively for the purposes of the company's trade.

The company appealed, effectively maintaining that the gold and/or the cash received by the directors on its sale were not earnings because of the obligation to pay the £300,000 (plus an amount reflecting RPI) to the Trust at a later date.

Decision

The First Tier Tribunal summed up the facts, stating that:

- the directors received £300,000 worth of gold in their names;
- they immediately sold the gold, using the proceeds to pay its purchase invoice;
- settling the invoice gave rise to a debt owed to the directors, reflected in the directors' loan accounts; and
- the directors later extracted cash, clearing the loan account balance.

Further, the Tribunal noted that, once the scheme had been implemented, the Directors received no other reward for their services.

The First Tier Tribunal found that the gold provided to the directors was the provision of money or money's worth and that this was a reward for their services taxable under s.62 ITEPA 2003.

There was no provision within legislation or case law entitling the directors to "a deduction or allowance for the obligation to make payment at a future time to the Trust."

The Tribunal moved on to consider the deductibility of the £300,000 paid for the gold and the £40,500 paid as fees for its purchase. Under normal circumstances the 'earnings' would be deductible expenses. However, by implementing the scheme, the wholly and exclusively test was not met as the expenses had a dual purpose:

- To reward employees;
- To implement a pre-arranged scheme to provide tax-free cash to the directors combined with a corporation tax deduction for the company.

As the Tribunal stated:

> "The purpose of the transactions was not simply to reward the employees. That could have been achieved in various, much simpler ways."

The taxpayers' appeal was dismissed.

Wired Orthodontics Limited, Ian Hutchinson and Susan Bessant v HMRC (TC08679)

Course fees paid **(Lecture P1361 – 16.29 minutes)**

Summary – The taxpayer received salary and not an exempt bursary as the course was neither attended on a full-time basis nor did it cover a complete year. Consequently, the claim to recover income tax and NICs paid on his salary were denied.

Edward Phelan worked as a volunteer counsellor for a charity for some years before taking up a fixed term salaried contract with the charity. Between 30 April 2012 to 22 March 2013, he attended a work-related course on a part -time basis, one day a week with the University of Essex. His continued employment was conditional on him attending and passing this fully funded course. On the days that he was not on the course, he provided one-to-one counselling sessions as a Psychological Wellbeing Practitioner to patients within GP surgeries. During this time, he paid tax and NICs on the salary that he received from the charity.

In March 2017, he claimed a repayment of these sums on the basis that the course fees were a bursary rather than salary and so were exempt from:

- tax (s.776 ITTOIA 2005);
- NICs (Sch 3, Part VII, para 12 of the National Insurance Contributions Regulations 2001.

Further, he argued that he was not taxable nor subject to NICs because the Course had been a "Widening Access Training Scheme" course, and so fell within a concession entitled "Widening Access Training Scheme: refunds for NHS Trust workers".

In 2019, HMRC disallowed the income tax claim, stating that it was out of time and refused the NICs claim as the necessary conditions had not been satisfied.

Decision

For the refund claim to be valid, the sums paid must relate to a full-time course lasting a complete academic year and neither of these conditions were satisfied. The First Tier Tribunal did not accept the argument that the four days spent working at the GP surgeries each week were part of the course as these days continued after the course had been finished. The payments to Edward Phelan were not a bursary and so did not fall within the National Insurance exemption.

The First Tier Tribunal agreed with HMRC that the claim was out of time for income tax as he would have needed to make the claim within the four-year time limit. Edward Phelan's letter dated 12 March 2017 was not a valid in-time claim for a repayment of income tax because:

- he did not quantify the amount of relief he was claiming;
- it did not explicitly state that he was making a claim for "overpayment relief"; and
- he did not provide a signed declaration that the particulars given in the claim were correct and complete to the best of his knowledge and belief.

As the letter of 12 March 2017 was not a valid in-time claim for a repayment, and as the four-year time limit had expired on 5 April 2017, he was out of time to make a claim for the income tax to be repaid. The Tribunal went on to state that even if the claim had been made in time, it would have been rejected for the same reasons as the NIC claim.

Finally, the Tribunal stated that it had no jurisdiction to decide disputes over the WATS concession. Had that jurisdiction existed, the Tribunal would have agreed with HMRC that the taxpayer did not fall within its scope as Edward Phelan was not an NHS employee, but rather he was employed by the charity.

The appeal was dismissed.

Edward Phelan v HMRC (TC08688)

Gifts to repay loans

Summary – Amounts gifted to two former employees enabling them to repay loans entered into in connection with a historic deferred share plan, constituted general earnings from their respective employments and, as such, were subject to PAYE.

In 2007 and 2008, two employees subscribed for shares, nil paid, as part of a deferred share plan. The individuals were loaned amounts to pay the outstanding subscription price.

The individuals remained as employees until March 2009 and November 2011 when they resigned, entering into call option agreements in 2011 for the sale of certain of the shares which included a tax indemnity for liabilities arising in connection with the sale of shares and/or the release of loans) ('the 2011 arrangements').

In 2014, further agreements were entered into, under which additional loans were made, another group entity indemnified the individuals in respect of tax exposures in connection with the arrangements, cash gifts were made to the individuals to repay outstanding loans (with the amounts being directed to the lender entities) and certain loans to the individuals were released in return for relatively nominal payments ('the 2014 arrangements').

The overall effect of the arrangements was designed to ensure the individuals were in an economically neutral position in respect of the deferred share plan, which they would not have otherwise been since the value of the shares held under the arrangements had depreciated due to the financial crisis (and was significantly less than the amount of the outstanding loans).

The individuals reported the amounts gifted as being capital sums derived from the tax indemnities (which were matched with a loss in respect of the disposal of the shares held).

Gain Capital Limited argued that the cash gifts were not payments 'from' employment (e.g., not awarded in return for acting as or being an employee) but instead averred that the operative cause of the gifts was the commercial need to address contingent liabilities under the tax indemnities in order to facilitate the sale of the relevant company.

Decision

Notwithstanding the fact that the 2011 and 2014 arrangements were entered into after the cessation of the individuals' employment, the First Tier Tribunal held that the gifts were derived from the individuals' former employment, principally on the basis that the 2014 arrangements were structured to 'honour' the objective of the 2011 arrangements, which was found to be that, in recognition of their historic service with the business, the individuals would be protected from financial loss in respect of the deferred share plan (participation in which was itself derived from employment).

Furthermore, following the Court of Appeal's decision in Murphy [2022] EWCA Civ 1112, the First Tier Tribunal held that the amount of the gifts which constituted earnings was the gross amount of the gifts with no deduction allowed for the loan repayments effected with the gifted amounts.

Gain Capital Limited v HMRC (TC08703)

Adapted from the case summary on Tax Journal (3 February 2023)

Voluntary Class 3 NICs non-refundable (Lecture P1361 – 16.29 minutes)

Summary – Voluntary class 3 contributions were non-refundable as no error or mistake had been made.

Mrs Garwood was a teacher who was employed between 1975 until 2008, with some gaps when she took time off to bring up her children. Although she retired in 2008, she did briefly return to work in 2015/16.

In 2019, having contacted the DWP's pensions helpline she learned that under the new pension rules she was not entitled to a full state pension. However, if she made voluntary contributions for three years (2016/17, 2017/18 and 2018/19), she would become entitled to the new state pension in full. She was told that the economic return from the voluntary contributions would be recovered after five years, and so was worth making if she expected to survive for five years after reaching state pension age.

At the time:

- Mrs Garwood did not tell the DWP advisor that she was recovering from cancer
- The DWP advisor did not tell Mrs Garwood that voluntary contributions were not refundable.

On 8 March 2019, she transferred £2,236 to HMRC as payment of the voluntary NICs.

In December 2019, Mrs Garwood learned that her cancer had spread, she was terminally ill and sadly, died a month later. This was just nine days after becoming entitled to her state pension.

As executor to her estate, her husband applied for a refund of the voluntary contributions. He stated that his wife was not told that the contributions were non-refundable, or that the voluntary payment deadline for payments for class 3 NICs for 2016/17 was 5 April 2023. He argued that had she waited until nearer the deadline to make the additional contributions, she would likely not have made the payment as by that time she would have known that she was terminally ill.

Decision

The First Tier Tribunal was sympathetic with the taxpayer’s position but found that there had been no error or mistake made by the DWP advisor which would give rise to a right to a return of the class 3 NICs paid.

As Mrs Garwood did not tell the advisor of her cancer diagnosis, he would have been unaware of her concerns about her prognosis, and the risk that she might die within five years of reaching state pension age.

It was unfortunate that she had made the payment of the voluntary contributions with the intention of increasing the amount of her state pension but unfortunately only benefitted from that increase for the few days.

The Tribunal concluded that it was a matter of speculation whether Mrs Garwood would have deferred making the voluntary class 3 NICs if she had been made aware that they were non-refundable, and that the payment deadline was in 2023. The Tribunal were aware that one of the reasons that she made the payment in March 2019 was in order to avoid the increase that would occur if payment was made after 5 April 2019.

The appeal was dismissed.

Stephen Garwood as Executor of Rosemary Garwood v HMRC (TC08710)

Redress payment chargeable? (Lecture P1361 – 16.29 minutes)

Summary – Redress payments of some £370,000 received for a mis-sold hedging product were refunds that were chargeable to income tax, and not non-taxable damages or payment to prevent further legal action.

In 2007, David Fox and Ian Barnett borrowed money from Barclays to acquire a property to be used by their company. Encouraged by the bank, the pair entered into an interest rate swap to hedge interest rate movements between exchange and completion of the property.

David Fox and Ian Barnett later fell out with the bank and following an independent review the hedging product was found to have been mis-sold.

In 2014/15, David Fox and Ian Barnett received a redress payment of £443,592.69, after deduction of income tax from the interest element of the redress payment. Both individuals included the interest payments on their tax returns but not the redress payment.

Following an enquiry by HMRC, closure notices were issued on 16 October 2017 charging the full amount received to income tax.

The taxpayers appealed.

Both parties agreed that if the basic redress amount was found to be a payment to refund all the amounts that would not have been paid by the pair had they not entered into the mis-sold swap, then it would be subject to income tax.

Decision

The First Tier Tribunal found that the fact that David Fox and Ian Barnett had started litigation did not change the nature of the redress payment. They chose to enter into the redress arrangement, and as stated in the offer letter, the payment of just over £370,000 was a refund of the amounts paid by the taxpayers for the mis-sold products.

Consequently, the First Tier Tribunal upheld the closure notices, with the full sum being liable to income tax.

The penalties for carelessness were also upheld. As experienced businessman, they should have informed their advisers about the full sums received and not just the interest element.

I.A. Barnett and D.J. Fox v HMRC (TC08704)

EIS relief - disqualifying arrangements? (Lecture P1361 – 16.29 minutes)

Summary – EIS relief was denied as, although the risk to capital conditions had been met, disqualifying arrangements were in place, with the production company being involved in the arrangement.

The company had been incorporated to develop and produce an animation show, “Daisy Boo and Monkey Too”.

In 2014 the company applied for and was granted advance assurance that share issues qualified from SEIS/EIS relief.

The company issued shares between 2015 and 2018, but having requested further information about the company’s activities, HMRC refused to issue the compliance certificates for the shares, stating that:

- the company did not meet the risk to capital condition; and
- there were disqualifying arrangements.

Following an unsuccessful review, the company appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal found that the company did meet the risk to capital condition as it could show that it intended to grow and develop its trade.

The original application for HMRC clearance included the statement that

> “If Daisy Boo & Monkey Too” is successful, it is anticipated that the Company will distribute the show’s broadcast rights both domestically and internationally and licence the show’s content to toy manufacturers, children’s clothes producers and app and video game developers as well as exploring other monetisation options.”

Having reviewed the evidence, the Tribunal was satisfied that turnover growth was intended, with long-term business planning having been undertaken. The aim was for broadcasting to lead on to merchandising, publishing and online content revenue.

Further, the executive producer was incentivised by linking remuneration to turnover. It did not matter that the number of employees did not increase as part of the growth plan. The executive producer, acting as the company’s agent, would decide what to produce and how to make it. The actual production could be validly outsourced to create the intellectual property from which fees were earned.

However, relief was denied as there were disqualifying arrangements. The money raised from the share issues was paid to the production company for producing the show and that company was also a counterparty to the production agreement. This made it a 'relevant person'. The fact that the payments were agreed by the parties to be on third-party terms did not change the legislative analysis.

Hoopla Animation Limited (Formerly Daisy Boo and Monkey Too Limited) v HMRC (TC08683)

Unauthorised employer payment

Summary – The loan made was an unauthorised employer payment meaning that HMRC’s scheme sanction charge was upheld.

Nilebond Limited was the administrator of a registered pension scheme, Nilebond Directors' Retirement Account. The scheme made a loan of £37,500 to the sponsoring employer, which was secured by a floating charge. The company repaid the loan in full by two instalments in March and November 2018.

In March 2019, HMRC issued the taxpayer with a scheme sanction charge of £15,000 (s.239 FA 2004) on the basis that the loan was an unauthorised employer payment within the meaning of s.160(4)(a) FA 2004.

The company appealed.

Decision

The First-Tier Tribunal considered whether the loan was an unauthorised employer payment or an authorised employer loan as defined by s.179(1) FA 2004. This depended on whether the charge had to have been registered at Companies House under s.859A CA 2006 as an authorised employer loan. The Tribunal agreed with HMRC that where a loan was made to a corporate employer, it was only an authorised loan if the related charge had been registered in accordance with the requirements of s 859A.

The sum had been registered late so the Tribunal went on to consider whether a retrospective registration would be sufficient. The Tribunal decided not as the purpose of the unauthorised loan provisions was 'to ensure that the tax-relieved funds in the pension scheme are not loaned in circumstances where there is a risk they might not be repaid'. So, loans to employers had to be 'secured by a charge of adequate value'. In this instance, while the loan was in existence, the charge was not registered at Companies House, placing the Nilebond Directors' Retirement Account in the same position as any other creditor. As a result, the loan was an unauthorised employer payment and the scheme sanction charge applied.

The appeal was dismissed.

Nilebond Limited (TC08676)

Adapted from the case summary in Taxation (19 January 2023)

Settlements legislation refresher (Lecture P1362 – 31.52 minutes)

The provisions of the so-called ‘settlements legislation’ are found in ss.619 – 648 ITTOIA 2005. The first part of these income tax anti-avoidance rules saw the light of day in the 1930s, with subsequent elements appearing on a piecemeal basis thereafter. They were finally rationalised in 1995 before being re-enacted into what one commentator has called ‘plain English’ by ITTOIA 2005.

Ss.619 – 648 ITTOIA 2005 apply to ‘settlements’. The meaning of ‘settlement’ is very widely defined in S620(1) ITTOIA 2005 as including ‘any disposition, trust, covenant, agreement, arrangement or transfer of assets’ and ‘settlor’ refers to the person by whom the settlement was made.

Any income arising from a settlement is deemed to be the settlor’s income for income tax purposes if that individual (or their spouse/civil partner) has retained an interest in the settled property (ss.624 and 625 ITTOIA 2005). It should be noted that the definition of 'settlement' extends well beyond the creation of a trust. For example, it is far-reaching enough to catch arrangements such as dividend waivers.

The rules are designed to prevent a person passing income, by means of a settlement, to another person who is not liable to tax or who is taxable at a lower rate than the settlor.

However, a fundamental principle is that what judges have called an 'element of bounty' must be present in order to allow HMRC to invoke the settlements code. This can be demonstrated by considering the decisions in Bulmer v CIR (1966) and CIR v Plummer (1979).

A settlor is regarded as having an interest in settled property if there are any circumstances in which the property, or any related property, is or may become payable to the settlor (or their spouse/civil partner). This does not mean that the income has had to be paid to the settlor, merely that he is taxed on the relevant amounts which are treated as forming the highest part of his total income (s.619A ITTOIA 2005).

In HMRC's view, the rules apply to any arrangement for income to be payable to a person other than the settlor, provided that:

- the settlor has an interest in the settlement;
- tax is saved; and
- the arrangements are:
  - bounteous; or
  - not commercial; or
  - not at arm's length; or
  - in the case of an outright gift between spouses or civil partners, wholly or substantially a right to income (see s.626 ITTOIA 2005).

These details are confirmed in Para TSEM4200 of the Trusts, Settlements and Estates Manual.

Illustration 1

Clarissa is a top rate taxpayer who owns all the 100 ordinary shares in Clarissa Products Ltd.

She wants to give her brother (a basic rate taxpayer) £25,000, but all her money is tied up in the company.

To avoid an additional rate charge on dividends paid out of Clarissa Products Ltd, Clarissa transfers 50 of the ordinary shares to her brother on the understanding that the shares are to be returned to her in one month's time.

In the meantime, Clarissa declares, and her company pays, a dividend of £500 per share so that £25,000 is paid to each shareholder.

The plan, under which the gifted property is expected to be returned to the donor, represents a 'settlement' arrangement where the donor, i.e., the settlor, has retained an interest in the property so that the dividend income paid to the brother is deemed to be the top slice of Clarissa's total income for the tax year in question under ss.624 and 625 ITTOIA 2005. It is not regarded as her brother's income.

By virtue of s.625(4) ITTOIA 2005, a settlor's spouse or civil partner does not include:

- a spouse or civil partner from whom the settlor is separated under a Court Order or a separation agreement;
- a spouse or civil partner from whom the spouse is separated in circumstances which are likely to be permanent;
- the widow or widower or surviving civil partner of the settlor;
- a person to whom the settlor is not married but may later marry; and
- a person who is not a civil partner of the settlor but may later become one.

In practice, HMRC normally accept that a separation of at least 12 months is likely to be permanent.

The Arctic Systems case

During the 1990s, HMRC started to attack income-shifting arrangements under which dividends were provided to the spouse of the individual who owned and ran a successful company. It was typically facilitated either by the creation of a new class of shares or by the person who controlled the company transferring some of their existing shareholding to the spouse. HMRC invariably argued that this planning, even where it involved ordinary shares, was caught by the settlements legislation and so it was not surprising that, before long, a test case arose. This was of course Jones v Garnett (2007) which was finally decided by the House of Lords in favour of the taxpayer and is often referred to as the Arctic Systems case (after the name of the company which the taxpayer used).

In this context, it is worth recording some of the important points which arose from the case:

- In Arctic Systems, the Courts at each level concluded that there was indeed an arrangement which, as already mentioned, is the first step to establishing a settlement so that the provisions of ss.624 and 625 ITTOIA 2005 can be invoked. There seems to be a widespread misconception that the reason for the taxpayer's victory was the absence of an arrangement, but this is not true. An arrangement existed in the sense that the taxpayer (Mr Jones) acquired a company from company formation agents, that Mr Jones and his wife each purchased a single share for £1, that Mr Jones generated all the company's profits through his work for which he was paid a modest salary and that, after allowing for corporation tax, the company's profits were distributed on a 50:50 basis as dividends.
- Not only was there an arrangement, but an element of bounty was clearly present. Why else would Mr Jones, as the company's sole director, have allowed his wife to acquire 50% of the company and receive 50% of the dividends when he earned all the profits?
- The real reason for the taxpayer's success was that all five of the judges in the House of Lords held that the important exemption in what is now S626 ITTOIA 2005 applied. This let-out was introduced as part of the independent taxation reforms

which took effect on 6 April 1990, specifically to enable spouses to make outright gifts to each other without fear of these rules being applied.

Paraphrasing the section, the settlements legislation is not in point if:

1. there is an outright gift of property from which income arises;

2. made by one spouse to the other; and

3. which meets two conditions – namely that the gift carries the right to the whole of the underlying income and that the property is not wholly or substantially a right to income.

On this last point, Lord Hoffmann, who delivered the leading judgment in the House of Lords, concluded his speech with these words:

'Finally, (HMRC) say that the property given, i.e., the share, was "wholly or substantially a right to income". It is true that the value in the share arose from the expectation that it would generate income. But that is true of many shares, even in quoted companies. The share was not wholly or even substantially a right to income. It was an ordinary share conferring a right to vote, to participate in the distribution of assets on a winding up, to block a special resolution, to complain under (S994 Companies Act 2006). These are all rights over and above the right to income. The ordinary share is different from the preference shares in Young v Pearce (1996), which conferred nothing except the right to 30% of the net profits before distribution of any other dividend and repayment on winding up of the nominal amount subscribed for their shares. Those shares were substantially a right to share in the income of the company.

In my opinion, this arrangement falls within the exception in (s.626 ITTOIA 2005). I would therefore dismiss the appeal.'

An important planning point can be derived from the words of Park J in the High Court hearing. He emphasised that the settlements legislation is only relevant where the parties are husband and wife (or civil partners). He said that 'if Mr Jones' co-shareholder was not his wife but, say, his sister, he could not be taxed on her dividends'. This may be a salient matter to bear in mind when advising on the structure of a family company.

Income paid to unmarried minor child of settlor

Splitting income between a parent and a minor child is never easy, unless the income is surplus to the family's immediate requirements and can be accumulated until the child reaches the age of 18. This follows from s.629 ITTOIA 2005. The section provides that income arising under a settlement which, during the life of the settlor, is paid to, or for the benefit of, an unmarried minor child of the settlor is to be treated as income of the settlor. There is a de minimis exemption of £100 per tax year. However, if the aggregate sums paid to, or for the benefit of, the child in any one tax year exceed £100, the full amount is treated as the parent's income. The term 'settlement' is defined in the same way as it is for s.624 ITTOIA 2005 purposes and thus covers income-producing assets gifted to minor children as well as trusts set up for their benefit. In this context, 'child' includes a stepchild, an adopted child and an illegitimate child (but not a foster child).

It is worth highlighting that income, which was originally received by the trustees of a children's settlement before the young beneficiary's 18th birthday, would have been taxed in the trustees' hands at the appropriate rate(s). As long as this income was accumulated and not paid out to, or for the benefit of, the son or daughter until the child attained the age of 18, it will then be treated as the child's income (and not the parent's). This can be a useful way of helping to finance, for example, university costs.

Other tax-efficient arrangements include trusts created by remoter relatives such as a grandparent or an uncle (or aunt).

Earnings of a child are not caught by the settlement rules nor are chargeable gains. If a parent gifts funds to a child direct, but they are invested for capital growth rather than income, there is no equivalent provision to s.629 ITTOIA 2005 in the CGT legislation. A child has their own annual CGT exemption and their own 10% and 20% CGT rates, and any gain is treated as the child's.

Capital sums treated as income of settlor

Ss.633 – 643 ITTOIA 2005 contain provisions aimed at preventing the settlor obtaining any benefit from a settlement in which the income may be taxed at a lower rate than that which would have applied had the settlor himself retained it. With the present trust rate of 45%, it is questionable whether this legislation still serves any useful purpose.

In effect, capital payments to a settlor (or to his spouse/civil partner) are matched with the undistributed income of the trust fund at the end of the tax year and taxed as the settlor's income. This sum is grossed up at 45%.

A capital sum means any sum paid:

- by way of loan (whether or not on commercial terms) or a repayment of a loan; and
- otherwise than as income and which is not paid for full consideration in money or money's worth.

A capital sum is only caught to the extent that it is equal to, or less than, the undistributed net income in the settlement. Any excess is not caught in the tax year in which the capital sum is received, but it may be charged later if income arises in the settlement in any of the next 10 tax years. Any part of the capital sum which is not matched within this 10-year period cannot be treated as income of the settlor.

Illustration 2

The undistributed net income of Patrick's settlement is as follows:

	£
Year 1	12,000
Year 2	nil
Year 3	10,000
Year 4	nil
Year 5	8,000

In Year 3, the trustees lend Patrick £48,000. This loan is a capital sum and therefore Patrick is liable to income tax in Year 3 to the extent that there is 'available income', i.e., the undistributed net income of the settlement. At this stage, the available income is £12,000 + £10,000 = £22,000. Thus, Patrick is taxed on £22,000 grossed up for 45% tax (i.e £22,000 x 100/55) which comes to £40,000. The remaining £48,000 – £22,000 = £26,000 is carried forward and assessed in subsequent tax years when income becomes available. For example, in Year 5, £8,000 is available and so Patrick is taxed on £8,000 x 100/55 = £14,545. If the loan is repaid, there can be no further charge. However, the income tax paid during the loan period cannot be recovered (s.638 ITTOIA 2005).

Contributed by Robert Jamieson

Tax-free distributions? (Lecture P1363 – 16.26 minutes)

The Upper Tribunal case of Clipperton v HMRC (2022) involved two individuals who were 50: 50 shareholder directors of a company called Winn & Co (Yorkshire) Ltd (WY) carrying on a successful accountancy practice. HMRC had assessed the two of them – Sharon Clipperton (C) and Steven Lloyd (L) – to income tax in respect of sums received in 2011/12 from WY. C and L appealed these assessments to the First Tier Tribunal. Their dispute was heard in December 2018, but judgment was not given until January 2021.

The taxpayers appealed against the First Tier Tribunal's decision (which largely went against them) and HMRC in turn cross-appealed on a particular matter.

The facts of the case were not in dispute and may be summarised as follows. WY had historically paid C and L substantial dividends from the company's business profits, e.g., £300,000 in respect of the year ended 31 May 2010.

However, the two shareholders subsequently adopted a plan, marketed by a company called Premier Strategies Ltd, designed to enable companies to put into the hands of shareholders money, which would otherwise have been taxable as distributions, without any charge to income tax. This was described as a 'dividend replacement strategy' and relied on the legislation in s.s619 – 648 ITTOIA 2005 operating to the advantage of the scheme users.

The relevant steps, which took place over a period of one month, were:

- WY subscribed for 199 'A' ordinary shares of £1 each and one 'B' ordinary share of £1 in a newly formed subsidiary called Winn Scarborough Ltd (WS).
- WY settled the 'B' share on trust largely for the benefit of the two accountants but on the basis that the company was entitled to receive a small amount of any income arising to the trust and that the trust property was to revert to it.
- WY subscribed for one additional 'A' share in WS at a premium of £200,000.
- WS's share capital was then reduced by £200,000 through the cancellation of the share premium account which had just been created and this amount was credited to the company's distributable reserves.
- WS declared a dividend of £200,000 on the 'B' share, using the distributable reserves produced by the capital reduction.

- The trustee of the trust paid the sum which it received as a dividend to the two beneficiaries. The amount which each of C and L received was £98,465, referred to as 'the income in dispute' (the balance of the dividend payment was used to settle bank transfer fees and to hand over small amounts to a designated charity and to WY).

The appellants disclosed details of the above arrangements in their self-assessment tax returns for 2011/12. They took the view that they were not taxable on the relevant receipts –

The success of this scheme depended on the settlements legislation in ITTOIA 2005 treating the income arising under the settlement as the income of the 'settlor'.

The intention was that:

- WY was the settlor of the trust;
- income arising under the trust would be deemed to be income of WY;
- the dividend declared by WS would be income of WY alone; and
- no tax would be payable by WY, given that companies do not pay tax on dividends and other income distributions which they receive.

The result was that the trust payments to C and L were ostensibly free of income tax.

The Clipperton dispute is the lead case for a number of other appeals using similar arrangements.

Disputing the beneficiaries' contention, HMRC's position was that C and L were liable to pay tax on the income in dispute for the following reasons:

- On a purposive construction of the legislation, this income constituted a distribution made by WY to each of the appellants within the meaning of ss.383 – 385 ITTOIA 2005 and S1000 CTA 2010. As a result of the line of cases starting with WT Ramsay Ltd v CIR (1981) which established the above principle, this reasoning is referred to as HMRC's 'Ramsay argument'.

- The settlements code applies to impose an income tax charge on C and L (and not WY) in relation to their disputed income on the basis that the two individuals were the real settlors of the settlement, given that they (as the sole shareholder directors of WY) arranged for all the steps involved in the scheme to be put in place. This is referred to as HMRC's 'settlement argument'.

The First Tier Tribunal judge found in favour of HMRC on the Ramsay argument, deciding that the 'B' share dividend was taxable as a distribution made by WY to the two appellants.

As far as the interaction between the distribution provisions and the settlements code was concerned, the judge concluded that the corollary of the finding about the distribution was that the income should not be regarded as arising under a settlement made by WY as settlor.

If the above argument was incorrect, the arrangements did create a settlement, but, in the judge's opinion, WY was the sole settlor of that settlement so that the income could not be apportioned to C and L.

As has been seen, the appellants were unsuccessful at this level because of the Ramsay argument. However, HMRC were unhappy with the finding that, if the settlements legislation had to be considered, the settlor was the company (WY) and not the two shareholder directors (C and L) – hence the appeal and the cross-appeal.

The judges in the Upper Tribunal held that the First Tier Tribunal's decision to approve HMRC's Ramsay argument was fully justified. WY had made a distribution out of assets in respect of shares to the two appellants. The detailed analysis of the case law beginning with WT Ramsay Ltd v CIR (1981) was accurate. Under the Ramsay principle, the income was a direct distribution rather than income from a settlement. C and L's appeal on this ground was dismissed.

The Upper Tribunal also determined that, where the distribution provisions were in point, the existence of the settlements legislation did not stop those provisions from taking effect.

In this context, the First Tier Tribunal had concluded that C and L were not settlors as a result of the judge's analysis of the settlements code. The appellants, the judge said, had not provided an element of bounty to WY. The Upper Tribunal disagreed. C and L had provided an element of bounty. In the words of the judges:

> 'The fact that the bounty was small, or that it was a tax-driven payment, did not mean that there was not an element of bounty on behalf of the appellants when making the settlement in relation to both WY and Cancer Research (the relevant charity). There is no authority in the case law to suggest that some sort of judicially-defined de minimis threshold applies. If, for instance, the . . . scheme had been utilised for a company with £100 million of funds, would the payment to WY and the charity of £1.5 million have been "small" or "immaterial"?'

The Upper Tribunal set aside the First Tier Tribunal's decision on this issue and remade it, determining, as one commentator remarked, 'that, if the sums were not taxable as distributions, the taxpayers were settlors of the settlement'.

The taxpayers' appeals were dismissed and HMRC's cross-appeal was allowed.

Contributed by Robert Jamieson

Capital taxes

Case study on a BADR claim by trustees **(Lecture B 1363 – 10.44 minutes)**

In The Quentin Skinner 2015 Settlements v HMRC (2022), the Court of Appeal unanimously decided in favour of the trustees on a question of the relationship between the forerunner of business asset disposal relief and the sale of shares in a qualifying trading company held by an interest in possession trust.

If an asset such as a shareholding in a family trading company is held by a discretionary trust, a sale of those shares by the trustees can never qualify for business asset disposal relief. The trustees' CGT will always be at the full rate of 20%.

However, the sale of shares held in a life interest trust where there is a 'qualifying beneficiary' can attract this valuable relief so that the 10% tax rate will be in point. This is subject to the caveat that the life tenant is prepared to surrender the relevant part of his personal relief entitlement to the trustees.

The key legislative requirements are illustrated in the case study below.

Case study

Donald and Alastair are UK-resident beneficiaries of a family trust which had been created in 2009. Since its inception, the trust has owned a 20% ordinary share stake in Rockshiel Developments Ltd (a qualifying trading company for business asset disposal relief purposes).

Donald became a director of Rockshiel Developments Ltd in 2015, owning 12% of the company's ordinary shares in his own name. These shares also carry 12% of the company's voting and economic rights.

Under the terms of the trust, Donald and Alastair are entitled to an equal share of the trust's income as it arises.

In February 2023, the trustees sold their shares in Rockshiel Developments Ltd, generating a gain of £560,000. Neither Donald nor Alastair has ever made a claim for entrepreneurs' relief or business asset disposal relief.

The following considerations apply to determine whether the trustees are able to make a competent claim for business asset disposal relief in respect of their 2022/23 gain:

- The sale of the shares in February 2023 is a disposal of 'settlement business assets' within S169J(1)(a) and (2) TCGA 1992;
- Donald is regarded as a 'qualifying beneficiary' (S169J(1)(b) and (3) TCGA 1992) since he is entitled to an interest in possession in the part of the trust which holds the shares in Rockshiel Developments Ltd.

- The condition in S169J(4) TCGA 1992 is satisfied, given that throughout a period of two years ending within three years of the share sale:

  – Rockshiel Developments Ltd was Donald's personal company (since it is a qualifying trading company in which Donald held at least 5% of the ordinary share capital, voting rights and economic rights per S169S(3) TCGA 1992); and

  – Donald was a director of the company.

Alastair is also entitled to a half-share of the income of the settled property. Thus S169O TCGA 1992 applies to apportion the gain which is eligible for business asset disposal relief on a 50 : 50 basis. However, no business asset disposal relief claim can be made in respect of Alastair's part, given that he does not appear to fall within S169J(4) TCGA 1992.

On the assumption that Donald makes a joint claim with the trustees under S169M TCGA 1992 in relation to his proportion of the gain:

- £280,000 of the gain (50% x £560,000) will be eligible for the 10% CGT rate in the trustees' hands; but

- the remaining £280,000 relating to Alastair's share will be chargeable at the normal trust CGT rate of 20%.

Contributed by Robert Jamieson

Access to communal garden (Lecture P1361 – 16.29 minutes)

Summary – The purchase of a leasehold flat bought with the right to use a communal garden was chargeable to the residential rates of SDLT.

On 19 January 2018 Dannielle and Emma Sexton jointly acquired a leasehold interest in a London flat. Provided they paid the 'garden rate' and used the garden in a quiet and considerate manner, they also had access to a communal garden.

Initially Dannielle and Emma Sexton paid SDLT at the residential rate, but later submitted an overpayment relief claim. They argued that the garden was non-residential as to be residential, the right to access the garden had to exist for the sole benefit of their flat. Shared used with other property owners meant that non-residential rates applied.

HMRC disagreed.

Decision

The First Tier Tribunal found that acquiring the leasehold interest in the flat was the main subject matter of the transaction and that was "residential property" within s.116(1)(a). Acquiring the right to use the gardens did not change the overall substance of the transaction.

Alternatively, if the Tribunal was wrong and the main subject matter of the transaction was the leasehold interest in the flat and the Easement relating to the garden, the main subject matter of the transaction would still fall entirely within section 116(1), the Flat falling within (a) and the Easement within (c).

The appeal was dismissed.

Danielle Katie Sexton and Emma Rachel Sexton v HMRC (TC08708)

ADS and the 18-month rule (Lecture P1361 – 16.29 minutes)

Summary – Additional Dwellings Supplement was not refundable as completion on the sale of the first property was more than 18 months after the effective purchase date of the second property.

Ian Tavendale owned a home in Grangemouth.

On 26 February 2021, he bought a second home in Forres, disclosing and paying Additional Dwellings Supplement (ADS) on his Land and Buildings Transaction Tax return of £7,106.

Subsequently he disposed of the first property and on 26 August 2022, he submitted a claim for repayment of the ADS previously paid. The refund was claimed on the basis he had sold his first property within 18 months of buying the second one.

Revenue Scotland refused the claim, as the evidence submitted showed the sale of the first property took place more than 18 months after the acquisition of second property.

Ian Tavendale appealed arguing that the sale of his first home had been agreed in writing within the required 18-month window.

Decision

The First Tier Tribunal for Scotland found that, as a matter of law, the effective date for Land and Buildings Transaction Tax was the date of completion, which was 29th September 2022. This was after the 18-month window had expired and so the ADS was not refundable.

The appeal was dismissed.

Mr Ian Alexander Tavendale v Revenue Scotland [2023] FTSTC 1

Administration

Sent and received

Summary – Self Assessment late filing penalties totalling some £280,000 had been validly served. The taxpayer's argument that the letters had not been received was dismissed.

Nicholas Burley appealed against 12 penalty assessments amounting to £282,397 for the late filing and late payment of tax, issued in January 2019. More than 80% of this sum was for successive 5% penalties applied in relation to a failure to pay tax within 30 days and 6 months of the due date, for 2016/17

Nicholas Burley appealed stating:

> "HMRC should accept that any penalty assessments that may have been made are not valid as they have not been notified to me as is required by statute."

Decision

The First Tribunal confirmed that HMRC needed to show, based on the balance of probabilities, that the penalties had been correctly raised and notified to the taxpayer. Provided HMRC were able to do so, the taxpayer would then need to displace the presumption they had been correctly served.

The Tribunal was satisfied that HMRC's evidence 'sufficiently detailed and cogent' which included:

- HMRC's print-out of Nicolas Burley's Self Assessment record showed the penalties being sent in January 2019.
- An internal HMRC document showed the penalties being imposed;
- The contractor, Communisis, responsible for the raising and despatching of penalty assessments providing "Evidence of print and despatch, based on Print Service records".
- No letter being received back through HMRC's 'dead letter' service.

Nicholas Burley was then unable to displace the presumption that notices had been correctly served as:

- he had a history of late filing and, as a result, being charged penalties
- he accepted that a significant volume of other post from HMRC had reached him, including information relating to other penalties and determination warning letters about the returns that had not yet been submitted;
- other correspondence with HMRC was not consistent with his argument. In March 2019 he sent an email replying to HMRC's letter of the same month, acknowledging that the penalties had been raised and asking why he was being

penalised despite being co-operative. He did not question what penalties were being referred to or ask where the penalty notices were.

The appeal was dismissed.

Mr Nicholas Burley v HMRC (TC08701)

Clearances to HMRC (Lecture P1364 – 15.15 minutes)

There are many situations where it is possible to apply for clearance to HMRC that a particular piece of legislation does or does not apply. Of course, there are going to be a smaller number of situations where clearance is commonly sought and we will look at those in more detail.

It should be noted that HMRC will not give informal or formal clearance about the application of the General Anti-Abuse Rule (GAAR). However, HMRC have always been (and will continue to be) willing to discuss commercial arrangements with large businesses and high net worth individuals, as long as what is being done does not amount to tax avoidance. In reality, that general facility is only going to be available to a select few companies and individuals who have their affairs dealt with by a named individual (often a Customer Relationship Manager or equivalent).

Statutory clearances

The first category of clearances will be those which have a statutory basis – that is that the legislation specifies that a taxpayer can seek clearance from HMRC on the operation of a specific point. It is always important to identify what you are seeking clearance for. If you apply to HMRC for clearance relating to a share for share exchange, for example, you are seeking clearance that HMRC agree that the deal is being done for bona fide commercial reasons and not for avoidance of tax. HMRC are under no obligation to tell you if they believe the transaction has another flaw which they could attack. The Clearance Section are normally willing to tell you if they believe that the transaction is not one to which the legislation would apply but the wording of the clearance is such that it does leave the possibility of enquiry on other aspects.

The main statutory clearances are as follows:

- Share for share exchanges (s138 TCGA 1992);
- EIS shares subject to acquisition by new company (s247 ITA2007);
- Reconstructions involving transfer of business (s139 TCGA 1992);
- Company reorganisations involving intangible fixed assets (s831 CTA2009);
- Transfer of UK trade between EU member states (s140B and s140D TCGA 1992);
- Purchase of own shares by unquoted trading company (s1044 CTA2010);
- Demergers (s1091 CTA2010);
- Transactions in securities (s748 CTA2010 and s701 ITA2007); and

- Transactions in land (s831 CTA2010 and s770 ITA2007).

There are others but these are typically the ones which you might encounter.

From a practical perspective, you can request clearance by email (reconstructions@hmrc.gov.uk) as long as the attachments are no greater than 2Mb in size. HMRC will reply by email, but you do need to include a permission as part of the email submission. It is also possible to write to HMRC (BAI Clearances, HMRC, BX9 1JL). If the application is market sensitive, the application should be sent by post and marked for the attention of the team leader. No correspondence on the case will be undertaken by email. An application is market sensitive if the information contained within it could affect the price of a stock market quoted company or there is information about the financial affairs of a well-known individual.

Clearance should be given within 30 days but if there are questions to be asked, then the 30-day time-limit is reset from the date of your response to the enquiries raised.

There is no standard form for completion of a clearance, but it is important to include as much detail as possible about the parties involved and the specific reasoning behind the clearance being sought. For example, if you are seeking clearance that a transaction is being undertaken for bona fide commercial reasons, you need to explain why you believe that is the case. It is not simply sufficient to state that this is the case.

Typically, you would want to include:

- Details of all parties involved including companies, shareholders;
- Copies of accounts;
- History of shareholdings;
- Details and reasons for transaction;
- Details of clearances sought;
- Confirmation that conditions are met.

This is particularly important under the current climate as we are seeing a much greater level of refusal of HMRC to grant clearance in specific circumstances. The main area of concern seems to involve the application of the transactions in securities provisions.

What if you do not seek clearance?

There is an interesting debate amongst some advisor about seeking clearance. There is nothing stopping someone undertaking a transaction without seeking clearance. Clearly there is a risk, but you do have the opportunity at that stage to make any technical arguments which relate to the case. You do not have the opportunity to engage in such discussions with Clearance Section.

Which leads us on to the question as to what you do if you have clearance refused? The Clearance section is under no statutory obligation to tell you why clearance has been refused. Historically, they often declined to do so to stop people simply changing their plans solely to obtain clearance. However, this has changed now so they will 'where possible' give reasons but these are often not explicit.

For example, in a recent case involving an MBO-type transaction involving a NewCo acquiring a business for a combination of cash/loan notes/shares, clearance was refused under the transactions in securities provisions and this was the wording used:

> 'they are concerned that by receiving cash and redeemable loan notes, the shareholder … will be able to realise almost the full value of the company in a capital form whilst retaining a significant indirect interest'.

This can be read in a number of ways.

So, what do you do? You can simply proceed with the transaction and make the technical arguments if it is challenged by HMRC. You can make additional arguments to HMRC, but the Clearance Section will not typically engage in discussion with you about the clearance that is given. There would be nothing to stop you tweaking the deal and then applying for clearance again but this is not a straightforward process.

Other clearances

There are other clearances that businesses may wish to seek.

<u>Transfer pricing</u>

It is possible apply for an Advanced Pricing Agreement (APA). This is a written agreement between a business and HMRC which specifies the methodology to be used in determining the arm's length price for transactions affected by the transfer pricing provisions. It will mean that the business will not be challenged by HMRC for the period of the agreement (typically five years).

Due to the costs and time involved in agreeing APAs, HMRC set certain conditions. The transfer pricing issue must be complex rather than straightforward which is taken to mean that there must be some doubt as to what the correct transfer pricing methodology is. It is not just about the quantum of the tax at stake but this will be a factor. It is also unlikely that HMRC will enter into an APA relating to UK-to-UK transactions. The business also must acknowledge the time it can take to put this agreement in place.

The APA process is initiated by an informal discussion via an Expression of Interest.

<u>EIS, SEIS and VCT</u>

The Venture Capital Relief team deals with various aspects of the administration of the Enterprise Investment Scheme, Seed Enterprise Investment Scheme and Venture Capital Trust scheme. This includes enquiries from companies about the schemes, requests for informal clearance that a company will qualify under one of the schemes, statutory applications from companies who have issued shares and statutory approval of companies as VCTs. They do not deal with the personal tax issues arising from claims by investors.

They can be contacted by email (enterprise.centre@hmrc.gov.uk), mail (Venture Capital Relief Team, HMRC, WMBC, BX9 1BN) or phone (0300 123 3440).

The most common approach to the Venture Capital Relief team will be to obtain advance assurance about a company qualifying as many investors will seek this before they will agree to invest.

The type of information that HMRC will want to see is:

- How much money is to be raised;
- Business plans and financial forecasts;
- A copy of the latest accounts if available;
- How the company will use the money invested;
- Details of all trading and other activities and how much is to be spent on each;
- A copy of the articles and details of any changes that are to be made;
- A copy of register of members at the time of the application;
- The draft of any documents to be given to potential investors;
- Details of any other agreements between the company and its shareholders;
- Any other relevant documents; and
- A statement as to how the risk to capital condition is going to be including how the money is going to be used for the growth and development of the company.

If the team do not believe that the conditions are met, they will explain why they believe this is the case. No feedback is given on incomplete applications. It is very common for these applications to be returned as incomplete.

Research and development

HMRC will give advance assurance for companies that wish to claim R&D tax reliefs. It is not mandatory. However, it means that HMRC will allow the R&D claims without enquiry for the first three years that the relief is claimed.

This is only available where:

- The company has not claimed R&D relief before;
- The annual turnover is £2m or less; and
- It has less than 50 employees.

If the company is part of a group where another group company has claimed R&D relief before, this process cannot be used. You are also precluded from participating if the company has entered into any scheme notified to HMRC under DOTAS or if they are a serious defaulter.

There is a specific form called CT R&D (AA) which can be accessed via their website.

Non-statutory clearances

This is a process whereby HMRC may give clearance where something is not covered by a statutory or specific clearance.

It can be quite difficult to get HMRC to give a non-statutory clearance as there are lots of caveats about when they will engage with this process.

Their guidance starts of by saying they will help if:

- You have fully read the relevant guidance or contacted the relevant helpline;
- You have not been able to find the information you need;
- You are uncertain about HMRC's interpretation of tax legislation.

HMRC will not process the application if you do not give them all of the information that is needed. There are checklists published by HMRC with details of what you need to send and it is important that these are followed.

HMRC will not give advice:

- unless there are genuine points of uncertainty. If they do not think that the question is uncertain, they will direct the taxpayer to the relevant guidance.
- on matters of fact. The example they give is whether or not an activity is a business which is particularly relevant when looking at incorporation relief for property businesses.
- if they consider that you are asking them to approve tax planning arrangements.
- the related return period is final.
- there is a statutory clearance process available.

The application should be submitted by email with all relevant information. HMRC say they will try to reply within 28 days, but this is definitely not happening currently when the response time is more likely to be three months.

It is important to note that you can only rely on this clearance if you have provided HMRC with the relevant information. If you disagree with the response given by HMRC you can still complete the return ignoring their view but you must make reference to this when completing the return so this can mean that some people would rather not seek the clearance.

Contributed by Ros Martin

Electronic sales suppression penalties **(Lecture P1365 – 12.14 minutes)**

In a previous article I covered issues relating to electronic sales suppression ("ESS"). This article will cover the penalty regime associated with ESS. An ESS penalty is one charged under the provisions of Schedule 14, Finance Act 2022.

Penalty for making, supplying, or promoting an ESS tool

The ESS penalty provisions provide for a liability to a penalty in certain circumstances.

Penalties can be charged for making an ESS tool, supplying an ESS tool, or promoting use of a tool to suppress an electronic sales record. The penalties for these offences are subject to the same provisions.

As a brief recap from the previous session, an ESS tool is one which is used to either hide or suppress the value of individual transactions in electronic sales records. There is a definition of various terms used in the legislation, at Paragraph 1, Schedule 14, Finance Act 2022. There is a wide-ranging definition of "tool", and the term can include software, computer code, hardware, and "any other thing".

A penalty of up to £50,000 per tool can be charged to:

- A person who makes an ESS tool (including modifying a tool that is not an ESS tool so that it becomes an ESS tool);
- A person who supplies an ESS tool to other persons;
- A person who promotes the use of a tool to suppress a relevant electronic sales record (a penalty can be applied for each such occasion).

The penalty is a percentage of the maximum that can be applied, by reference to 3 things.

1. The type of ESS tool:
    - Where the tool is considered to be of "low complexity", the maximum penalty for this category is 40% of the maximum £50,000 penalty;
    - Where the tool is considered to be of "medium complexity", the maximum penalty for this category is 80% of the maximum £50,000 penalty;
    - Where the tool is considered to be of "high complexity", the maximum penalty for this category is 100% of the maximum £50,000 penalty.
2. The type of disclosure ('unprompted' or 'prompted') - This determines the minimum penalty percentage that HMRC will charge.
3. The 'quality of disclosure':
    - Telling – up to 30% of the maximum reduction;
    - Helping – up to 40% of the maximum reduction;
    - Giving – up to 30% of the maximum reduction.

The penalty range is determined by reference to the type of ESS tool and whether the disclosure was prompted or unprompted.

Nature of ESS tool	Unprompted disclosure	Prompted disclosure

Low complexity	10% to 40%	20% to 40%
Medium complexity	30% to 80%	45% to 80%
High complexity	50% to 100%	70% to 100%

HMRC have produced a factsheet on ESS (CC/FS68), which includes consideration of what is meant by "low complexity", etc. The factsheet can be accessed here:

https://www.gov.uk/government/publications/compliance-checks-electronic-sales-suppression-ccfs68/electronic-sales-suppression-ccfs68#:~:text=Penalty%20for%20making%2C%20supplying%2C%20or,or%20promoted%20an%20ESS%20tool.

The penalty is calculated by reference to the reduction for telling/helping/giving. When determining the quality of the disclosure, HMRC will take into account how long it has taken the person to make it. Where it has taken the person a 'long time', which HMRC consider to mean three years or more, to correct or disclose what is wrong, they will usually restrict the maximum reduction applied for the quality of the disclosure. In these circumstances, HMRC will restrict the maximum reduction to 10 percentage points less than the maximum reduction.

Penalty for being in possession of an ESS tool

A penalty of up to £1,000 can be charged if a person possesses, has obtained or has access to an ESS tool and one of two conditions is met.

The first condition is where HMRC has notified the person (in writing) that an officer of HMRC has reason to believe that the person is in possession of, or has otherwise obtained access to, an ESS tool. There is a 30-day period of grace, in which the person can satisfy the officer that they are not, or are no longer, in possession of, and does not otherwise have access to, an ESS tool.

The second condition is that the person has been assessed to an ESS penalty within five years of the day on which HMRC has reason to believe that the person has access to an ESS tool. If this condition is met, HMRC have stated that their policy will be to charge the full £1,000 fixed penalty.

Where a fixed penalty has been charged under these provisions, a further, daily, penalty can be charged if the person continues to possess, or have access to, the ESS tool. The penalty is up to £75 per day for each subsequent day for which the default continues, subject to a maximum penalty of £50,000. HMRC have stated that where they charge the full £1,000 fixed penalty following the imposition of a previous ESS penalty, see above, the daily penalty rate will normally be £75 per day.

The penalty for possession, etc, can be charged whether or not the person owns the tool, whether or not they only access the tool remotely, or whether or not other persons also have access to the tool. A penalty for possession will not be charged if the person has been assessed to a penalty for making, supplying or promoting the tool that they are in possession of, or has otherwise obtained access to. A penalty will also not be charged if the person can satisfy HMRC, or, on appeal, the tribunal, that they were not aware that the tool they were in possession of, etc, was an ESS tool.

Other penalty considerations

There are provisions within the legislation (see Part 3, Schedule 14, Finance Act 2022) which impact on the ability to impose a penalty, or the level of a penalty. These include where the activity that would otherwise give rise to a penalty is a legitimate activity.

In addition, the principle of double jeopardy applies, and person will not be charged an ESS penalty where they have been convicted of an offence.

Advisers are likely to be familiar with the concept of a "special reduction" from other penalty regimes, and those provisions are mirrored in the ESS legislation. Where a person becomes liable to an ESS penalty, if HMRC assess the penalty they must notify the person. However, the notification must be made within two years from the day on which sufficient evidence of facts to indicate liability to the penalty, in the opinion of HMRC, comes to HMRC's knowledge.

When a penalty is assessed, the person has the usual rights of appeal, including to the tribunal. Finally, advisers need to be aware that HMRC may be able to impose other penalties, in addition to those charge under the ESS provisions, including, for example, for the submission of an incorrect return.

Practical points for advisers

The ESS provisions are relatively new, at the time of writing, being introduced in February 2022, so it is too early to determine their application by HMRC, and any subsequent considerations by the tribunal. When faced with a client with a potential ESS penalty position, the adviser needs to establish the facts, particularly in view of the potential high level of penalties that can be charged.

Advisers need to be pro-active if there is a disclosure to make, and consideration needs to be given to the 'unprompted v prompted' position, particularly where HMRC have started an enquiry, or initiated contact with the client. Unfortunately, the adviser is often faced with a "damage-limitation" exercise and needs to ensure that the client acts in an appropriate way to maximise the potential for penalty reduction. Finally, advisers should consider seeking specialist help, to minimise the penalty, and assist with the overall "damage limitation" exercise.

Contributed by Phil Berwick (Director at Berwick Tax)

Deadlines

1 March 2023

- Corporation tax for periods to 31 May 2022 for SMEs not liable to pay by instalments
- Review HMRC car mileage fuel rates.

2 March 2023

- Unpaid income tax/class 4 NICs for 2021/22 will attract an automatic 5% penalty

7 March 2023

- VAT returns and payment for 31 January 2023 quarter (electronic)

19 March 2023

- PAYE, NIC, CIS, student loan liabilities for month to 5 March 2023, not paying electronically
- File monthly CIS return

21 March 2023

- Online monthly EC sales list for businesses based in Northern Ireland selling goods
- Supplementary intrastat declarations for February 2023
  - arrivals only for a GB businesses
  - arrivals and despatch for a business in Northern Ireland.

22 March 2023

  - PAYE liabilities should have cleared HMRC's bank account

31 March 2023

- Accounts to Companies House
  - private companies with 30 June 2022 year ends
  - public limited companies with 30 September 2022 year ends
- Reclaim tax paid by a close company on a loan to a participator if loan repaid during the year ended 31 March 2019
- CTSA returns filed for companies with accounting periods ended 31 March 2022
- Claims for VAT partial exemption special method must receive approval if to be backdated to 1 April 2022 (March year ends)
- End of CT61 reporting period

News

Text messaging

The CIOT has shared a message from the HMRC Communications Team that explains a new system that HMRC is trialling. Where taxpayers contact HMRC about routine guidance matters, HMRC will automatically send texts with links to relevant guidance.

An extract from the message reads as follows:

> "From 19 January SMSs will be sent to some customers who call our helplines from a mobile phone asking for help with a routine matter that would be better resolved if they used our digital services.
>
> SMSs will automatically be triggered using the customers' reason for calling and their message will include a direct link to relevant information. The SMS messages will be short and simple, and will not contain any personal or sensitive customer information. The call will then be disconnected so that customers can follow the link and continue online.
>
> Instances where SMS will be offered or sent are:
>
> - find your Unique Taxpayer Reference;
> - help registering for HMRC online services;
> - lost or forgotten online service password or user ID;
> - queries on whether they should register for Self Assessment or still have to complete a tax return;
> - requests for income and employment history ;
> - lost National Insurance number, or a letter confirming their number;
> - help filling in their tax return;
>
> Our SMS messages will be sent to customers while they're on the call, providing them with instant information available online."

https://www.tax.org.uk/intelligent-sms-services-new-service-to-help-customers-get-it-right-message-from-hmrc

Interest rates rise again

Following the Bank of England's latest interest rate rise, HMRC has announced the following changes:

- Interest payable on late payment of main taxes will increase to 6.5%;
- Interest on repayments from HMRC will increase to 3%.

The change will apply from:

- 13 February 2023 for quarterly instalment payments;
- 21 February 2023 for non-quarterly instalment payments.

https://www.gov.uk/government/publications/rates-and-allowances-hmrc-interest-rates-for-late-and-early-payments/rates-and-allowances-hmrc-interest-rates

Institute for Fiscal Studies - even out tax relief on pension savings

In *A blueprint for a better tax treatment of pensions*, IFS researchers propose several changes which they believe could be revenue-neutral in the long run, and even in the short run.

The IFS suggest:

1. reforming the 25% tax-free component. At a minimum, this should be capped so that it applies only to 25% of, say, the first £400,000 of accumulated pension wealth: this would still leave about four-in-five of those approaching retirement unaffected. Going further, the report suggests replacing the tax-free component with a new subsidy. This could be designed to be as generous as the existing system to basic rate taxpayers but provide equivalent support to non-taxpayers and stop supporting those paying higher rate income tax in retirement.

2. giving upfront employee National Insurance contributions (NICs) relief on all pension contributions, and tax pension income instead. This would align the income tax and NI systems and benefit low and middle earners.

3. decoupling the upfront tax subsidy from employer NICs. Instead, the report recommends applying employer NI to employer pension contributions and introducing a new subsidy on all employer pension contributions.

4. reforming the annual and lifetime allowances. The lifetime and annual limits on the amount that can be saved free of income tax in a pension have been cut sharply since 2011, especially for the highest earners. The government should consider making the annual allowance more generous and end the policy of tapering annual allowances for very high earners, as well as increase the lifetime allowance.

Adapted from Taxation (9 February 2023)

Mandatory disclosure rules

The government announced it would implement MDR at Budget 2021 and launched a consultation on draft implementing regulations on 30 November 2021. Following the consultation, the government decided to implement MDR on 28 March 2023.

Following Brexit, DAC6 regulations are being withdrawn and are being replaced with Mandatory Disclosure Rules (MDR). Currently 16 jurisdictions, including the UK, have signed up to the MDR rules, which will apply globally.

Under these rules:

> "promoters and advisors must disclose details of certain types of arrangements to HMRC. An arrangement will be reportable if it involves the use of opaque offshore structures or if it circumvents reporting under the Common Reporting Standard (CRS). The CRS involves the reporting and exchange between tax authorities of financial account information, to prevent people hiding money offshore. Arrangements which circumvent the CRS or involve the use of opaque offshore structures arrangements can be used to hide beneficial ownership of assets from the tax authorities.
>
> HMRC will share and exchange information on these arrangements with other tax authorities implementing the rules where the taxpayers involved in the arrangement are resident and will use the information received to identify and challenge potential cases of offshore tax non-compliance. These new disclosure rules are also expected to influence taxpayers to help ensure that any relevant structures they implement are reported correctly for tax purposes, with all tax due being declared.

Comprehensive guidance will be published by HMRC to help taxpayers and businesses comply with the regime.

https://www.gov.uk/government/publications/mandatory-disclosure-rules/mandatory-disclosure-rules-mdr

Business Taxation

Former rugby union player wins IR35 case (Lecture B1361 – 19.06 minutes)

Summary –A former rugby union player provided commentary services to Sky TV in business on his own account. Tax had been correctly paid through his personal service company.

A former rugby union player, Stuart Barnes became a freelance writer, TV presenter and commentator, as well as a newspaper columnist. His services were provided through his personal service company, S & L Barnes Limited to a range of organisations including the Times and the Sunday Times newspaper, Rugby World Magazine and other broadcasters such as Ireland's TV3 and Fox Sports.

This case concerned Stuart Barnes' work for British Sky Broadcasting Limited (now Sky TV Limited) covering the period from 6 April 2013 to 5 April 2019. HMRC issued PAYE and NICs determinations totalling some £695,000 covering this period, arguing that Stuart Barnes was effectively a Sky TV employee during this time.

The parties agreed a four-year initial term, followed by a second two-year contract. In exchange for up to 228 days of work in total, an annual fee was agreed at £235,000, paid monthly in arrears. This increased annually by £10,000 for the next three years. During this time, around 60% of the company's income was received from Sky, dropping substantially to closer to 30% in 2019/20.

During this time, S & L Barnes Limited agreed to provide Stuart Barnes services, to include preparatory work and rehearsals, commentary as well as analysis programmes and interviews. Typically, the production team would draw up a schedule of sports events at the beginning of, and on an ongoing basis during, the season and schedule from a roster of commentators in advance. Where Stuart Barnes was unable to provide services himself, any substitute was always subject to Sky's approval. More typically, if he was unavailable, Sky would choose another pundit to take his place.

While Stuart Barnes would carry out his own research and write his own script, he was required to adhere to Ofcom Guidelines and was expected to work under the direction of Sky's production manager, with Sky having full editorial control over programmes.

Sky provided all necessary studio equipment and made the necessary travel and accommodation bookings, reimbursing reasonable expenses claimed by Stuart Barnes.

Stuart Barnes assigned all intellectual property and copyrights to Sky, giving Sky exclusive rights to commercially exploit the work he did for them. Stuart Barnes agreed not to exploit his image rights, or to undertake other broadcasting or media assignments that breached the 'non-compete' clause within his agreement.

Decision

As with other personal service company cases, the First Tribunal considered the hypothetical contract that existed between Stuart Barnes and Sky, applying the three-stage test from the Ready Mixed Concrete case.

Mutuality of obligation: Sky was required to pay Stuart Barnes a fixed monthly fee over the contracted period and in return he was obliged to provide his services. S & L Barnes Limited accepted that this test was met.

Control: The core services being provided was live commentary. Sky had control over the date, location and timing of this work. While Stuart Barnes decided the content of his commentary, this was within the wider controls of Ofcom rules, Sky's Editorial guidelines, and the directions of the executing producer for the Sky Sports programmes. Further, the contracts included warranties, non-solicitation and non-disclosure clauses assigning rights to Sky, ensuring that Sky would retain the absolute control over the exploitation of the output from the games broadcast. This was met.

Finally, the First Tier Tribunal considered 'Other provisions and factors'.

Typically, the days worked in each year were less than half of the maximum stated in his contracts. As a result, the Tribunal viewed the money paid as a 'block fee' for the exclusive right to have first call of Stuart Barnes' services. This was not a salary.

Stuart Barnes worked for many organisations, with only 60% of income coming from Sky. He was not financially dependent on Sky and as the Tribunal stated his income from the Times/Sunday Times "was by no means modest." Further, at the end of his second contract in 2019, he refused to enter into a new contract with Sky.

Although the contract stated that Sky had first call on his time, there was a long-standing understanding between the parties that Stuart Barnes would be unavailable to commentate during the Six Nations season, and the World Cup, key events in the rugby calendar, not broadcast by Sky. However, during this time, he could be asked for pre-match interviews by Sky Sports News, not something that would be asked of an employee.

The Tribunal found that, as a world-renowned expert on rugby, Stuart Barnes reputation was personal to him. He was not dependent on Sky. Without Sky's exclusive right for his services, he would have found other media-related work.

Stuart Barnes was able to publish his views for other media organisations, with Sky-related analysis often replicated in his Sunday Times columns. Sky's ownership of intellectual rights did not prevent this happening.

The Tribunal found that he was in business on his own account.

The appeal was allowed.

S & L Barnes Limited v HMRC (TC08697)

Creditors Voluntary Liquidation and PLNs **(Lecture B1361 – 19.06 minutes)**

Summary – Inaccuracies in the company's records were a result of deliberate actions by the sole director and shareholder of a company and led to inaccurate VAT and corporation returns being submitted. With the company in liquidation, personal liability notices were valid.

Colm Malone had traded as a sole trader, and then a partnership that had been required to provide security due to unpaid VAT of £20,818 and surcharges. Subsequently, he set up another partnership with his son which became insolvent in May 2014, owing £75,718 in unpaid VAT and an additional £11,369 in surcharges. At this time, the business was continued from the same premises as a newly formed company, Maloney's Diner Limited, with Colm Malone as the sole director and shareholder.

In 2018, as part of a compliance check, HMRC officers visited the premises twice, concluding that takings did not match those declared for tax purposes.

Later, the company was issued with estimated corporation tax and VAT assessments for undeclared income and penalties.

With the business likely to become insolvent, HMRC issued Colm Malone with two personal liability notices for VAT and corporation tax inaccuracies. Shortly after, the company was placed in Creditors Voluntary Liquidation.

Colm Malone appealed, arguing that the notices were invalid, as the inaccuracies were not deliberate.

Decision

The First Tier Tribunal noted that there was no appeal against the assessments and penalties by either the company or its liquidator.

The Tribunal agreed with HMRC that:

- there was a deliberate act by the company to conceal records leading to inaccurate VAT and corporation tax returns;
- the returns were provided in the knowledge that they were not accurate and with the intention that HMRC should rely on them;
- the inaccuracies were attributable to Colm Malone, as the sole director and shareholder.

With the deliberate inaccuracies attributable to Colm Malone, the personal liability notices were upheld.

Colm Brendan Malone v HMRC (TC08720)

Cryptocurrency (Lecture B1362 – 14.41 minutes)

Cryptocurrency and the tax treatment of transactions is an area designed to make many tax advisors feel very old and out-of-date due to the complexity of the subject.

What is cryptocurrency?

If I tell you it is a peer-to-peer electronic currency, that makes it sound too simple.

Although most people will have heard of Bitcoin, what about Ethereum, Tether, Terra, Cardano, Solano, Avalanche, Polkadot, Dogecoin, Cronos or Tezos (all in the top 50 currencies to buy on crypto.com as at the date of writing)?

To give you a sense of the size of the market, $24Bn of Bitcoin was traded in the last 24 hours as of today. It is also a very volatile market with the price having fallen by around 50% in the last year.

There has also been the recent publicity about the failure of the FTX platform recently where investors have lost significant amounts of money (maybe as much as $50bn). Some of those investors will be in the UK.

Tax treatment

However, what we really need to understand is how transactions are treated for tax purposes. There are an increasing number of questions being asked about the tax position and HMRC are also starting to get interested. Recent publicity suggests that they have 20 ongoing criminal investigations into cryptocurrency. It is unclear, however, whether those cases relate to the use of cryptocurrency to facilitate other types of tax evasion and money laundering or whether the investigations relate to the currency itself.

HMRC has recently published its 'Cryptocurrency Manual' although it is light on details in some key areas. It would be helpful if there was more guidance but it is acknowledged that this is a new area so there is bound to be many grey areas.

Trading or capital?

For most individuals, any profit made on trading in cryptocurrency will be capital in nature and so subject to capital gains tax. For anyone with a small holding the gain may be covered by the annual exemption so no tax will be due, assuming no other gains are made in the tax year. Significant gains will be subject to tax at 10% or, more likely, 20%. It is not going to be possible to argue, as some would like to, that any profit is tax-free on the basis it is similar to gambling.

The rules then follow the basic provisions as if they were any other asset. For example, if a client has lost $1m on the FTX exchange, that would be a capital loss which would be available to set off against current year or future capital gains but cannot be carried back to offset against gains in previous years.

In some cases, HMRC might wish to argue that an individual is trading so the profits are subject to income tax. Whether someone is trading is determined by reference to the 'badges of trade' which is a complex area based on case law. HMRC are always reluctant to accept anyone who is dealing in financial assets, stocks and shares, contracts for difference and now cryptocurrency, is trading unless they are a regulated dealer or they are doing this as an integral part of a larger trade. This is mainly because HMRC do not want losses generated to be able to be offset against wider income. It will depend on the facts of each case though.

In reality, you would need to be looking at large numbers of transactions, a degree of structure and organisation, and a significant commitment of time to even be close to being able to argue there is a trade.

Individuals will be liable to pay income tax (and possible National Insurance Contributions) on cryptocurrency that they receive from their employer or from certain other types of activities. Again, this is where it is all quite puzzling for the uninitiated.

'Mining' is where tokens are awarded to persons who are verifying additions to blockchain digital ledgers, typically by using computers to solve mathematical problems which generate new tokens. The same applies to 'Staking' where the ability to create new entry into the token register is determined by the size of the original stake. 'Airdrops' are where someone receives an allocation of tokens as part of a marketing or advertising campaign.

Any of these might be a trade (based on the badges of trade referenced above) or it might just be miscellaneous income. Airdrops might not even be taxable income if the person receives them without doing anything in return. Of course, any business which receives cryptocurrency in exchange for provisions of goods or services will be liable to tax on those as the value will be included as part of the trading profits. This may become more relevant in the future but it is not something which we are seeing very often at the moment.

If the profit is going to be taxed as a capital gain, the other point we need to consider is when is there a disposal? A disposal is going to occur when the cryptocurrency is sold for money, exchanged for different types of cryptocurrency, used to pay for goods or services or given away for no consideration. However, because of the strange nature of this new world, there are transactions which are not disposals. Currency can be split out into 'wallets' and moving the same currency from one wallet to another will not be a disposal. Gifts of cryptocurrency to charity would be free from capital gains tax under normal rules as long as none of the anti-avoidance provisions apply.

Another good question is what are the allowable expenses that you can deduct from the proceeds when calculating the gain? We are following normal principles here so you can deduct:

- The consideration originally paid for the asset;
- Transaction fees for having the transaction included on the relevant ledgers;
- Advertising for a purchaser or vendor; or
- Professional costs

Paragraph 22150 of the HMRC Cryptocurrency Manual explains that 'exchange fees' paid to perform transactions may or may not be allowable, depending on the exact nature of the fee.

Impact of residency

The final point to note generally is that you need to be careful about the situs rules for disposal of assets. Individuals who are resident in the UK but not domiciled may be able to claim remittance basis on disposals of foreign assets. However, it is the view of HMRC that cryptocurrency is located where the holder is resident. If someone is resident in the UK when they make any profit, that will be subject to UK tax. It is not relevant that they might have bought the cryptocurrency outside the UK. It is uncertain as to whether you could argue that the server is outside the UK such that assets have a foreign situs, but the guidance suggests that HMRC will not accept that argument.

But how might this apply in practice?

Whilst those are the basic rules, you might be interested to here of a specific case I was asked about by a client as it shows some of the complexity associated with this area.

The initial question was …

> 'I have a client who was paid in Flux for some data processing work. Income tax was paid on this. These Flux have gone up in value and are now standing at a profit of £300,000. Our client uses these as a trading asset and is looking to incorporate. Can we holdover the gain on the Flux on incorporation?'

My first question (having acknowledged that I was probably being very stupid) was how did he use the Flux as a trading asset? I had made an assumption that Flux was a cryptoasset of some type!

The first answer we got back was:

> 'If you hold a certain amount of Flux (currently 10000, 25000 or 100000) in a wallet you can then run a node and link the node to the network, the number of Flux determines the size of the node you can run and the size of the reward. The Flux is effectively locked as collateral whilst your node is running. A node could be a PC or a server. That node will then be awarded some Flux for being part of the network and will be used for running applications'

So, in essence, the Flux tied up in the node enables you to carry out data tasks which are paid with more Flux. You always retain ownership of the original Flux and you can always take it back (or sell it to someone else).

Whilst this clarified to an extent what it is, the next issue was that the answer did not really clarify the tax treatment if the client wanted to incorporate. My conclusion was that there were probably two options, assuming that the Flux is not some kind of trading stock, but I do not think that is the case.

The first is that this Flux is used as something like a licence which enables further work to be done which earns money for the holder. It is portal into a system which then uses your computer power for the purposes of the host business. If it were something like a licence, then I think you could claim holdover relief on incorporation.

However, there is a second alternative which is that this is effectively an investment asset which is generating a return similar to interest. It is a strange one though because whilst the return gained from this is passive (which is similar to interest) it can also be switched off if you do not have the node linked to the network. I suppose I would ask whether, in practice, the 'node' is always linked via the Flux held by the client (and I suppose I cannot see any reason why you would disconnect it given that it involves no real work from what I can see!).

The difficulty is that it is a struggle to see how this could be considered to be a trading activity which is what you would need to be able to prove so that the Flux currency itself is a capital asset being used for the purposes of the trade so that business asset disposal relief and holdover relief become relevant. It is probably the case that any income generated from the arrangement is going to be income but the capital gains position is not as clear.

My ultimate conclusion was that I didn't really know the answer but that there was a risk in transferring these assets on incorporation on the assumption that holdover relief was available. This is particularly true since we know that it is an area that HMRC are looking at.

Conclusion

The tax treatment of cryptocurrency is going to be determined by reference to general principles unless the Government put in place specific legislation to deal with these. The complexity relates to understanding exactly what is going on and what the terminology means. Once you can work that out, the answer may be relatively straightforward or it may be that it is impossible to give a definitive answer because the attitude of HMRC is not clearly expressed. An interesting area but maybe one where it is difficult to give clients certainty in relation to the tax treatment.

Where there is uncertainty, the key is to clearly document the reasoning for treating a transaction in a particular way as this will protect the client from penalties (on the basis that they took reasonable care in trying to work out the tax treatment) in the event that HMRC disagree with the way it has been reported.

Contributed by Ros Martin

Non-Tax-Advantaged Schemes (Lectures B1364/1365 – 17.55/11.08 minutes)

This article explains some of the tax issues and attractions of non-tax advantaged share schemes.

Where does the term come from? Originally HMRC would approve all schemes under the tax approved regime including CSOP (Company Share Option Plan), SAYE (Save As You Earn Plan) and SIP (Share Incentive Plan) and EMI (Enterprise Management Incentive Scheme). However, some years ago HMRC changed their process so that all one needed to do was register those plans and therefore the name changed to tax advantaged plans. Plans which fell outside these special schemes then became known as Non-Tax-Advantaged Plans.

Why do companies adopt Non-Tax-Advantaged Plans?

Non-Tax-Advantaged Plans do not have to comply with the HMRC requirements and therefore can be more flexible. Multi-National Enterprises often adopt Non-Tax-Advantaged plans so that they have similar or the same plans in all the countries in which they operate.

Many companies set up Non-Tax-Advantaged Plans to link employee remuneration to company performance. They are looking to align the company's objectives with the employees' objectives. This may be reinforced by having conditions under which the vesting of options or the release of shares is affected.

Because the share schemes are linked to a person's status as an employee, they are normally considered as Employment Related Securities. The gains are treated as remuneration and normally subjected to Income Tax and National Insurance in the same way as other remuneration.

What are the formats for Non-Tax-Advantaged Share Plans?

Typically, they take the form of either a share purchase plan or a share option plan. A common feature of these plans is that there are conditions to be fulfilled for the employee to benefit from the plan. These conditions often include maintaining employment and the company meeting revenue or profits thresholds.

Under a share option Plan, an employee is granted an option to buy a share at a pre-determined price; normally the market value at the time of the grant of the option. For example, an option may be granted at £1 meaning that the employee is able to buy the share at the fixed price of £1 in say 3 years' time.

The period between the grant of the option and when the option can be exercised is known as the vesting period. When that vesting period has finished, the employee can exercise his/her option to buy the share at the price that has been fixed. This means that if the share is now worth £3, the individual will have now made a paper gain of £2. When and if he sells the share, this gain will then be turned into cash. If the price has risen from the time of exercise at £3 to a sale price of £4, then there would be a capital gain of £1.

As the Schemes are called Non-Tax-Advantaged does that mean that there are no tax advantages?

In theory the answer to this is yes, as the default position would be that the gain on exercise is subject to full tax and NI in the same way as cash. So, in the previous example where the individual paid £1 for an option and at the time of exercising the options, the shares were worth £3, the gain of £2 is subject to tax and NI. This is the case even if the shares are not sold and that would create a "dry tax charge" where tax would be due without providing the funds to pay it. Quite often this tax would be provided by the individual selling enough shares to cover the tax bill. Or if the employee wishes to keep all the shares, he/she would fund the tax bill from other resources.

Are there any differences between the treatment of Non-Tax-Advantaged Share Plans and cash?

There can be significant differences. For example, if shares are given to an employee which are a minority interest in an unquoted company, this would be discounted for the lack of voting control and liquidity of the shares. This could amount to a discount of up to 80% on the value which means that a share which based on the total value of the company is worth £10, has a taxable value of say £2 because of the discounts available for unquoted trading shares.

National Insurance

National Insurance is not due on shares which are not readily convertible assets, i.e., not easily tradeable for cash. Quoted shares on a recognised stock exchange would be considered as readily convertible assets and therefore subject to NIC and PAYE. Unquoted shares may escape the NIC liability and any tax might only be due when the individual is required to file a self-assessment tax return. One needs to be careful that if any shares are subject to trading arrangements, they can be classified as Readily Convertible Assets.

What other planning is often used for Non-Tax-Advantaged Plans?

An election is often made under S.431 ITEPA 2003 by which the individual and the company pay the relevant tax and NI upfront on the value of the share at the start of the plan. If this is done then, any subsequent growth is only subject to capital gains tax (CGT). The top rate of CGT is 20% as opposed to income tax and NI for an employee of 47% and employer NIC of 13.8%. One major consideration is that if the shares fall in value, the tax paid upfront is not refunded.

What are the consequences for Internationally Mobile Employees?

The UK will look to tax the gain on a time apportioned basis. The gain relating to the individual's period of residence in the UK and, when non-resident, the time spent performing employment duties in the UK, is what would be taxed. For example, an individual has a 3-year share option plan and spent one year in the UK, one year in France and one year in Singapore. On the exercise of the options after 3 years the individual makes a gain of £30k. £10k i.e., one third, would be subject to UK tax.

Conclusion

Large numbers of companies use Non-Tax-Advantaged Plans for their employees. The tax treatment is not as straight forward as cash but there are some potential tax advantages for the well-advised company.

Contributed by Jeremy Mindell

VAT and indirect taxes

Organix and Nakd bar products (Lecture B1361 – 19.06 minutes)

Summary – The First Tier Tribunal had erred in law in deciding that whole food bars were confectionery, making them standard rated. The case has been referred back to the First Tier Tribunal to be reconsidered by a differently constituted panel.

In 2017/18, WM Morrison Supermarkets Plc sought to reclaim output tax of just over £1.1 million on the grounds that 'Nakd' raw fruit and nut bars as well as Organix bars for children had been wrongly treated as standard rated confectionery. The supermarket believed that they were zero-rated (Item 2 of Group 1 of Schedule 8 of VATA 1994).

HMRC refused the claim and WM Morrison Supermarkets Plc appealed. The First Tier Tribunal found in HMRC's favour. The bars did not look like cakes, were marketed as snacks rather than cakes and would have looked out of place on a plate of cakes.

The case moved to the Upper Tribunal.

Decision

The Upper Tribunal found that the First Tier Tribunal had erred in law by:

- finding that the healthiness of the product, and its marketing as such, was irrelevant to their decision as to whether the products were confectionery;
- failing to consider the absence of traditional confectionery ingredients used in the bars such as cane sugar, butter and flour.

The Upper Tribunal concluded that had these two things been taken into account, the First Tier Tribunal might have reached a difference decision. Without the full facts in front of them, the Upper Tribunal remitted the case back to the First Tier Tribunal to reconsider the case on the following basis:

- The case should heard by newly constituted tribunal to be selected by the First Tier Tribunal President, who may have access to the recording and transcript of the original hearing;
- Additional findings of fact must be made on the basis of the evidence before the original First Tier Tribunal and, if relevant, the new Tribunal's own taste test of the product samples.

WM Morrison Supermarkets Plc v HMRC [2023] UKUT 00020 (TCC)

Neil Warren, independent VAT consultant, commented:

> "HMRC's view is that if the bars qualified as zero rated, then any VAT rebate paid to Morrisons would be reduced by law (VATA 1994, s 80) to net off any input tax claimed by Morrisons on the purchase of the goods in question, which would then be classed as zero rated. This could reduce the rebate for the 2014 to 2018 period from £1.1m to about £100,000 – on the assumption that

> supermarkets achieve an average gross profit of 10% on their goods – and Morrisons would have difficulty getting a VAT credit from their suppliers because the purchase invoices will be more than four years old, which is outside the error correction period. HMRC asked the Upper Tribunal judges to consider this issue, which they refused to do because it is currently hypothetical."

He also commented:

> "As a separate issue, HMRC might also claim that the output tax rebate should be less than £1.1m because of "unjust enrichment" issues. In other words, some of the VAT refund should be repaid to the individual customers who purchased the bars in the first place and not Morrisons."

Default surcharge and COVID 19 **(Lecture B1361 – 19.06 minutes)**

Summary – The impact of COVID-19 on a new business, that had no access to government support, was a reasonable excuse for the company's defaults.

Bicester Property Interiors Limited was an interior renovation company that fitted kitchens and bathrooms as well as other interior renovation work. The company began trading in August 2019 and was registered for VAT from 25 February 2020.

The company paid the VAT due on its returns late for all periods between July 2020 and October 2021 and submitted the majority of returns late. This resulted in 5% default surcharges becoming payable from April 2021, increasing to 10% and 15% for the next two quarters.

Jake Holdsworth, as company director, appealed. He argued that lack of funds caused by COVID-19 were a 'reasonable excuse' for the late payments and the surcharges should be cancelled.

He provided extracts from email correspondence with its clients setting out instances of the kinds of difficulties that had arisen as a result of the pandemic. These circumstances were clarified during the appeal.

Loss of revenue was one factor but so too was having to wait for revenue "for far longer periods than normal". Projects would start but poor product availability would delay the project. Further delays arose as a result of the government's 10-day isolation period when either staff or client contracted COVID-19. Jobs went on for two to three times longer than would have been expected, meaning that the business had to wait two to three times longer to be paid.

Jake Holdsworth admitted that he had consciously chosen to pay staff or suppliers over HMRC. In his view paying HMRC late had far less of a consequence than a staff member missing a mortgage payment or not being able to buy food.

As a new business, the company was not eligible to receive any COVID-19 related government grants; nor were loans or overdrafts available until 2022. Further, he pointed out that HMRC had extended the Self Assessment filing deadline by a month, whereas the longest HMRC had had to wait for his company to make its VAT payments had been 17 days.

Jake Holdsworth claimed that he “had made several attempts to call HMRC during the relevant period but had been placed on hold for very long periods of time before cancelling the calls.” HMRC had their own staffing issues at this time.

Decision

The First Tier Tribunal found the director to be a credible witness who had provided comprehensive examples of how the pandemic had affected his business. Staff and customers isolating, driver shortages and lack of government support for the new company had all contributed to its problems. This was a company “with only around 5 staff, with very limited cash resources and no overdraft or other reserve funding”. The difficulties encountered as a result of the COVID-19 pandemic were particularly bad for such a company, which relied on staff going into homes for extended periods to carry out their work.

Under normal circumstances it is not appropriate for a taxpayer “to take matters into its own hands” and decide to pay staff and suppliers ahead of HMRC. However, the Tribunal found that in this case it was acceptable.

The Tribunal noted that:

- Raising sales invoices before the end of some jobs did not help the company’s cashflow position as VAT then became payable, even though the customer did not need to pay until the work had been completed;

- Using the cash accounting scheme would have benefitted the company as output tax would have been declared on payment by the customer rather the date that the invoice was raised. However, access to the cash accounting scheme is normally not available where a business is not already up to date with VAT returns or payments. Once the company had begun its first surcharge liability period, it was too late to adopt the cash basis.

However, since COVID-19, the company has kept fully up to date with its VAT obligations. The invoicing system in operation has not caused defaults under normal circumstances.

The Tribunal concluded that, on balance, the company’s actions were “objectively reasonable” and the failures were remedied without unreasonable delay. Further, the delays in question of between three and 17 days were not considered to be an excessive length of time.

The appeal was allowed.

Bicester Property Interiors Limited v HMRC (TC08675)

Matchmaking services (Lecture B1361 – 19.06 minutes)

Summary - A dating matchmaking service was not a supply of consultancy for VAT purposes. This meant the UK VAT would be due even when the services were supplied to customers outside the UK and EU.

The background to the case arises from the way the place of supply rules apply to certain services. Usually, for services supplied to individuals, the place of supply (and where VAT should be accounted for) is where the supplier is established.

However, under Article 59(c) of the EU Principal VAT Directive (PVD), ‘consultancy’ services (and similar services including data processing and the provision of information) are not subject to UK VAT if supplied to overseas clients (non-EU for the services under consideration in this appeal, now non-UK applying the rules as they now stand post-Brexit).

The services provided by Gray & Farrar were high-end matchmaking facilities, and it operated three tiers of service levels (club, custom and private commission), with fees ranging from £15,000 to over £100,0000 per annum. The unique selling point of Gray & Farrar was that it provided its clients access to an exclusive dating pool, with personalised levels of matchmaking services, rather than relying on the more modern methods of psychometric testing and app-based matches.

Gray & Farrar believed its services fell within the definition of consultancy services for VAT purposes, and thus, applying the legislation referred to above, took the view that its services to individuals outside the EU should be outside the scope of UK VAT.

HMRC disagreed with this. The First Tier Tribunal found in HMRC’s favour, before the Upper Tribunal subsequently overturned this decision. The Upper Tribunal found that the First Tier Tribunal had erred in law by failing to correctly identify the predominant element of the single service provided by Gray & Farrar. The service was the provision of introductions, which involved the provision of expert advice and information. The Upper Tribunal found that based on the viewpoint of the typical client, the service should be categorised as consultancy and allowed Gray & Farrar’s appeal.

Decision

However, on further appeal, the Court of Appeal has allowed HMRC's appeal and reinstated the First Tier Tribunal decision. Whilst the Court of Appeal agreed with the Upper Tribunal that the predominant element test is the primary test to be applied in characterising a supply for VAT purposes, it held that the single supply in this case was of introductory services and not consultancy services.

In reaching this view, the Court of Appeal compared the services to those ‘principally and habitually’ provided by consultants, and the Court of Appeal concluded that the matchmaking service was not of a type habitually provided by consultants or consultancy firms. Accordingly, the services supplied to overseas clients did not fall within Article 59(c), PVD and they were within the scope of UK VAT.

Gray & Farrar International LLP v HMRC [2023] EWCA Civ 121

Raising funds for acquisitions **(Lecture B1361 – 19.06 minutes)**

Summary – Input VAT incurred on costs to raise funds to make acquisitions were not recoverable as they were incurred by a company that did not have actual or intended business activities at that time.

The VAT denied in this case related to the flotation of Gordon Dadds Group Limited on the Alternative Investment Market and the simultaneous raising of £20 million. This was effected using a reverse takeover in which Work Group plc acquired Gordon Dadds Group Limited, with Work Group plc joining the VAT group on the same day.

Work Group plc received and paid for services in relation to the takeover, and sought, via the VAT group representative member to recover the input tax.

HMRC denied the claim on the basis that Work Group plc did not make or intend to make taxable supplies.

Gordon Dadds Group Limited, the representative member, appealed on the bases that:

- the supplies were treated as made to the VAT group representative which was carrying on the taxable economic activities of the group as a whole;

- the cost of the supplies formed part of the overheads of the VAT group representative and were recoverable as such.

Decision

The First Tier Tribunal accepted that:

- Work Group plc had joined the VAT group;

- Work Group plc incurred costs for the purpose of raising funds;

- The funds were to be used to make acquisitions that would benefit from the management services supplied by the representative member of the VAT group.

However, the Tribunal found that the use of the funds did not result in the required direct and immediate link between the costs incurred by Work Group plc and the management services supplied by the representative member; or that the costs should be treated as overhead costs for VAT recovery purposes.

The First Tier Tribunal's reasoning was summed up in Tax Journal (3 February 2023):

> "The decision in Heating Plumbing Supplies Ltd v HMRC [2016] UKFTT 753 (TC) may appear to support the argument for VAT recovery referred to above, but the FTT commented that that decision 'seems partly to rely on the (wrong) proposition that the VAT group itself is the single taxable person, which the Supreme Court in HMRC v Taylor Clark Leisure plc [2018] UKSC 35 said is wrong'. In deciding that the VAT incurred by WG was not recoverable, the FTT distinguished the facts in this case from those in Frank A Smart & Son Ltd v HMRC [2019] UKSC 39 and in Hotel La Tour Ltd v HMRC [2021] UKFTT 451 (TC), where it was found that VAT on the cost of raising funds was recoverable. In each of those cases, it was the entity which had incurred the cost of raising the funds that had used the funds to develop business activities that provide entitlement to VAT recovery."

Ince Gordon Dadds LLP v HMRC (TC08699)

Legislative error caused delay in claim

Summary – The property condition 'error' caused the delay in payment from the time that the taxpayers would have made refund claims. Interest was therefore due from this time.

Between 1989 and 1997 the taxpayers made supplies of vehicles by means of hire purchase. Sometimes customers defaulted on their obligations under the agreements and this gave rise to a right of the taxpayers to terminate the contract, repossess the vehicle and sell it. When the net sales proceeds were less than the sums due under the original agreement, the taxpayers suffered bad debts.

In 2007 (HBOS) and 2009 (Lloyds) made claims for bad debt relief for periods between 1989 and 1997.

HMRC denied these claims because until 1997 the UK’s bad debt relief provisions included a condition that for bad debt relief to be claimed on a supply of goods, title in the goods must have passed. Consequently, as the law stood, they were unable to claim bad debt relief.

However, in 2016 the Court of Appeal in GMAC v CRC [2017] STC 1247 said the property condition was unlawful under EU law. In February 2019 HMRC paid the taxpayers the bad debt relief claims plus interest running from the dates of their claims until February 2019.

A dispute arose as to whether, as HMRC argued, the interest – about £870,000 – should run from the date of the claims or whether, as the taxpayers argued, it should run from the date the valid conditions for bad debt relief were met – about £10m.

The relevant interest provision was VATA 1994, s 78 under which HMRC would be liable to pay interest where 'due to an error on the part of the commissioners … a person has suffered delay in receiving payment of an amount due to him from them in connection with VAT'.

Decision

The Upper Tribunal held first that the First Tier Tribunal had erred by holding that the enactment of the property transfer condition and its continued presence on the statute book up to 19 March 1997, was an error on the part of parliament, not HMRC.

It was necessary to consider whether, but for the legislative error, the taxpayers not only could but also would have made their claims earlier than they did. The judges believed that they would. This was on the basis that the taxpayers made bad debt relief claims in relation to supplies which did not involve retention of property clauses.

The Upper Tribunal concluded that the property condition 'error' caused the delay in payment from the time that the taxpayers would have made refund claims. Interest was therefore due from this time.

The taxpayers' appeal was allowed.

HBOS and Lloyds Banking Group v HMRC, [2023] UKUT 00013 (TCC)

Adapted from the case summary in Taxation (2 February 2023)