Tolley®CPD

May 2017

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Finance Act 2017

June election disrupts Finance Bill

The Finance Bill received its second reading on 18 April 2017.

However, the Prime Minister's announcement of a General Election on 8 June 2017 has now disrupted things as Parliament will be dissolved on 3 May.

Public Bills cannot be carried forward into a new Parliament – they either need to be passed or scrapped! This one was too big to be passed in the required time.

Following discussion with the Opposition, the Government removed a majority of the Finance Bill (72 out of 135 clauses and 18 out of 29 schedules). Essentially any contentious or complex clauses have been withdrawn.

The government completed all remaining Commons stages of the revised Bill on Tuesday 25 April. It was read in the House of Lords on 26 April and received Royal Assent on 27 April 2017.

The CIOT has produced a handy list of clauses, clearly indicating what is still included and what has been excluded. This can been accessed at

http://www.tax.org.uk/media-centre/blog/media-and-politics/government-drop-majority-finance-bill

The excluded clauses include:

- Making Tax Digital (!)
- Dividend tax rate for 2018/19
- £1000 tax free allowances for property and sundry income
- £500 tax free pensions advice
- Changes to taxation of terminations payments
- Reduction in money purchase annual allowance from £10,000 to £4000
- Power to tax capital gains made from UK land as income tax not CGT
- Deemed domicile for all taxes for non-doms
- Changes to substantial shareholding exemption
- Changes to EIS, SEIS, SITR and VCT schemes
- Restrictions on corporation tax losses

It is likely that most, if not all, of the provisions dropped will return in a second Bill after the election, regardless of who wins the election.

As Robert Jamieson has said:

> "virtually all the Finance Bill measures (which are largely revenue-raising) have been included in the Government's financial budget for the current year. Therefore, I think that it pretty clear that, whatever the outcome on 8 June, the next Government will be reintroducing them at the earliest opportunity. My view is that the original starting dates are likely to stand - after all, we have already had advance notice of the measures."

Unfortunately the IR35 provisions for workers performing contracts in the public sector were not regarded as contentious and remain in the Bill. It could be argued these needed more consideration than they have been given.

As Bill Dodwell, CIOT President, commented:

> "This is a sensible, pragmatic approach from the Government and Opposition. Agreeing to leave most of the complex and controversial clauses in the Finance Bill until a post-election Finance Bill where they can be scrutinised at greater length."

Personal tax

Reporting Expenses and Benefits for the 2016-2017 tax year

Reporting online

Remember, the deadline for reporting Expenses and Benefits in Kind for tax year 2016-2017 is 6 July 2017. Reporting online is quicker, easier, cheaper and it is more secure. Consider advising clients to switch to online reporting in the future.

Payrolling benefits

Tax year 2016-2017 was the first year that employers could use the payrolling benefits service but employers still need to send a P11D(b) for each PAYE reference to report how much Class 1A NICs is due;

Amending a P11D or P11D(b)

If an employer makes a mistake, they must send a new form with all of the boxes completed, not just the ones to be corrected.

Amended rules

From 6 April 2016, HNRC have changed the rules on how to tax and report expenses. Full guidance on how to treat each type of expense is available at www.gov.uk/expenses-and-benefits-a-to-z

2016-2017 P11Ds and P11D(b) will be the last year that returns can be submitted via Electronic Data Interchange (EDI) or Magnetic Media. From 2017-2018 electronic P11D and P11D(b) forms have to be submitted by XML via the Government Gateway. Employers should start collating information in a way that can be easily convert into the right format.

Source: Employer Bulletin - April 2017

Wrong PAYE code

Summary – When no P46 was returned, the employer should have used code OT.

Under her contract, a full-time receptionist at Champneys was not allowed to work elsewhere. On joining, Champneys issued her with a P46. Having never received the P46 back from the employee, they operated the tax code that they believed to be correct, paying her on the basis that statement A applied (that it was her first job since the previous 6 April.

However, having started to work for Champneys in July 2013, the employee continued to work for another business. When questioned, the employee claimed that she had ticked statement C, indicating that she had another job. As a result the employee underpaid tax by using the 944L code.

HMRC followed this up with Champneys, but who did not reply and so HMRC issued a determination under reg 80 of the Income Tax (PAYE) Regulations 2003 to collect the underpaid tax.

Champneys claimed that HMRC should have picked up the incorrect code through the RTI system but HMRC said it is for the employer to determine the tax code to be applied.

Decision

The Tribunal said that the Champneys showed a lack of reasonable care by assuming that statement A applied; when no P46 was returned, they should have operated an OT code.

The appeal was dismissed.

Champneys Tring Ltd v HMRC (TC05685)

Intermediaries legislation (IR35) – updated guidance

Following the new 'check employment status for tax' online service launched in March 2017, HMRC has updated its guidance on the Intermediaries legislation to reflect

Remember If the legislation applies then the intermediary must operate PAYE and National Insurance contributions on any deemed salary or wages that it pays during the tax year and that the intermediary can be a:

- limited company
- service or personal service company
- partnership

References to managed service companies have been removed, as these are covered by separate legislation.

www.gov.uk/topic/business-tax/ir35

Effectiveness of employer-provided cars and fuel (Lecture B1011 – 17.32 minutes)

Introduction

In the past buying a car through a taxpayer’s company and letting the company pay for all fuel was very tax efficient.

In recent years, the tax regime has increased the charges for both of these which begs the question as to whether employer-provided cars and fuel for private use are still worthwhile.

Fuel benefit

If an employer pays for fuel for private motoring of the employee, a scale charge benefit arises which for 2017/18 is £22,600 x % used for car benefit, the percentage being based on CO_2 emissions.

It is an all or nothing charge. If the employee is required to reimburse the full cost of private motoring (and does so by end of tax year) no benefit arises, otherwise the full scale charge benefit applies.

So what private mileage would justify the employer pay for all fuel and accepting the scale benefit, rather than the employee paying themselves for the fuel consumed on non-business journeys?

Calculation variables

It is possible to calculate a private mileage minimum that makes the fuel scale charge advantageous.

For an employee who is not the shareholder of the company, this needs to take into account:

- Income tax payable by the employee on the benefit
- The price of fuel per gallon (1 imperial gallon = 4.52 litres)
- The fuel economy of the car (miles per gallon)

For a company where the director is the sole shareholder, we must additionally include:

- Employer's NIC payable
- Net saving from company paying for the fuel rather than the director - this results in reduced company profits, tax saving, reduced dividends so reduced tax on dividends

All of this should be modelled using a spreadsheet.

Specimen calculations for fuel – 3rd party employer

Assumptions:

- Petrol as fuel
- 125g/km of CO_2
- Price of fuel £1.15/litre (£5.20 per gallon)
- Fuel economy 35 mpg
- Private mileage 10,000 miles

The fuel benefit would be 24% x £22,600 in 2017/18 i.e. £5,424. Income tax on this at 40% would be £2,170.

The cost of the fuel for private mileage would be 10,000 miles x £5.20/gallon ÷ 35mpg i.e. £1,486

It would clearly be cheaper for the taxpayer to pay their own private fuel cost (or reimburse the company in full if it pays).

A spreadsheet can demonstrate in this case that the fuel benefit would be worthwhile if private mileage was more than 14,606 miles per annum.

Spreadsheet extract

Fuel example - 3rd party employer

Fuel (select)	Petrol
CO2 emissions	125
MPG	35
Price of petrol/litre	1.15
Private mileage	10000
Corporation tax rate	19%
Fuel multiplier	22600
Price of petrol/gallon	5.20
Petrol scale benefit %	24
Taxable benefit	5424
IT payable @ 40%	2170
Cost of fuel for private mileage	1486
Net (loss)/saving if company pays	-684
Break even mileage to cover	
income tax cost (£2,170/£5.20 per gallon x 35 mpg)	14606

The petrol scale benefit percentage can be selected from a table of CO_2 emissions for petrol and diesel cars using an 'Index/match' formula.

Specimen calculations for fuel – taxpayer's own company

If the car is provided by a director's own company (see later), the fuel cost comparison is more complex.

If the company pays for the fuel, the relevant variables are:

- 13.8% Class 1A NIC cost for company
- Company saves tax on fuel cost
- Director gets smaller dividends (but saves income tax as a result)

So if company pays the fuel cost, using same assumptions as before (i.e. 10,000 private miles, 35mpg, £5.20 per gallon):

- Income tax payable by the director is still £2,170
- For 10,000 miles, the fuel cost is £1,486 as before

But if company pays this fuel cost, then net of Class 1A NIC and CT savings at 19%, post-tax dividends (at dividend rate of 32.5%) would be £1,221 less than if the director paid the fuel personally

So the fuel cost of £1,486 has only really cost the taxpayer £1,221, saving £265

The net cost of the company paying for the fuel is therefore:

- Extra income tax on scale charge £2,170, minus savings above from the company paying the fuel rather than the director personally, of £265, i.e. £1,905 net cost
- Compared to £1,486 if fuel is paid for privately

So it costs £419 more if the company pays for the private fuel

Sensitivity analysis shows that it is more worthwhile for the company to pay for the private fuel if mileage is above 11,945 private miles if the taxpayer is the director / shareholder of the company.

Spreadsheet extract

Fuel example - OMB (using same input data as above)

Income tax payable			2170
Tax savings for owner			
using company to pay			
Company position		No fuel paid	Fuel paid
Profit before fuel (say)		10000	10000
Fuel costs		0	-1486
Employers NIC on benefit		0	-749
		10000	7765
Corporation tax	19%	1900	1475
Profit after tax = dividends		8100	6290
Income tax on divs	32.50%	2633	2044
Post tax income		5467	4246
"Lost" post tax dividends		1221	

Net cost if paid privately	1486
Cost if company pays fuel	1221
Net saving on fuel cost if company pays	265

Income tax payable	2170
Tax savings by company paying the fuel	-265
	1905
Cost of fuel if paid privately	1486
Net (loss)/saving if company pays for fuel	-419

Break even mileage to cover	
income tax cost (using Goal Seek, or trial and error to turn the -419 to zero	11945

Employer provided cars

The tax regime has increased the taxable benefit on cars each year for the past 5 years and will continue to do so until 2020/21 (and possibly beyond).

The maximum benefit is still 37% for both petrol and diesel cars.

Specimen calculations show that generally a company car is a worthwhile benefit assuming there is no salary sacrifice required for it. If there is a salary sacrifice then it is a more complex argument (see the example below).

For new arrangements entered into from 6 April 2017, foregoing salary to receive a car is no longer tax effective if the CO_2 emissions are more than 75g/km (and this will drop to 50g/km from 1 April 2018). If this is the case, the taxpayer will now be taxed on the higher of the salary foregone and the car benefit.

Existing arrangements are protected from the new rules until at 5 April 2021, but if the car is replaced, the new arrangement would operate from then.

Specimen calculations – car from 3rd party employer

Assumptions as before with a list price of £20,000 and business mileage of 11,000 p.a.

The taxable benefit for a 125g/km car in 2017/18 would be 24% x £20,000 = £4,800, giving rise to tax payable for a higher rate taxpayer of £1,920.

To buy a car privately over 3 years using a bank loan at 3.6% per annum typical APR would cost £7,152 p.a. in repayments.

If running costs (except fuel) were £800 per annum, the total cost of buying the car personally would be approximately £7,950 per annum.

If 11,000 business miles are driven each year, the employee could be reimbursed at 45p/25p, a total of £4,750, reducing the net cost to £3,200 p.a. (this is essentially the cost of the private journeys).

Any resale value after 3 years might also be brought in here (but is ignored in this illustration).

Accepting a company car with no salary foregone would therefore save the taxpayer (3,200 – 1,920) £1,280 p.a.

If there was a salary sacrifice of anything over £2,672 per annum (if the marginal employees NIC is 12%), or £2,211 (2% marginal NIC) it would make the company car less beneficial than buying it privately.

Cars supplied by director's own company

This again results in more complex calculations.

We would need to factor in :

- The cost, list price and resale price of car
- The tax saved by the company through capital allowances (net of the tax cost of depreciation disallowed each year)
- Class 1A NIC cost for company (and CT relief)
- Running costs being put through the company rather than paid personally
- The reduction in post-tax profit (and hence dividends) if the company pays for the car and the running costs
- The reduction in post-tax income of director/shareholder due to reduced dividends if the company buys and runs the car

Specimen calculations – car owned by director's company

Assumptions

- Car cost and list price £20,000
- 125g/km CO_2
- Held for 4 years then sold for £4,000
- CT rates as enacted
- Car bought 1 April 2017 by company with 31 March year-end
- Car benefit increasing to 2020/21 as announced previously
- Running costs £800 p.a.
- Income tax on benefit would be at 40%
- Dividend rate would be 32.5% and dividend allowance fully utilised

We can demonstrate (using a spreadsheet) that over a 4 year period, it would cost the director approximately £1,800 more if the company purchased the car than if the director purchased it privately.

With lower CO_2 emission cars, it may be more beneficial for the company to purchase the car. For example, with same facts above, if the CO_2 emissions are less than 105g/km it becomes cheaper for the company to buy the car.

		2017/18	2018/19	2019/20	2020/21	Total
Corporation tax rate (31 Mar year end)		19%	19%	19%	17%	
Benefit in kind rate on list price		24%	26%	29%	30%	
Tax relief for company on purchase price		684	561	460	1195	2899
Tax on disallowed depreciation		-760	-760	-760	-680	-2960
Saving for owner compared to private purchase						6983
Income tax on benefit	tax rate 40%	-1920	-2080	-2320	-2400	-8720
Tax saving/(extra cost) overall						-1798
Capital allowances	18%	3600	2952	2421	7027*	16000

* assumed there would be some kind of balancing adjustment for simplicity. In practice WDAs would continue on the WDV, net of the proceeds of sale.

Combination of current and deferred tax would give effective P&L rate equal to CT rate

		No company car	With company car 2017/18	2018/19	2019/20	2020/21	Total
Profits before car	(say)	10000	10000	10000	10000	10000	40000
Running costs			-800	-800	-800	-800	-3200
Class 1A NIC			-662	-718	-800	-828	-3008
Depreciation			-4000	-4000	-4000	-4000	-16000
		10000	4538	4482	4400	4372	17792
Tax	18.5%	1850	862	852	836	743	3293
Dividends		8150	3676	3630	3564	3629	14499
Higher rate tax on divs	32.5%	2649	1195	1180	1158	1179	4712
Post tax income		(pa) 5501	2481	2450	2406	2450	9787
	x 4						

Net purchase cost if buy car individually	16000	
Running costs if bought individually	3200	
	19200	
Cost if company buys car	12217	(lost dividends net of tax saved)
Saving if company buys car	6983	

Contributed by Malcolm Greenbaum

Employment related securities (Lecture P1013 - 26.54 minutes)

Overview

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

General principles

The legislation can only apply to securities acquired by reason of the employment (s.421B ITEPA 2003); this can include former or prospective employments. However, any right or opportunity to acquire securities given by the employer is treated as by virtue of the employment unless the person offering the right or opportunity is an individual and is made in the course of normal domestic or personal relationships.

HMRC have become much stricter on this particular point. For example, they had previously accepted that employees undertaking MBOs via a new company vehicle were obtaining shares in that vehicle as entrepreneurs and not by virtue of their employment. This is no longer acceptable; it has made the structuring of such transactions difficult.

Any ERS received for which the employee pays less than market value will be taxed on the difference as employment income.

Since the basic tax charge is calculated as being the difference between the market value and the price paid, it would be in the interests of employers to minimise the market value to mitigate the tax payable by the employee.

This can be done in various ways and legislation has been put in place to counter all of the common devices to reduce value. It is this legislation which causes such significant problems when considering the taxation of ERS.

Various share schemes are tax-advantaged and these will be familiar to the tax practitioner (such as Sharesave Schemes, Company Share Option Plans, Enterprise Management Incentive Schemes, and Share Incentive Plans). Generally shares acquired under these plans will not give rise to income tax liabilities if the relevant conditions are met, only CGT when disposed of.

Anti-avoidance legislation

The basic principles relating to ERS are then enhanced by the stringent anti-avoidance legislation often generically referred to as the 'Schedule 22' provisions although these are now found in Part 7 of ITEPA 2003. If the securities have certain properties, there are ongoing tax consequences.

In basic terms, where the legislation applies, increases in value after issue of the shares may be liable to tax as employment income rather than being taxed under the capital gains tax code.

An employee often assumes that they will get capital gains treatment of gains on shares but are then caught by employment income rules creating a considerable unexpected cost.

The legislation catches the following situations:

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

This session will just consider the first category as an introduction to the way the tax regime operates.

Reporting requirements

There are practical implications of the issue of ERS. S.421J ITEPA 2003 imposes a reporting requirement where a reportable event occurs.

The return must be made on Form 42 which will be familiar to many practitioners.

Reportable events

The reportable events include the following:

- The acquisition of ERS
- An event which is a chargeable event in relation to restricted securities
- An event which is a chargeable event in relation to convertible securities
- An event which is a chargeable event in relation to shares with artificially suppressed or artificially enhanced market values
- The receipt of post-acquisition benefits on ERS

Companies incorporated where initial subscriber shares are acquired:

- Directly on incorporation or
- On transfer from a company formation agent or
- From another person forming the company, for example a solicitor or accountant
- Do not need a Form 42 report if all of the following conditions are met:
- All the initial subscriber shares are acquired at nominal value and
- The shares are not acquired by reason of or in connection with another employment
- The shares are acquired by a person who is a director or prospective director of the company, or someone who has a personal family relationship with the director and the right or opportunity is made available in the normal course of the domestic, family or personal relationship of that person

HMRC guidance on Form 42 also gives other events where reports *may not* be required:

- Transfers of shares in the normal course of the domestic, family or personal relationships
- Flat management companies
- Members' clubs formed as companies
- Share for share exchanges
- Rights issues
- Bonus issues
- Scrip dividends
- Dividend reinvestment plans
- Shares acquired independently by employees

If there is a reportable event in a tax year ending 5 April, a report must be made to HMRC before 7 July following the end of the tax year.

Restricted securities

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

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

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

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

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

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

- shares are unpaid or partly paid and will be subject to forfeiture if the calls are not met; or

- the individual must dispose of the securities where employment is ended because of misconduct.

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

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

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

There is a charge to tax in relation to restricted securities on the occurrence of a chargeable event.

The following are chargeable events:

- The shares ceasing to be restricted;
- Variations being made to the shares without them ceasing to be restricted securities; and
- Shares being disposed of for consideration whilst still being restricted.

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

- The ERS are shares in a company of a particular class;
- The provision (by virtue of which the ERS are restricted securities) applies to all the company's shares of the same class;
- The event which affects the ERS has not been done as part of a scheme or arrangement the main purpose (or one of the main purposes) of which is the avoidance of income tax or NICs;
- All the company's shares of the class (other than the ERS) are affected by an event similar to that which is a chargeable event in relation to the ERS; and

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

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

UMV x (IUP – PCP – OP) - CE

The key to the formula is given below.

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

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

The following are the definitions of each part:

UMV = MV of the shares assuming no restrictions. This is measured immediately after the chargeable event.

IUP = initial uncharged proportion. This represents the proportion of the IUMV which was not charged to tax at acquisition. This proportion is charged over the chargeable events and calculated according to the formula $\frac{\text{IUMV - DA}}{\text{IUMV}}$

DA = Deductible Amounts, which are:

- The amount of any consideration given for the ERS;
- Any amount that constituted earnings or employment income from the employee’s employment in respect of the acquisition of the ERS, in relation to the legislation as currently and previously enacted.

If the ERS were acquired on a conversion of other employment related securities then any amount that counted as employment income on such conversion, in relation to the legislation as currently and previously enacted.

If the ERS were acquired pursuant to a securities option, any amount that counted as employment income under ITEPA2003/S476 (or s476 or 477 as originally enacted).

PCP = previously charged proportion. This is the part of the IUP which has already been charged at previous chargeable events.

OP = Outstanding Proportion. The proportion of the UMV which is still reduced by the restrictions and calculated according to the formula

$$\frac{UMV - DA}{UMV}$$

CE = Consideration and Expenses. Amounts incurred by the employee in lifting the restrictions or in connection with disposal of the shares.

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

- An election to ignore the restricted securities rules and take the unrestricted market value into account on acquisition of the shares (s431 ITEPA 2003); and
- An election to ignore the future outstanding restrictions on a subsequent chargeable event (where not all restrictions are lifted) (s430 ITEPA 2003).

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

Why might such an election be made?

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

a) What is the tax charge on acquisition?

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

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

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

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

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

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

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

If a s430 election is made:

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

c) A second chargeable event occurs when Actual MV = 15 and Unrestricted MV = 16.

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

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

If a s430 election is made:

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

d) A third chargeable event occurs when Actual MV = Unrestricted MV = 20. At this

Assuming no previous elections:

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

In summary:

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

The elections have resulted in earlier charges to tax but less charge overall. If the share value has decreased over time then the election would have resulted in a higher charge.

The advantage of the s431 election is to give certainty of the charge on acquisition and if the share values increase dramatically, the difference in overall tax payable can be significant.

Contributed by Malcolm Greenbaum

Airbnb and rent-a-room

Rather than staying in a hotel or B&B, Airbnb allows people to rent spare rooms for short periods of time with landlords potentially taking advantage of rent-a-room relief.

Remember, rent-a-room relief allows a taxpayer to receive tax-free rental income from letting furnished accommodation in their own home. Historically the annual income limit was £4,250 but from 6 April 2016 this limit increased to £7,500.

If the taxpayer exceeds the threshold, the taxpayer may choose to be taxed on their rental income less the rent-a -room threshold rather than claiming actual expenses against rental income.

You can opt in to the scheme if

- you are a resident landlord, whether or not you own your home
- run a bed and breakfast or a guest house

You cannot use the scheme for:

- homes converted into separate flats
- rooms let as offices or for storage
- your UK home while you live abroad

However, you can use the scheme if your lodger works in your home in the evening or at weekends or is a student who is provided with study facilities.

Adapted from article by Julie Butler, Taxation (23 March 2017)

Omitted rents, interest and gains

Summary – Mr Bobat had deliberately omitted rental income, interest and gains from his returns over a number of years and HMRC were correct to assess to him to tax on properties held in his own name, as well as the names of various family members.

This was a hearing concerning the loss of income tax in tax years 1994-95 to 2009-10 and in 2011-12 and whether the inaccuracies were deliberately made with appropriate penalties charged.

Broadly the tax returns contained rental income from up to two properties (but some with none), DIY partnership profits, interest and dividends.

HMRC explained that they had obtained details of sales of four properties totalling £900,000 in 2010-11 where Mr Bobat's name appeared as the vendor but where no chargeable gains had been reported. They had also obtained information suggesting that income from these and other properties had been received by Mr Bobat but not returned. In 2012, HMRC issued a COP9 fraud enquiry notice.

Under a Contractual Disclosure facility signed on 22 August 2012, Mr Bobat made an outline disclosure naming himself, his wife and children as being in volved with the properties but that he was:

"Currently in the process of establishing the capital gains and rental profits at stake over the years in question, with help from my recently appointed tax advisors [Eaves & Co]. Due to the volume of information it is not possible to provide an accurate estimate at this stage.

He ticked a box saying "I have no further errors to disclose".

At a meeting in October 2012, twelve properties were identified, four of which had been sold and one of which it was claimed did not belong to Mr Bobat but rather, his son. Other than the two properties where he had declared rental income, Mr Bobat claimed that the other properties were not in his name but in his family's name. However he also confirmed that he had bought all of the properties and although there were no tenancy agreements in place, the tenants (mainly students) would see Mr Bobat as their landlord and they paid their rent into Mr Bobat's bank account.

The only records that Mr Bobat had was his bank statements which made it difficult for his accountants to estimate the total net rental incomes due for each tax year.

HMRC explained that they had obtained information from a number of sources apart from Mr Bobat and his agents. These included papers forming part of his divorce proceedings that showed a number of the properties being legally owned by family members but stating that Mr Bobat was either the equitable owner or that he had an equitable interest.

HMRC also obtained a number of landlord insurance policies and other correspondence in relation to the disputed properties. All were addressed to Mr Bobat and the policies showed him as the "policyholder". Information from the Local Council about Homes in Multiple Occupation ("HMOs") shows the landlord as "Gulam Bobat" or "Mr G Y Bobat".

The biggest area of contention was whether Mr Bobat should be taxed on the rental income on the properties owned by other family members?

Decision

The Tribunal considered separately the properties that were clearly owned by Mr Bobat and then moved on to consider those owned by various family members.

They found that Mr Bobat was the beneficial owner of the disputed family member properties in that he had the entire equitable interest in them. As legal owners the children merely held the properties as nominees or bare trustees for their father. The Tribunal based their decision on tenancy agreements, HMO registers and the insurance policies as well as the fact that Mr Bobat paid for the properties and that the rents were paid into Mr Bobat's bank account.

The Tribunal were satisfied that Mr Bobat had deliberately omitted the income from rents, interest and the chargeable gains and so had fraudulently delivered incorrect accounts The Tribunal were satisfied that HMRC had shown that there had been a loss of tax in each of the tax years from 1996/97 to 2011/12. They thought it was more than likely that the 1994/95 and 1995/96 returns would not have disclosed the full amount of the rents that the appellant was receiving.

Although the discovery assessments were made after the time limit of four years theye were validly made within the time limit in s 36(1A) TMA (20 years) because of the deliberate conduct of the appellant.

Broadly the penalties raised were valid and the abatements were reasonable although the inaccuracies were not “deliberate and concealed” and an adjustment was made.

Gulammohammed Bobat V HMRC (TC05715)

Capital Taxes

PPR on disposal of off plan apartment

Summary - HMRC argued that the period of ownership for PPR commenced and ended with the date of the contract to acquire and dispose of the apartment per section 28 TCGA but the First Tier Tribunal disagreed.

This case considered the acquisition of the lease of an off-plan apartment and the period of ownership that was eligible for Principal Private Residence on its subsequent sale.

In 2004 Mr Higgins paid a £5,000 deposit to secure a right to be granted the lease of an apartment in the former St Pancras station at Kings Cross. On 2 October 2006 he entered into a contract with the seller but at that stage the apartment did not exist; it was simply a space in a tower.

The progress of the works was delayed and was not completed until December 2009. Mr Higgins was informed that legal completion would occur on 5 January 2010 from which date he had the right to occupy the apartment.

From July 2007 when Mr Higgins sold his former residence and until January 2010 Mr Higgins had stayed with his parents some of the time, travelled some of the time and stayed in another apartment owned by Mr Higgins which had previously been occupied by a tenant.

Mr Higgins subsequently sold the apartment on 5 January 2012.

The issue to be considered was how much of the gain was covered by PPR relief?

- It was agreed that Mr Higgins occupied the apartment as his principal private dwelling from 5 January 2010 until completion of its sale on 5 January 2012;

- HMRC argued that ownership actually started earlier on 2 October 2006 when Mr Higgins entered into the contract. They considered that PPR relief should be confined to increases in value during the period of occupation as a residence. Increases in value before occupation should not be covered. The gains should be pro-rated to the period of ownership pre and post the date of occupation.

Decision

The Tribunal found as a matter of fact that there was no other dwelling that Mr Higgins regarded as his principal private residence throughout the period July 2007 to January 2010. This was not challenged by HMRC.

The period of ownership for the purpose of sections 222 and 223 TCGA 1992 began when Mr Higgins owned the legal and equitable interest in the lease and owned the legal right to occupy the property. That was the date of legal completion of the purchase of the lease on 5 January 2010.

The period of ownership ended on the 5 January 2012 when the contract for sale (entered into on 15 December 2011) was completed.

The appeal was allowed.

Desmond Higgins v HMRC (TC05724)

Negligible value claim by personal representatives

Summary – The Upper Tribunal reversed the First Tier Tribunal's decision, finding that the personal representatives could not make a negligible value claim .

During his life Mr Leadley had invested in £25,000 in Datalase Limited and another £25,000 in Keronite Limited. He had also made a loan of £334,784 to a company called Rollestone Crown Limited.

By 5 April 2010, the shares had become valueless and the loan irrecoverable.

Under normal circumstances, where an asset has become of negligible value, or a loan irrecoverable, the taxpayer owning the asset or having made the loan may be able to make a negligible value claim for tax purposes. However, before filing his 2009/10 return, Mr Leadley had died in a motor accident.

Could his personal representatives claim the relief?

Decision

S24 TCGA 1992 states that a claimant must still own an asset at the point that a negligible value claim is submitted and S62 TCGA 1992 states personal representatives are deemed to acquire the assets of a deceased person on his death for a consideration equal to their market value without a disposal. The Upper Tribunal concluded that a deceased person and his personal representatives could not be equated. As they stated:

> "… the possibility of a negligible value claim in respect of the shares in Datalase and Keronite died with Mr Leadley."

The Upper Tribunal found that the Executors were not entitled to claim relief in respect of either the shares in Datalase and Keronite or the loan to Rollestone.

The Upper Tribunal allowed the appeal.

HMRC v Peter L Drown & Mrs R E Leadley (as executors of Jeffrey John Leadley deceased) [2017] UKUT 0111 (TCC)

CGT hold-over relief

Summary – S165 Gift relief was not available as S167 TCGA 1992 applied

Mr Reeve established a new UK incorporated and resident company, WHR Investments. He was the sole shareholder and director of that company. He gifted his interest in a business, BlueCrest Capital Management LLP, to WHR Investments which crystallised a gain of £33 million and he claimed gift relief under S165 TCGA 1992 to holdover the gain.

HMRC disallowed the claim under the rule contained within S167, gifts to foreign-controlled companies which says:

> (1) Section 165(4) shall not apply where the transferee is a company which is within subsection (2) below.
>
> (2) A company is within this subsection if it is controlled by a person who, or by persons each of whom—
>
> (a) is neither resident nor ordinarily resident in the United Kingdom, and
>
> (b) is connected with the person making the disposal.

It was accepted that under a strict interpretation of S167 Mr Reeves was not entitled to hold-over relief as although WHL was controlled by Mr Reeves, s 416(6) ICTA attributed his control of the company to his non-resident wife and children. Therefore, for CGT purposes, WHL is a company controlled by a person or persons neither resident nor ordinarily resident in the UK and hold-over relief is precluded by s 167 TCGA.

Mr Reeves contended that a literal construction of s 167 would produce an irrational, arbitrary and unjust result, so that a purposive interpretation should be adopted to allow the claim. Alternatively, if the statutory language did not admit such a purposive interpretation, a literal construction should not be applied, as s 167 did not conform to ECHR.

Decision

The First Tier Tribunal concluded that it was not possible to amend the legislation. In particular, the tribunal accepted that the effect of importing ICTA 1988 s 416(6) into TCGA 1992 s 167 may not have been considered by Parliament, but it was not 'abundantly sure' that this was the case given that anti-avoidance provisions often cover a wider area than necessary (Steele v EVC [1996] STC 785).

Finally, the Tribunal found that the denial of hold-over relief was not discriminatory for EU law purposes. Mr Reeves had been treated in the same way as a UK resident with a non-resident wife.

The tribunal dismissed the appeal.

William Reeves v HMRC (TC05680)

Expenditure to remove restriction and be able to sell shares

Summary – Expenditure incurred by Blackwell to release him from a personal contractual obligation to a third party and enable him to sell shares was not deductible.

Mr Blackwell held shares in BP Holdings. In 2003, after an unsuccessful takeover by Taylor & Francis Group, he entered into an agreement with them, accepting obligations in relation to his shares in return for £1m.

In 2006, Mr Blackwell paid £17.5m to be released from these obligations and shortly after, he sold the shares for just over £100m, claiming a deduction under S38(1)(b) TCGA 1992 for the £17.5m that he had paid to enable him to carry out the sale.

HMRC refused to allow the deduction. Mr Blackwell successfully appealed to the First-tier Tribunal but the Upper Tribunal subsequently over turned that decision and so Blackwell appealed to the Court of Appeal.

For s 38(1)(b) TCGA 1992 to apply the expenditure needed to be incurred:

1. on the asset and still reflected in the asset when the it was sold
2. in establishing, preserving or defending title to, or to a right over, the asset.

Decision

The state or nature of the asset had been unaffected by removing the 2003 restriction, because this was merely a personal agreement between Mr Blackwell and a third party. The nature and state of the shares had remained the same throughout as determined under BP Holdings Articles of Association.

Mr Blackwell's payment for the release of the 2003 agreement had nothing to do with his title to the shares or his title to rights over the shares. It had been a payment to buy back rights and those rights were personal rights of the third party over Blackwell, not rights of Blackwell over the shares. The payment did not establish or re-establish title.

The appeal was dismissed.

Blackwell v Revenue and Customs Commissioners [2017] EWCA Civ 232 (Court of Appeal)

Residence nil-rate band and transferable residence nil rate band

Updated versions of the IHT400 suite of forms to accommodate Residence nil-rate band are now available. The new form IHT435 will allow a claim for Residence nil-rate band and IHT436 for Transferable residence nil rate band.

This will continue to be a paper based process initially while work continues on expanding the IHT Online service available. PDF versions of the forms are available at: https://www.gov.uk/government/collections/inheritance-tax-forms

There is a simple guide that explains how the Residence nil-rate band applies in most circumstances and includes key information on the basic rules along with case studies. This can be accessed at https://www.gov.uk/guidance/inheritance-tax-residence-nil-rate-band.

More detailed technical guidance on the RNRB has recently been published in the Inheritance Tax Manual (IHTM46000).

Extending IHT to enveloped UK residential property (Lectures P1014/ P1015 – 20.04/ 21.54 minutes)

Individuals who are not domiciled in the UK enjoy a significant IHT advantage over other taxpayers. UK domiciliaries are liable to IHT on the value of their worldwide assets, while those who are non-UK domiciled are only chargeable on property that is situated within the UK. This is the case, regardless of the individual's residence status.

Any residential property in the UK directly owned by a non-UK domiciliary has always been within the charge to IHT.

However, it has been standard practice for many years for non-UK domiciled individuals to hold such properties through an overseas company (or some similar vehicle). In these circumstances, the individual's property consists of a shareholding situated outside the UK that is therefore excluded from IHT. Enveloping properties in this way provides a tax advantage for non-UK domiciled individuals that is not available for anyone else.

This technique has continued to be effective for IHT purposes, albeit at the potential cost of exposure to ATED which has applied since 2013. Indeed, the IHT benefit was a significant factor in discouraging de- enveloping when ATED was first introduced (along with the lack of both SDLT and rollover reliefs).

The key change

In the original Finance Bill 2017, the Government had decided to bring UK residential properties within the charge to IHT where they are held in an overseas structure. Despite being taken out of the truncated Bill that is due to receive Royal Assent on 28th April, the proposed change has been included in the Government's financial budget for the current year. Given that it is a revenue-generating provision, it seems likely that, whatever the outcome on 8 June, the next Government will reintroduce this new measure at the earliest opportunity and the original starting date is likely to stand - after all, we have already had advance notice of the measures.

The new charge will apply both to individuals who are domiciled outside the UK and to trusts with settlors or beneficiaries who are non-UK domiciled. It comes into effect on 6 April 2017 and the relevant legislation is set out in Cl 44 and Sch

15 FB 2017. Para 1 Sch 15 FB 2017 inserts new Sch A1 IHTA 1984 (where all the material changes can be found).

In order to implement this extended IHT charge, the Government have removed any UK residential property owned indirectly through an offshore vehicle from the definition of 'excluded property' in Ss6 and 48 IHTA 1984. It will make no difference whether the overseas structure is owned by an individual or a trust.

By virtue of Para 2 Sch A1 IHTA 1984, shares in overseas companies which would be 'close' if they were UK-resident will no longer be excluded property if, and to the extent that, the value of any interest in the entity is attributable, directly or indirectly, to residential property in the UK. Similarly, where a non-UK domiciled individual is a member of an overseas partnership which holds residential property in the UK, such properties will also cease to be treated as excluded property for IHT purposes. Thus the normal IHT chargeable event rules will henceforth apply to assets that fall into these categories.

Para 2(3) Sch A1 IHTA 1984 provides a very limited *de minimis* exemption from this new regime. Interests will be disregarded where the foreign domiciliary or trust holds a less than 5% interest (by value) in the overseas company or partnership.

It should be emphasised that these FB 2017 changes only appertain to UK residential property. They do *not* affect any other UK situs assets owned by offshore entities.

In this context, the Government are determined that the definition of UK residential property should be wide. There will be no monetary threshold below which the new charge will cease to apply. And there will be no special relief for an individual's main residence or for properties that are let out commercially.

Properties affected

HM Treasury have stated:

> 'The legislation will need to define the types of property which will become liable to IHT. However, introducing a wholly new definition for IHT purposes could risk creating unnecessary complexity and uncertainty. The Government therefore intend that the new charge should be based as far as possible on other definitions of residential property which currently exist within tax legislation.'

The Government, after consultation, have decided to use the definition of 'residential property' found in the FA 2015 extension of CGT to non-UK residents, on the ground that this means amending the relevant definition less heavily than would be necessary if, for example, the definition applying for the ATED regime were to be adopted (Para 8 Sch A1 IHTA 1984).

The FA 2015 definition covers a property that is:

- suitable for use as a dwelling; or
- in the process of being constructed or adapted for such use.

Land which is, or is intended to be, occupied or enjoyed with a dwelling as a garden or grounds (including any building or structure on such land) is taken to be part of that building.

A building is not regarded as a dwelling if it is used as:

- residential accommodation for school pupils;
- residential accommodation for members of the armed forces;
- a home or other institution providing residential accommodation for children;
- a home or other institution providing residential accommodation with personal care for persons in need of such care (eg. because of their age or disability);
- a hospital or hospice;
- a prison or similar establishment;
- a hotel, inn or similar establishment;
- an institution (not falling within any of the above) which is the sole or main residence of its residents; or
- purpose-built student accommodation or a student hall of residence.

A building that becomes temporarily unsuitable for use as a dwelling is treated as continuing to be suitable for such use, but there are exceptions (found in Sch B1 TCGA 1992) which apply where the property has been damaged or is undergoing major structural change – this includes partial or complete demolition.

Change of use

In some cases, residential property might have previously been used for commercial purposes.

The extended IHT charge needs to take account of such situations in order to determine the amount that will be liable to IHT in the event of a chargeable occasion. With non-UK resident CGT, there are rules which apply in these situations and which are designed to ensure that tax is charged on the basis of a 'just and reasonable' apportionment of the value of the property. A time-based approach is used. However, in the context of IHT, there are difficulties with such a procedure. Unlike CGT, IHT does not operate on the basis of annual tax years – instead, the charge represents a snapshot of an estate immediately before a chargeable event. An apportionment of value may not necessarily be the most appropriate course of action.

Accordingly, in their 2016 consultation document, the Government planned to employ a two-year 'look-back' period so that, if the property had been residential during any part of that period, it would be caught.

A number of representations pointed out that this went against the fundamental snapshot principle behind IHT and so this provision was reluctantly dropped. The position of the property at the time of the chargeable event is now all that is relevant.

Duality of use

Although the above approach means that there will be no apportionments of value, there will still be a need for such an apportionment where a property has been used for both residential and commercial purposes, eg. a flat above shop premises. It would appear that this is going to be dealt with on a 'just and reasonable' basis.

Valuation

As already mentioned, this IHT change is given effect by modifying the meaning of 'excluded property' so that the term will no longer cover shares or other forms of capital in an offshore entity which has an interest in UK residential property. It therefore follows that, when a chargeable event occurs, it is the value of the holding in the owning entity that is required, and not the value of the underlying property itself.

Where the offshore entity owns more than just UK residential property (for example, foreign property or other types of asset), an adjustment will be necessary in order to ensure that it is only the value deriving from the UK residential property interest which is taken into account.

Deduction of debts

Where the owning entity only holds UK residential property, debts can be offset for IHT purposes in determining the value derived from the UK property. There is, however, a special attribution rule where there are liabilities and the owning entity additionally has other types of asset. In this case, it appears that, even if the debt is specifically secured on the UK residential property, the liability must be allocated across *all* the assets in proportion to their market values at the time of the chargeable event (Para 2(4) Sch A1 IHTA 1984) – example below.

The position with regard to any debts which, as an alternative, the foreign domiciliary or trust may have taken out in order to acquire the holding in the owning entity is not referred to in the legislation. In these circumstances, it seems that the normal rules relating to the deductibility of debts must apply.

Example

Alastair is a UK-resident foreign domiciliary – he is not deemed domiciled. He owns all the shares in Cook Overseas Ltd (a New Zealand company). In turn, the company owns Cook Mews (a residential property in London worth £10,000,000) and a foreign share portfolio worth £90,000,000. The company borrowed £8,000,000 to finance the acquisition of Cook Mews – this is secured on the London property. The legislation means that only one-tenth of £8,000,000, can be deducted in calculating the value attributable to the UK residential property.

Relevant loans and collateral

In addition to the original extension of the scope of IHT where UK residential property is held within an overseas ‘close’ company or partnership, there will be an exposure to tax where:

- there is a ‘relevant loan’ (see (u) below); or
- money or money’s worth is used as security, collateral or a guarantee for this loan; or
- the right or interest which a shareholder or partner holds is directly or indirectly attributable to the loan or to the collateral for it (Paras 3 and 4 Sch A1 IHTA 1984).

The term ‘relevant loan’ refers to the situation where money or money’s worth is made available (directly or indirectly) to finance:

- the acquisition of UK residential property by an individual, partnership or the trustees of a settlement; or
- the maintenance or enhancement of the value of UK residential property which belongs to an individual, partnership or settlement; or
- the acquisition by an individual or trustees of:
    - a right or interest in an overseas ‘close’ company; or
    - an interest in an overseas partnership,

  provided that the funds are used for the acquisition, maintenance or enhancement of UK residential property.

Any loan can be a ‘relevant loan’ if it meets the applicable conditions – the term is not limited to loans between connected parties. These new charging provisions have the potential effectively to duplicate liabilities so that the amount subject to IHT could significantly exceed the actual value of the UK residential property! This anomaly is best explained by way of an example

Example

Joseph is a UK-resident foreign domiciliary – he is not deemed domiciled. He owns all the shares in Root Overseas Ltd (a New Zealand company). In turn, the company owns Root Manor (a residential property in Leeds worth £4,000,000) and a foreign share portfolio worth £6,000,000. The company borrowed £2,000,000 from a non-UK resident family discretionary settlement to finance the acquisition of Root Manor. The trust secured this loan on the share portfolio.

The following points should be noted:

- There is a qualifying interest in UK residential property. As a result, only four-tenths of the £2,000,000 mortgage (ie. £800,000) can be deducted from the worth of the Leeds property in ascertaining the value of Root Overseas Ltd which derives from this property. Therefore, Root has an asset value of £3,200,000 which will be subject to IHT should a chargeable event occur (such as his death).

- The 'relevant loan' of £2,000,000 will constitute relevant property within the discretionary settlement and so will have to be taken into account for the purposes of 10-year anniversary and exit charges.

- Although it is not entirely clear, there is a serious concern that the entire £6,000,000 of collateral provided for the loan is also caught by Sch A1 IHTA 1984 and so would fall within Joseph's estate.

This cannot be right. One hopes that, in due course, the legislation will be amended so that IHT can never be charged in these circumstances on an amount in excess of the UK residential property's value.

Disposals and repayments

There are anti-avoidance provisions which apply where, on or after 6 April 2017, a UK residential property is sold, or a 'relevant loan' is repaid, within two years before a chargeable event for IHT purposes (Para 5 Sch A1 IHTA 1984). These catch:

i. property which constitutes consideration in money or money's worth for the disposal of an overseas 'close' company or partnership through which there was an interest in a UK residential property or a 'relevant loan';

ii. repayment of a 'relevant loan'; and

iii. any property directly or indirectly representing (i) and (ii) above.

Para 5 Sch A1 IHTA 1984 appears only to apply to sales of interests in the foreign company or partnership, and not to disposals of the underlying property. Thus a company that sold its UK residential property and reinvested the proceeds in some other form of asset would not fall foul of the anti-avoidance legislation. Of course, during the two-year run-off period, the property will continue to be subject to IHT. Where there is a sale of the residential property, the two-year period runs from the date of the disposal and, where there is a loan repayment, the two-year period runs from the date of that repayment.

More anti-avoidance

The Government are keen that the extension of IHT to enveloped property should not be circumvented. With this in mind, a specific targeted anti-avoidance rule (TAAR) has been introduced so that any 'arrangements' will be disregarded where their main purpose, or one of the main purposes, is to secure a 'tax advantage' by sidestepping the new provisions.

'Arrangements' are defined as including any scheme, transaction (or series of transactions), agreement or understanding (whether or not legally enforceable and whether or not entered into), together with any associated operations.

The term 'tax advantage' covers:

(i) a relief or increased relief from tax;

(ii) a repayment or increased repayment of tax;

(iii) the avoidance or reduction of a charge to tax or an assessment to tax;

(iv) the deferral of a payment of tax or advancement of a repayment of tax; and

(v) the avoidance of an obligation to deduct or account for tax.

Given that the extension of IHT to enveloped property does not take effect until 6 April 2017, it might reasonably be assumed that the TAAR only applies to transactions entered into on or after 6 April 2017. This would appear to be the case.

No transitional reliefs

Despite calls for a de-enveloping relief to allow existing structures to be unwound without triggering unexpected and/or onerous tax liabilities, the current position is that there will be no transitional reliefs.

HM Treasury say that the Government can see that there might be a case for encouraging de-enveloping but, in the circumstances, they do not think that 'it would be appropriate to provide any incentive to encourage individuals to exit from their structures at this time'. Many individuals and trustees holding UK residential property within offshore companies have been waiting to see whether there would be any de-enveloping relief before taking action. Unfortunately, it seems very unlikely that there will be such relief. It may now be time to consider collapsing structures that have become ineffective for tax purposes.

Collection of tax

The Government recognise that HMRC will have some difficulty in identifying when a chargeable event has taken place and a liability to tax has arisen. In order to assist HMRC in this regard, there is to be an extension to the normal reporting obligations. Anyone with a legal interest in the property (including the directors of the company which holds the property) will have a responsibility to account for the tax. In addition, HMRC are to have an expanded power enabling them to prevent the sale of a property if there is an unpaid liability to IHT.

Contributed by Robert Jamieson

Assets appropriated to trading stock (Lecture B1013 – 12.42 minutes)

Where a chargeable asset acquired by a trader as a fixed asset or an investment is subsequently appropriated by him for use as trading stock, the general rule is that the trader is treated as having sold the asset for its market value at the time of the appropriation (S161(1) TCGA 1992). This gives rise to a chargeable gain or allowable loss and the amount brought into the trading accounts is the market value of the item in question.

Collection difficulties might, however, arise, given that tax on any chargeable gain could become due and payable some time before there was an actual disposal of the asset. This is sometimes referred to as a 'dry' tax charge. In order to deal with the problem, traders are allowed to make an election under S161(3) TCGA 1992, as a result of which:

- no chargeable gain or allowable loss arises on the appropriation to trading stock; and

- the market value of the asset in the trading accounts is reduced by the amount of the chargeable gain or increased by the amount of the allowable loss.

The effect of this election is that the trading results will now include the totality of any income profit or loss and any capital gain or loss accruing on the asset over the whole period of ownership.

Under self-assessment, an election under S161(3) TCGA 1992 must be made:

- for CGT, by 12 months after 31 January next following the tax year containing the last day of the period of account in which the asset was appropriated to trading stock; and

- for corporation tax, within two years of the end of the accounting period in which the asset was appropriated to trading stock.

Illustration

John is a second-hand bookseller. He also collects antiquarian books as a hobby. In March 2004, he acquired a set of rare books for his personal collection at a cost of £26,500. In January 2017, when the market value of the set was £70,000, he decided to offer it for sale through his business. John's CGT computation is:

Market value on appropriation	70,000
Less: Cost	26,500
CHARGEABLE GAIN	43,500

If John elects to roll the gain over into the value of the set in his trading accounts, no chargeable gain will arise. Instead, the cost of the set for the purpose of working out John's trading profit will be reduced to:

Market value on appropriation	70,000
Less: Chargeable gain	43,500
COST OF SET IN TRADING ACCOUNTS	26,500

On the assumption that the books were eventually sold for £74,700, John's trading profit will be £74,700 – £26,500 = £48,200. Depending on how quickly the books sold, John might well prefer to pay CGT rather than income tax on his appropriation profit. His CGT rate would presumably be 20% rather than a charge of 40% or 45% under income tax.

However, what about the position where there is a loss? In that case, the effect of a S161(3) TCGA 1992 election is to convert an amount which is classified as an allowable loss while the asset was held as a fixed asset or an investment into a more flexible trading deduction. This is a widely recognised planning point which was often used by, for example, property developers during the recent property troubles.

Unfortunately, the Chancellor has decided that this form of tax planning is a step too far. For appropriations into trading stock made on or after 8 March 2017, Cl 38 FB 2017 disallows the election facility where there is a loss in order to ensure that the loss retains the character which it had when it accrued. Elections can still be made where there is a gain.

While this clause was dropped in the Finance Bill that received Royal Assent on 27th April 2017, it seems likely that it will still be enacted in a second Finance Bill following the results of the June General Election.

Contributed by Robert Jamieson

ATED in 2017 (Lecture B1014 – 10.05 minutes)

ATED is an annual tax payable by non-natural persons such as companies and corporate partnerships owning UK residential property valued at more than £500,000.

The ATED chargeable period is linked to financial years, ie. it runs from 1 April in one year to 31 March in the next. The amount of tax charged is based on the value of the property on a particular date.

The annual chargeable amounts are normally subject to indexation and, for the year to 31 March 2018, the relevant figures are:

Property value	
More than £500,000 but not more than £1,000,000	£3,500
More than £1,000,000 but not more than £2,000,000	£7,050
More than £2,000,000 but not more than £5,000,000	£23,550
More than £5,000,000 but not more than £10,000,000	£54,950
More than £10,000,000 but not more than £20,000,000	£110,100
More than £20,000,000	£220,350

The charge to ATED is handled by self-assessment, with owners needing to file a return each year based on an estimated value of their property. The ATED return is due on 30 April at the beginning of the relevant financial year. Any tax liability is also payable by the same date.

In addition, a 28% ATED-related CGT charge applies to disposals of UK residential property where ATED has been payable at any time during the ownership period.

There are a number of reliefs in relation to ATED and the ATED-related CGT charge for properties which are:

- let to a third party on a commercial basis (and are not occupied by anyone connected with the owner);
- being developed for resale by a property developer;
- used by a business to provide living accommodation for qualifying employees

and so on. These reliefs need to be claimed on an ATED Relief Declaration Return. Another important point is that charitable companies using a residential property for charitable purposes are exempt from the charge.

The recent reductions in the valuation thresholds for ATED have brought a significant number of structures into the scope of the charge. Clients should be increasingly mindful of the requirement regularly to review their property holding arrangements in order to ensure that they are meeting all their tax compliance obligations.

Contributed by Robert Jamieson

Administration

File paper tax returns for 2016/17 to avoid errors

As we know, the new savings and dividend nil rate bands introduced from 6 April 2016 has forced advisers to consider carefully how to allocate their client's personal allowance and other deductions in the most tax efficient manner.

The Self Assessment online filing parameters set by HMRC mean that individuals with certain fact patterns should file their 2016/17 Tax Returns on paper rather than online. If taxpayers file online, they will pay more tax than is necessary due to the calculation errors in the parameters set by HMRC.

HMRC has had problems setting the online filing parameters for 2016/17 due to the complexity of the starting rate for savings, savings nil rate band and dividend nil rate band and the interaction of these with the tax efficient use of the personal allowance and other deductions. Whilst most were ironed out in time to be included in the Self Assessment online filing parameters used by the tax software providers to code their products, the issues discussed above remain outstanding. It is important to realise this is not the fault of the tax software providers. Their software must follow the HMRC parameters or else none of the online Tax Returns prepared using that software will be accepted by HMRC. They have had no choice but to code their products to give the incorrect answer.

Non-savings income < £16,000, with savings income in excess of the starting rate for savings and the savings nil rate band

The personal allowance is set against the non-savings income as usual and, depending on the level of taxable non-savings income, some or all of the starting rate for savings is available as well as the savings nil rate band (as long as the taxpayer is not an additional rate taxpayer). However, the tax software does not apply the starting rate for savings in this scenario, leading to the difference in tax due.

Filing the 2016/17 Tax Return on paper and correctly utilising the starting rate for savings will save the individual up to £1,000. The precise saving will be the starting rate for savings band remaining multiplied by 20%.

Total income > £145,000 where the non-savings income or savings income is between £27,000 and £32,000 and the balance is dividend income

Here, it is the dividend nil rate band which causes the problem. The tax software treats the dividend nil rate (that actually sits within the basic rate band) as being deducted from the higher rate band. This means £5,000 of dividend income is incorrectly taxed at the dividend additional rate of 38.1% rather than the dividend upper rate of 32.5%.

Filing the 2016/17 Tax Return on paper and correctly taxing the dividend income will save the individual up to £280 (£5,000 x (38.1% – 32.5%))

Does that mean these Returns must be filed by 31 October 2017 to avoid a penalty?

If the Return cannot be filed electronically because it falls into one of the HMRC exclusions it can be filed at any time up to and including 31 January after the end of the tax year without attracting a penalty, because the taxpayer has a reasonable excuse. Where the paper Return is submitted after 31 October, it should be accompanied by a reasonable excuse claim. If a late filing penalty notice is received despite the claim for reasonable excuse, it should be appealed within 30 days of the date of the notice.

What if the Return is filed online by mistake?

Filing such Returns online mean that both the tax due for the 2016/17 tax year and the payments on account calculated for the 2017/18 tax year will be incorrect. it is not possible to amend the Return online and resubmit, as you would do in the case of other amendments to online Returns. This is because the tax software thinks the Return as filed is correct. The only way to amend the Return is to file a paper amendment, ideally supported by a tax calculation and include a covering letter to explain that the original calculation submitted online was incorrect due to the error in the HMRC online filing parameter. HNRC has confirmed that this approach is acceptable.

What about 2017/18 Tax Returns?

HMRC states that these issues will be fixed such that the 2017/18 Tax Returns can be correctly filed online.

Posting cheque did not constitute payment of tax bill (Lecture P1012 – 10.58 minutes)

In *Coomber v HMRC (2016)*, the First-Tier Tribunal dismissed a taxpayer's appeal that he had a reasonable excuse for paying his tax late because his bank (Santander) failed to honour a cheque, despite the fact that the account held sufficient funds.

The taxpayer posted a cheque for just under £18,842 to HMRC on 2 February 2016 in settlement of his outstanding income tax liability. This cheque was received by HMRC on 4 February 2016 and, in accordance with their usual practice, the amount was credited to the taxpayer's account.

The cheque was dishonoured by Santander and was recorded as an 'unpaid cheque' on 8 February 2016, despite the fact that the taxpayer had sufficient funds within his account for the cheque to clear.

On 1 March 2016, HMRC mistakenly told the taxpayer's accountants that there was no outstanding payment due. This was apparently because HMRC's records were not updated until 2 March 2016.

The taxpayer then found that his cheque had not been honoured when reviewing his latest bank statement.

There was no evidence as to why Santander had dishonoured the original cheque. However, having become aware of the situation, the taxpayer paid the tax due and this was credited to his account on 17 March 2016.

In the meantime, HMRC imposed a late payment penalty of £942, being equivalent to 5% of the amount of tax remaining unpaid 30 days after the due date, on 15 March 2016.

The taxpayer contended that he had a reasonable excuse for the late payment of his tax so that the penalty of £942 should be set aside. He argued that the first opportunity that he had had to monitor his bank statement was at the beginning of March 2016 and that he could not be 'expected to contact the bank by telephone, on a regular basis, to see if cheques have cleared'.

Decision

The First-Tier Tribunal disagreed with this view and made the following findings:

- It was the taxpayer's choice to use a cheque rather than BACS, Faster Payment or Direct Debit which would have given him the immediate knowledge and assurance that the payment had been safely received;

- It was the taxpayer's choice to leave his payment to such a late stage (while perfectly entitled to do so, he was running a risk that, if anything went wrong with the cheque or if it was lost in the post, payment would be late);

- The cheque represented a large payment, Santander had a Freephone number at which the bank could be contacted, but, despite this, the taxpayer gave no reason for not having asked the bank to see that the cheque had cleared.

The First-Tier Tribunal judge concluded:

> 'It is the taxpayer's responsibility to ensure that any sums due to HMRC are paid on time. In my view, it was not HMRC's responsibility to have told (the taxpayer) that his cheque had been dishonoured and I am not pointed to any statement of principle or decided case that HMRC is subject to any such duty.'

The taxpayer's appeal was therefore dismissed and the late payment penalty stood.

This case is a timely reminder that taxpayers who settle their HMRC liabilities by cheque should follow up or confirm online that the payments have cleared satisfactorily.

Contributed by Robert Jamieson

Partnership late filing penalties

Summary – The Tribunal wee satisfied that the partnership's 2010/11 tax return had been filed on time.

For the year ending 5 April 2011 Steven Englefield of Englefield Carpenters filed the partnership tax return non-electronically which HMRC claimed to receive on 11 September 2012.

As the Return was received late, HMRC issued a series of penalty assessments to:

- Steven Englefield, but not to John Englefield, in February 2012 for £100;
- both Mr Steven Enlefield and Mr John Englefield in August 2012 and September 2012 for 90 days at £10 per day;
- both Mr Steven Englefield and Mr John Englefield in August 2012 and September 2012 a £300 penalty for being more than six months late.

Following an HMRC review, John Englefield appealed to the First Tier Tribunal as he did not accept that the return had been filed late.

Decision

The Return was dated 26 October 2011 and certified by the partnership's accountants as delivered to HMRC on that date.

The Tribunal noted that there had been a similar dispute with the late filing of the Return for years ending 5 April 2009 and 5 April 2010. The Return for each of these earlier years appeared to have been accepted by HMRC.

The Tribunal decided that it was highly unlikely that Parsons and Company would have failed to submit the Returns for the years ending 5 April 2009, 5 April 2010 and 5 April 2011 particularly when the firm had confirmed to the partnership that each Return had been filed by the due date.

Finally, the Tribunal was not satisfied that HMRC had demonstrated that its procedures for recording receipt of a return were sufficiently robust to prevent an administrative failure in processing the Return for the year end 5 April 2011

John Englefield T/A Englefield Carpenters V HMRC (TC05727)

Was caring for parents a reasonable excuse for late filing?

Summary – The taxpayer had a reasonable excuse for the late filing of her tax return while caring for her elderly parents in their terminal decline.

This case considers an appeal against penalties totalling £1,300 imposed by HMRC for the late filing by Christina McDonald of her self-assessment tax return for the tax year 2010/11 which was not submitted until 17 September 2012.

On 6 January 2013 Christina's agent wrote to HMRC submitting an appeal against the penalties levied stating:

> "In early June 2012 I was called by (the appellant) to visit her at home in order to assist her to get out of her predicament of being so stretched and distressed in the prior four years with the care of her two elderly parents in their terminal decline; her mother with a succession of strokes and her father latterly with cancer."

Her mother died at the end of April 2010 and her father just under 5 months later. She then needed to sort out the house, the belongings, the estate, her father's financial affairs, their pensions and so on. As soon as was practicable she sought to catch up with her tax affairs and paid in one sum all amounts due up to April 2011.

She hoped that this gave an adequate account on compassionate grounds for HMRC to re-consider in these exceptional circumstances the penalties that they were looking to impose.

On 21 January 2013 HMRC dismissed the appeal on the grounds that it was out of time and that she did not have a reasonable excuse. They said that serious illness can only be accepted if the situation meant that the taxpayer was incapacitated for the whole period from the filing date to the date the return was received. During her parents' illness and her subsequent bereavement period, HMRC pointed out that her self-employment continued and HMRC records showed profits of over £19,000 each year for 2008-2009, 2009-2010 and 2010- 2011. They considered that she had not provided a reasonable excuse for the late submission of the return.

Decision

The Tribunal agreed with HMRC that it was the taxpayer's responsibility to submit her Self Assessment return on time by 31 January 2012 but that it was submitted late on 17 September 2012. Penalties totalling £1,300 were therefore due unless the taxpayer could establish a reasonable excuse for the delay.

The Tribunal found it difficult to understand why HMRC considered that the taxpayer's letter explaining her circumstances did not lead them to conclude that she did have a reasonable excuse. Clearly the taxpayer had gone through a challenging time.

"running her own business, looking after her own home, looking after her ailing parents and their home; attending to her parents personal needs and for a time driving her father to visit her mother in various hospitals sometimes twice a day. ….She then suffered the loss of her parents in April and September 2010. During this period of bereavement she had to deal with her parents personal effects and deal with their financial affairs."

Once she was in control of her circumstances, she immediately looked to sort out her tax responsibilities. She had a reasonable excuse for the late submission of her return for the period ended 5 April 2011.

The taxpayer’s appeal succeeded.

Christina Mary Mcdonald v HMRC (TC05745)

Incorrect penalty

Summary – The tribunal cancelled the penalty as there had been no understatement of tax and HMRC were criticised in their approach.

Dr Pandey was a paediatric heart surgeon who appealed against penalties for two alleged careless inaccuracies in her 2009/10 tax return. During this time, she was employed by the NHS and paid a salary that was subject to PAYE.

In 2012, while working in Australia, she received a phone call from HMRC informing her that she owed £100,000.

In 2013, with the assistance of a UK accounting firm she filed her 2009/10 and other returns. Unfortunately, she had no tax records in Australia and wrote to all of her previous employers for pay and tax details and told her accountants about her professional fees.

In January 2015 she received notice from HMRC that they had opened an enquiry into her 2009/10 return because she had omitted to include employment income. The matter was resolved but HMRC imposed a penalty on the taxpayer for careless inaccuracies in the return. The taxpayer appealed.

Decision

The First-tier Tribunal found that, by omitting her only income of the year and the tax deducted from it, the taxpayer's accounting firm was careless but so too was the taxpayer for not checking the return.

However, the tribunal found there was no potential lost revenue as the taxpayer's employers had not operated the correct codes and another had incorrectly allocated income from 2008-09 to 2009-10. The Tribunal concluded that it was more than likely that the employer had failed to deduct the right tax and the taxpayer would be entitled to a credit for it under reg 185(5) of the Income Tax (PAYE) Regulations 2003.

The tribunal cancelled the penalty as there had been no understatement of tax.

The judge criticised HMRC's behaviour as 'unreasonable' and said the case should never have reached the tribunal. He agreed with the taxpayer's accountant that it was 'astonishing' that a determination charging more than £50,000 could be made in 'a case where a person is clearly a PAYE-only employee earning in the region of £60,000 with PAYE fully deducted in that year as shown on records that HMRC possessed'.

The judge ordered the department to pay the taxpayer's costs.

Dr Rajini Pandey v HMRC (TC05706)

Making Tax Digital – What did the Finance Bill 2017 say?
(Lecture B1012 – 15.21 minutes)

The shelving of the MTD provisions in Finance Bill 2017 does not represent the end or even the deferral of MTD. If the Conservatives win the election one would expect the clauses to be reintroduced in a second Finance Bill of 2017.

So what did the Finance Bill 2017 draft clauses tell us?

HMRC are still aiming to introduce MTD in the following phases:

- Income tax in 2018
- VAT in 2019; and
- Corporation tax and in 2020.

Partnerships with turnover over £10m will be able to defer their <u>income tax</u> MTD obligations until 2020.

HMRC confirm that extensive piloting will be undertaken in 2017 to ensure a smooth transition to MTD.

The underlying tax rules will be simplified to support these changes.

Digital record keeping and regular updates to HMRC are central to Making Tax Digital. Businesses will be required to update HMRC quarterly with summary data that is uploaded direct from their software or app within one month of that quarter end. Quarterly updates will be needed for each trade or business undertaken by the taxpayer. If a self-employed trader also has a buy to let they will have to submit a set of quarterly updates for their self-employed business and another set of quarterly updates for their letting business.

At the end of the year, businesses are likely to have ten months to complete any annual tax adjustments that are needed via an End of Period Statement (EoPS). The EoPS is completed electronically and it is where the taxpayer declares they have submitted complete and accurate information concerning their trade. Separate EoPSs are required for each trade or business undertaken by the taxpayer.

Taxpayers will also be required to make a Final Declaration – the MTD equivalent of a self assessment return. The Final Declaration will report income (and deductions) not reported via the quarterly updates e.g. investment income, dividends, employment income, pension contributions etc. The deadline for submitting the Final Declaration will be the same 31 January as now.

The quarterly updates and EoPSs are likely to be in the same basic profit and loss categories as the current self-assessment returns and three line accounts will be retained for the smallest clients.

Taxpayers will be supported in a number of ways through product guidance, free software, financial support, extra tax relief and training sessions.

In their consultation response HMRC did confirm that spreadsheets were an option BUT the spreadsheets will have to go through some form of MTD compatible software in order to upload into the HMRC system. Software developers will be left to develop this conversion software!

Small businesses with gross income of less than £10,000 will be exempt from quarterly uploading and presumably the EoPS. A Final Declaration would still be required.

Those that are digitally excluded would be able to claim an exemption from MTD.

MTD is likely to commence for sole traders, small partnerships and unincorporated landlords for the first accounting period commencing after 5 April 2018.

Businesses with turnover below the VAT registration limit may defer entry into MTD by one year if they so wish.

A self employed taxpayer with turnover of £90,000 (say) with a **year end of 31 August** would be within MTD from 1 September 2018 i.e. the year to 31 August 2019 is the first accounting period commencing after 5 April 2018.

	Covering	**Deadline**
Quarter 1	1 September to 30 November 2018	31 December 2018
Quarter 2	1 December 2018 to 28 February 2019	31 March 2019
Quarter 3	1 March 2019 to 31 May 2019	30 June 2019
Quarter 4	1 June 2019 to 31 August 2019	30 September 2019
EoPS	Year to 31 August 2019	30 June 2020
Final Declaration	Tax year 2019/20	31 January 2021

If their turnover was £80,000 (say) then all the above dates can be pushed back one year.

A self employed taxpayer with turnover of £90,000 (say) with a **year end of 31 March** would be within MTD from 1 April 2019 i.e. the year to 31 March 2020 is the first accounting period commencing after 5 April 2018.

	Covering	Deadline
Quarter 1	1 April 2019 to 30 June 2019	31 July 2019
Quarter 2	1 July 2019 to 30 September 2019	31 October 2019
Quarter 3	1 October 2019 to 31 December 2019	31 January 2020
Quarter 4	1 January 2020 to 31 March 2020	30 April 2020
EoPS	Year to 31 March 2020	31 January 2021
Final Declaration	Tax year 2019/20	31 January 2021

If their turnover was £80,000 (say) then all the above dates can be pushed back one year!

A business with a year end of 5 April would be well advised to change their accounting date to 31 March if they want the defer their entry into MTD. As yet there are no anti-avoidance rules preventing this taking effect.

Property letting businesses will all have tax year ends with no scope to change to 31 March. These clients will have their first quarterly update to 5 July 2018 unless their income is under the VAT registration limit.

Deadlines

1 May 2016

- Due date of payment of corporation tax liabilities for accounting periods ended 31 July 2016 for small and medium-sized companies not liable to pay by instalments.
- From this date £10 daily penalties apply to late online self-assessment tax returns for the year ended 5 April 2016 to a maximum of £900.

5 May 2017

- Last day for 2017/18 tax credit claim to be backdated to 6 April 2017

7 May 2017

- Due date for electronic filing and payment of VAT liability for quarter ended 31 March 2017.

14 May 2017

- Quarterly corporation tax instalment for large companies (depending on accounting year end) due.
- Filing date for EC sales list for quarter ended 31 March 2017 due (paper form).

19 May 2017

- Due date of payment of PAYE/NIC/construction industry scheme/student loan payment liabilities for month ended 5 May 2017 if not paying electronically.
- File monthly construction industry scheme return by this date.

21 May 2017

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

22 May 2017

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

31 May 2017

- Employees at 5 April 2017 and from whose pay tax was deducted should have received form P60 from their employers by this date.
- The date by which Companies House should have received accounts of private companies with 31 August 2016 year end.

- Companies House should have received accounts of public limited companies with 31 November 2016 year end by this date.

- HMRC should have received corporation tax self-assessment returns for companies with accounting periods ended 31 May 2016.

1 June 2017

- Due date for payment of corporation tax liabilities for accounting periods ended 31 August 2016 for small and medium-sized companies where payment is not required by instalments.

7 June 2017

- Due date for electronic filing and payment of VAT liability for quarter ended 30 April 2017.

News

HMRC policy paper - changes to the PAYE tax system

HMRC has issued a policy notice outlining the changes being introduced from 31 May 2107 to the PAYE system, and how they will affect the public.

The current system doesn't always work for customers' whose circumstances change during the year: HMRC say that the current system can take up to two years for an individual's tax account to be balanced after an underpayment has occurred. Thy believe that the changes will stop most people paying too much tax during the year or getting unexpected tax bills at the end of the year. They will now pay the right tax at the right time.

The vast majority of PAYE taxpayers won't notice a change. They believe that millions of the lowest paid employees will pay less tax on a monthly basis by the end of the tax year because HMRC will catch overpayments sooner and prevent them from building up.

A smaller number of customers, who previously would have had an unexpected bill at the end of the year, will pay the right tax from the moment their circumstances change, so they will be able to manage their tax payments better.

If there is a change which affects an individual's tax HMRC will send them a tax code change notice, along with instructions on what to do. This will explain the change, and encourage them to use their online personal tax if they need more information or further support.

For those who can't go online there will be other ways to work with HMRC, such as telephone and home visits as appropriate. Taxpayers will also be able to nominate a Trusted Helper – either a friend or relative – to manage their affairs on their behalf, and agents will continue to have a key role in supporting their customers' use of online services.

What it means for employers

Employers and pension providers could receive more tax codes, but still on a batched basis as we operate now. Regular PAYE RTI submissions will continue unaffected, and it remains critical that employers submit accurate data on time.

What HMRC is doing to support employers

HMRC has been discussing these changes with employers since August 2016. We have produced guidance and support packs, and will continue to update agents and employers to make sure they are prepared for the new system.

https://www.gov.uk/government/publications/issue-briefing-changes-to-our-paye-tax-system/helping-customers-pay-the-right-amount-of-tax-on-time

HMRC launches criminal investigation into Credit Suisse

HMRC have announced that they are investigating senior employees and certain customers of a 'global financial institution' for suspected tax evasion and money laundering. Press reports have named Credit Suisse as the institution in question.

Their statement read:

> "Yesterday HMRC, working with our international partners, launched a criminal investigation into suspected tax evasion and money laundering by a global financial institution and certain of its employees. The first phase of the investigation, which will see further, targeted, activity over the coming weeks, is focused on senior employees from within the institution, along with a number of its customers.
>
> The international reach of this investigation sends a clear message that there is no hiding place for those seeking to evade tax. Promoters and facilitators of tax evasion schemes, and their customers, need to wake up to reality and accept that attempting to hide wealth overseas, or within institutions, doesn't work and doesn't place them out of our reach. Alongside this new investigation we are currently investigating more than 1,100 cases of offshore evasion around the world, and have brought in more than £2.7 billion from offshore tax evaders since 2010.
>
> As this an ongoing investigation HMRC are unable to provide any further detail at this time."

www.gov.uk/government/news/hmrc-launch-criminal-investigation-into-global-financial-institution

OTS updates papers on tax complexity

The Office of Tax Simplification has published a focus paper summarising and reviewing the topics covered in the papers published since the OTS was formed in 2010.

1. Length of legislation (First Published April 2012)

Using the 2011/12 Tolleys tax handbooks as the basis of the study, analysis showed that there only 50% of the claimed length of the tax code was 'actual' tax code. The length has increased steadily and however it is analysed, there is a lot of UK tax law. The OTS:

- do not believe that length necessarily equates to complexity but, given that others associate length with complexity they have used length as one of the ten factors in their Complexity Index (see later)

- think the methodology remains valid.

2. Tax thresholds (First Published February 2013)

Thresholds can be useful and aid tax simplification by excluding low-value transactions and certain taxpayers. However, leaving them unaltered means they are less effective or start to have different effects.

They highlighted that it would be a big job to review all 639 thresholds and ceilings identified at once, to decide if they needed to be updated or abolished.

They believe that it should be possible to draw up a priority list of which thresholds should be looked at first, taking account of which would have the greatest simplification impact.

3. Layered legislation (First Published September 2013)

Despite taxpayers living and operating in a complex world, could the tax law be written in a different way that would lead to simpler, more accessible rules?

The concept of 'layered' legislation involves writing the legislation based on user's needs:

- The general taxpayer would be able to use just a summary briefing;
- Businesses and general professionals would use a fuller system;
- Experts would have further detail to assimilate.

This idea was noted in the recent paper from the IFS, CIOT and Institute for Government on 'Better Budgets'1 which has prompted the OTS to revise and update their earlier paper and are welcoming our comments.

4. Definitions in tax legislation (published October 2013 with response published April 2014)

The OTS's conclusion was that there is scope for policy makers and draftsmen to focus more on definitions to aid users.

They suggested the creation of a database of all definitions as a readily accessible reference point, not only for policy makers and draftsmen, but also for users of legislation.

5. How to avoid complexity in the tax system (First published June 2015)

This paper sets out 4 principles for avoiding complexity, each with some subsidiary lessons:

1. Ensure the proposed tax measure meets the policy aims
2. Focus the measure carefully
3. Design the measure to meet the aim
4. Maintain the measure properly

The recent paper from the IFS, CIOT and Institute for Government on 'Better Budgets'2 draws out principles that echo the points we make in our paper.

6. OTS Complexity Index

The OTS published a number of versions of this index between 2012 and 2015, refined to reflect comments and further research and see it being used in two ways:

1. To prioritise and target efforts to simplify the existing tax system

2. To give policy makers a tool to track the relative complexity of their policy changes

The index produces two figures, based on ten factors which are aggregated and averaged to produce ratings:

1. The underlying complexity: a measurement of the structural complexity of a tax measure, based on the policy, legislative and administrative complexity, incorporating six factors

2. The impact of complexity: a measure of the costs of complexity in the tax system, to both the taxpayer and HMRC, incorporating four factors

The ten factors are

1. Number of exemptions plus the number of reliefs
2. The number of Finance Acts with changes (since 2000)
3. The Gunning-fog readability index
4. Number of pages of legislation
5. Complexity of HMRC guidance
6. Complexity of information requirement to make a return
7. Number of taxpayers affected
8. Aggregated compliance burden for a taxpayer and HMRC
9. Average ability of taxpayers
10. Revenue at risk due to error, failure to take reasonable care (FTRC) and avoidance

7. Avoidance and Complexity

In 2014. the OTS did some initial work on corporation tax but were unable to progress the work due to lack of resources and pressures of other work.

Many stakeholders have suggested this is an area the OTS should pursue, citing the GAAR as giving the opportunity to review and repeal many specific anti-avoidance provisions.

www.gov.uk/government/publications/ots-papers-on-aspects-of-complexity-in-the-tax-system

General Anti-Abuse Rule - HMRC guidance updated

HMRC published amendments to its GAAR guidance effective from 31 March 2017.

The changes include bringing diverted profits tax in from 1 April 2015 and apprenticeship levy within the rules from 15 September 2016, as well as introducing powers for HMRC to make provisional counteractions and impose specific GAAR penalties from 15 September 2016.

Pooling and binding of cases

Where there are a number of similar cases, these may be pooled by HMRC and the GAAR advisory panel may be asked to consider one case from that pool, or in certain circumstances a generic referral may be made by HMRC. The GAAR advisory panel's opinions will then be applied to the similar cases.

Penalty provisions

The GAAR legislation includes specific provisions, enacted in Finance Act 2016, which impose a penalty where a taxpayer submits a 'tax document' to HMRC relating to a tax arrangement for which HMRC issues a notice of final decision stating that the tax advantage is to be counteracted and then subsequently counteracts the tax advantage by making just and reasonable adjustments.

www.gov.uk/government/publications/tax-avoidance-general-anti-abuse-rules

The effect of BREXIT on UK tax

With article 50 now triggered and the process of leaving the European Union underway, what does this mean for UK tax?

Indirect taxes

As a general rule, indirect taxes have been most affected by membership of the EU. There are constraints on excise duties, including EU minimum rates on most but not all alcoholic drinks and on cigarettes.

Going forward, chancellors will have greater freedom to vary indirect taxes than they have been able to do while in the EU but on the downside they will not be able to blame the EU for any unpopular decisions.

The UK's intention is a continuation of tariff-free trade with the EU, although achieving this may be easier said than done. Failing to strike a trade deal would result in tariffs being set under the rules of the World Trade Organisation.

VAT

EU law specifies a minimum standard rate of 15% and a minimum reduced rate of 5%. Attempts to by Gordon Brown to abolish the 5% VAT rate on domestic gas and electricity and later, in 2015, by George Osborne to do the same for sanitary products, were thwarted by the EU.

The EU permitted zero-rating in the UK, though items that were taken out of zero-rating could not be returned there.

Leaving the EU will not mean the abolition of VAT. Given the cost and the state of the public finances, it is unlikely that any chancellor will take the opportunity to reduce the standard rate below 15%, though a symbolic post-Brexit abolition of the tampon tax is highly likely.

Corporate tax

Rates of direct taxation are not the subject of EU rules. Ireland's 12.5% corporation tax rate survives, and the planned reduction to the targeted 17% from April 2020 in the UK should go ahead. Leaving the EU should have little impact here.

Personal tax

Harmonisation of personal and wealth taxes is very much unfinished business for the EU and the UK was always a voice against it. Across the EU personal direct taxation is a hotchpotch of different schemes. There is nothing quite like the UK system of income tax and national insurance, and each country has its own method of taxing wealth.

It will be interesting to see what happens within the EU with the UK’s departure. In the UK it should be business as usual.

Adapted from an article by David Smith (Tax Journal 7 April 2017)

Business Taxation

Sideways loss relief denied

Summary - The Upper Tribunal found that individual partners in the Icebreaker LLP partnerships were not entitled to sideways loss relief for their share of partnership losses.

With HMRC's agreement, seven individuals were chosen as a representative cross-section of the individual members of the Icebreaker LLPs, each member being a member of different LLPs.

In total there were some 900 members, of which about half had joined the Icebreaker Members' Action Group agreeing to be bound by the courts' decision. In practice, the decision will bind the other members as well.

In principle each LLP was set up and operated as follows:

- 20% of the partnership funds were provided by individual members and the remaining 80% from a bank; members were personally liable for the bank loans
- The LLP paid 5% to the management company, Icebreaker Management Limited, as an advisory and administration fee with the remaining 95% being paid to the exploitation company (Shamrock Solutions Ltd or Centipede Ventures Ltd)
- A production company would produce a music CD, a book, or some other product.
- The exploitation company effectively paid 10% for the product but also gave the production company entitlement to some of the product revenues if and when sold.
- The exploitation company put 80% on deposit with the interest paid as an income stream by quarterly payments to the LLPs, matching the quarterly interest payments that the members of the LLP are obliged to pay to the lending bank for the initial borrowing of the 80% to fund their contribution to the LLP.
- The 80% on deposit is also used to pay the LLP what is described as the "Final Minimum Sum" due from Shamrock to the LLP and that sum is then available to be used to repay the principal amount borrowed by the members of the LLP."
- If the products were successful, the exploitation company would split the profits between the production company, itself and the LLPs.

The issues to be considered by the Upper Tribunal were

1. Were the LLP trades carried on commercially with a view to profit?

2. Were members actively involved? (S118ZH ICTA and S103B

Overall the First Tier Tribunal found that none of the LLPs had come close to earning a commercial rate of return on its members' personal contributions. The Upper Tribunal accepted the First Tier Tribunal's conclusion that a trade, which is virtually certain to lead to a loss, cannot realistically be described as commercial.

The Tribunal said that:

> 'The critical finding here is that the individual referrers spent the time because they had been told they must, and not in the expectation or hope that anything useful might come of them.'

They were therefore not active members and failed the test on that count too.

The taxpayers' appeal was dismissed.

Seven Individuals v HMRC [2017] UKUT 132, Upper Tribunal (Tax and Chancery Chamber)

Thoughts on incorporation from 2017 (Lecture B1011 – 19.13 minutes)

Just as we had started to get used to the new dividend tax rules, the Chancellor has made changes that impact the tax position of both the self employed small business owner and similar businesses run through limited companies. Add in the promised reductions in corporation tax and you have a complex picture, varying from year to year over the next three years or so.

So here are the changes we know about over the next few years, looking only at those that are likely to affect decisions about business structure. This means that I am regarding the tax and NIC thresholds as frozen at 2017/18 amounts, despite the fact that we know they will rise, and in the case of the tax figures, rise fairly substantially.

Each of the sets of figures have been prepared on the following basis:

- For the sole trader, tax and NIC payable have been based on 2017/18 rates and thresholds, except for the known abolition of Class 2 NIC in 2018. Following the Chancellor's u-turn on 15 March, Class 4 NIC is regarded as static through the period.

- For the company tax liability, I have assumed that a salary equal to the NIC start point (£8,164 for 2017/18 onwards) is paid, and the balance of post tax profits are distributed by way of dividend. This provides a like for like comparison, as the company profits are then available to spend on living expenses etc.

- There are other factors which will bear on this decision, as indeed there are ways of reducing the tax liability in the company still further by paying interest on a loan to the company from the owner/director, but as not all businesses are in a position to take advantage of this, it has been excluded.

The main issue to bear in mind is the additional costs of running the business through the limited company – mainly in administrative costs, but also potentially through issues arising in relation to business motoring.

Table 1 – for comparison – 2016/17 position

Profit	Sole trader	Company	Saving
£20,000	£3,020	£2,509	£511
£30,000	£5,920	£5,109	£811
£40,000	£8,820	£7,709	£1,111
£50,000	£12,630	£10,309	£2,321
£75,000	£23,130	£21,462	£1,668
£100,000	£33,630	£32,962	£668

This rather complex picture indicates that advice about incorporation is not driven by the tax outcomes, as these are uncertain. While there is a consistent tax saving at all profit levels shown, this saving ebbs and flows through the income range. Providing advice about the likely tax implications of incorporation (or remaining incorporated) probably demands an understanding of the likely profit levels and the amount of profit that the client is likely to extract. Retaining profits in the company will save tax at the higher levels of profit as the dividends forgone are taxed at 32.5%.

The marginal rates of tax borne on profits are:

	Self employed	Company
Basic rate	29%	26%
Higher rate	42%	46%

The marginal rate calculations ignore the personal allowance and the dividend nil rate band and look only at income squarely within each band.

Table 2 – 2017/18

The changes that are coming through for 2017/18 are :

- Increase in personal allowance to £11,500
- Increase in higher rate threshold to £45,000
- Increase in NIC threshold to £8,164 per annum
- Increase in the Class 2 rate of NIC to £2.85 per week

- Reduction in corporation tax to 19%

Profit	Sole trader	Company	Saving
£20,000	£2,913	£2,343	£570
£30,000	£5,813	£4,850	£963
£40,000	£8,713	£7,358	£1,355
£50,000	£12,263	£9,865	£2,398
£75,000	£22,763	£20,459	£2,304
£100,000	£33,263	£31,790	£1,473

This shows a slight increase in the benefit of incorporation against 2016/17 at all levels, and the reduction in the tax savings at £75,000 and £100,000 of profit is less marked. This is because the marginal rates in the higher rate tax band have drawn slightly closer together.

The marginal rates of tax borne on profits are:

	Self employed	Company
Basic rate	29%	25.07%
Higher rate	42%	45.32%

Table 3 – 2018/19 and 2019/20

The tax changes we shall see from April 2018 are more complex. The u-turn on Class 4 NIC means that the self employed actually experience a tax reduction, while director shareholders will pay more tax as a result of the reduction in dividend allowance:

- Abolition of Class 2 NIC
- The reduction of the dividend allowance to £2,000 per annum

Profit	Sole trader	Company	Saving
£20,000	£2,765	£2,568	£198
£30,000	£5,665	£5,075	£590
£40,000	£8,565	£7,583	£983
£50,000	£12,115	£10,090	£2,025
£75,000	£22,615	£20,684	£1,931
£100,000	£33,115	£32,015	£1,100

At lower levels of profit the tax saving on incorporation is eroded. This is because the abolition of Class 2 NIC and the increase in the main rate of Class 4 NIC results in a net reduction in liability for those with low profits.

However, the benefit of incorporation at higher levels of profit increases, as those clients are paying more NIC as a result of the changes. As you can see, at £50,000 the changes virtually balance each other out.

For this taxpayer, the reduction in dividend allowance has increased his tax liability by 7.5% x £2,000 = £150.

The marginal rates are unchanged, as I have calculated these based on the income within the band, rather than taking the dividend allowance into account:

	Self employed	Company
Basic rate	29%	25.07%
Higher rate	42%	45.32%

Table 5 – 2020/21

In fact, by this point the personal allowance will reach £12,500 and the higher rate threshold £50,000, but as we know nothing about the other variables, I have used the 2017/18 limits. So the change to report is:

- Reduction of 2% in the rate of corporation tax.

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Profit	Sole trader	Company	Saving
£20,000	£2,765	£2,349	£416
£30,000	£5,665	£4,671	£994
£40,000	£8,565	£6,994	£1,571
£50,000	£12,112	£9,316	£2,796
£75,000	£22,615	£20,282	£2,333
£100,000	£33,115	£31,276	£1,839

So the final part of the jigsaw is a significant increase in the benefit of trading through a limited company through the two percentage point reduction in corporation tax. This suggests that there may be other action between now and then to reduce the gap which is regarded as "anomalous".

The final marginal rates on profits are:

	Self employed	Company
Basic rate	29%	23.23%
Higher rate	42%	43.98%

Conclusion

Corporates are still the optimum trading vehicle when profits are above £40,000 but their differential is not as great as it once was. However, when we introduce remuneration planning to owner managed corporates (later in the notes) we start to reinstate the tax savings that corporates offer the owner managed business.

Corporate interest restriction - draft guidance

The new corporate interest restriction regime is expected to have a significant impact on a number of taxpayers, both in terms of interest restrictions and from a compliance perspective. As the rules are now in force, businesses will need to assess the impact, plan their tax provisions and quarterly instalments accordingly and consider the financing and strategy going forward in light of the rules.

The new rules

The aim of the rules is to restrict a group's deductions for financing costs to an amount which is inline with its activities taxed in the UK, taking account how much the group borrows from third parties. Amounts that are disallowed in one accounting period may be carried forward and may potentially be deducted in a subsequent period.

From 1 April 2017, a group will have its interest expense restricted to a maximum deduction of 30% of earnings before interest, tax, depreciation and amortisation (EBITDA) that is taxable in the UK.

Groups with less than £2 million of net interest expense and other financing costs per annum will not suffer any restriction.

In the Spring Budget, the Government announced a series of detailed amendments to eliminate 'unintended consequences' and reduce 'unnecessary compliance burdens'.

Initial guidance

HMRC has published an initial tranche of draft guidance on the new corporate interest restriction that takes effect from April 2017, for comment until 31 July 2017. This guidance focuses on the core rules and other aspects where guidance has been specifically requested.

Further draft guidance is due to be issued by 31 May. When finalised, this guidance will be incorporated into HMRC's Corporate Finance Manual.

www.gov.uk/government/publications/corporate-interest-restriction-draft-guidance

Disguised remuneration: the new EBT loan charge

Historically many employers transferred substantial bonuses into offshore EBTs that in turn lent the money to employees, often interest free, on an open-ended basis. This resulted in the employee having immediate access to their bonus and paid no tax on it.

In 2011, HMRC introduced the 'disguised remuneration' regime whereby an employee was taxed on an EBT loan as employment income and there was no refund of tax if the loan was repaid.

They now propose a major extension to this regime whereby:

- There will be a new loan release charge
- EBT loans made since 1999 will be liable to income tax and NICs if they are outstanding on 5 April 2019
- There may a charge on third party payments to participators in close companies, who are also employees

New loan release charge

Any release of a loan to an employee may already be charged to income tax under existing rules, either as earnings on general principles or under the benefits code. However, under the draft FB 2017 clauses, the release or writing off of a loan made to an employee or other relevant person will also be chargeable to income tax under the disguised remuneration rules with the amount released falling within PAYE.

New charge on loans outstanding on 5 April 2019

The most significant measure announced at Budget 2016 is the proposed introduction of a new tax charge on most loans made on or after 6 April 1999 that are outstanding on 5 April 2019. The employee will generally have to make good the PAYE payable by the employer by the 90th day of next tax year.

The tax charge is on the amount 'outstanding' which is:

- the initial principal amount;
- plus additions to principal (other than by capitalising interest);
- less repayments of principal before 17 March 2016;
- less repayments of principal in money made by the employee or certain other relevant persons on or after 17 March 2016 (other than under tax avoidance arrangements).

Loan repayment before 5 April 2019

If the employee repays their loan before 5 April 2019 but the repayment is retained within the EBT, the new charge will not apply but the money will remain within the scope of the disguised remuneration rules and charged to tax if they are paid out to an employee in the future.

EBT releases a disguised remuneration loan before 5 April 2019

The release will normally attract employment income tax as earnings, under the benefits code or, from 6 April 2017, under the disguised remuneration rules.

Under the draft FB 2017 clauses this amount is deemed to remain 'outstanding' and can be caught by the 2019 charge. This result is confirmed in HMRC's technical note of 5 December 2016, which points out that a release is not a repayment of principal; and, accordingly, does not reduce the amount deemed to be 'outstanding', even if in reality it eliminates the loan.

To avoid the double charge to tax both as a release and under the new outstanding loan charge, it is necessary to rely on FB 2017 Sch 16 para 10 where relief is available if a 'sum of money or asset' is the subject of both the new loan charge and the release. Perhaps consideration could also be given to extending the relief to cases where the employee is within the scope of UK tax in respect of the new loan charge, but was non-UK resident at the time of the waiver and paid a foreign tax (but not UK tax) on the release. The relief does not appear to apply in these circumstances.

Adapted from an article by Ashley Greenbank, Macfarlanes

(Tax Journal April 2017)

VAT

R&C Brief 1/2017: Historical VAT bad debt relief claims

Following the Court of Appeal judgments in British Telecommunications plc v HMRC and HMRC v GMAC UK plc, HMRC have published Business Brief 1/2017 setting out details of the evidence needed to substantiate claims for historical VAT bad debt relief.

Period of a claim

Between 1 January 1978 and 1 April 1989, to claim relief the defaulting customer had to be formally insolvent. However, from April 1989 and until 19 March 1997, there was also a condition that title in any goods must have passed to the customer.

The Court of Appeal found that the above former conditions were disproportionate. However, it also decided that it was too late to make claims under the scheme that existed before 1 April 1989 and so only claims relating to supplies of goods made between 1 April 1989 and 19 March 1997 will be paid subject to satisfactory evidence that the bad debts occurred and that the VAT hasn’t been previously reclaimed.

The litigation does not affect the current scheme set out in Notice 700/18 Relief from VAT on bad debts.

Evidence

To ensure that any businesses making claims have not previously claimed relief, claims will need to meet the requirements set out in conditions 1 to 5 in paragraph 2.2 of Notice 700/18. If a business is unable to meet these requirements it will need to satisfy HMRC by other means that it did not previously obtain bad debt relief. HMRC will consider alternative evidence for amount and methodology.

The responsibility is on the claimant to show:

- they suffered bad debts on supplies of goods made under retention of title terms
- they didn’t previously claim relief
- the amount claimed is correct

www.gov.uk/government/publications/revenue-and-customs-brief-1-2017-vat-historical-bad-debt-relief-claims

Practical tips with the bad debt relief rules (Lecture B1015 – 13.57 minutes)

Introduction

The recession years are hopefully behind us but many businesses are still suffering from bad debts. There is nothing more frustrating for a business than a bad debt but the good news is that the VAT element of an unpaid sales invoice should not be a problem if the relevant rules for bad debt relief are properly followed.

Basic rules

A business can claim bad debt relief on a VAT return when the following conditions are met:

- The sales invoice in question is more than six months overdue for payment;
- The invoice has been written off in the business records and accounts ie the customer's sales ledger account has been credited and a bad debt expense also created; and
- Output tax must have been accounted for on the original sales invoice and declared and paid to HMRC on a VAT return
- The debt must not have been sold, factored or paid under a valid legal assignment.

Note – the latest time a claim can be made is four years and six months after the later of the time of supply (usually invoice date) or due date for payment. If an invoice is written off and bad debt relief has been claimed, then output tax must be declared on any payment subsequently received from the customer.

Example 1

Anne's accountant is completing her year-end accounts to 31 March 2016 and identified two unpaid sales invoice that are more than six months overdue for payment:

Invoice 0124 dated 20 June 2015 - £5,000 plus VAT

Invoice 0144 dated 31 July 2015 - £2,000 plus VAT.

Anne does not use the cash accounting scheme and has accounted for output tax on both of the invoices in question according to the invoice date. She is not confident of receiving payment for either invoice (which were made on 90-day payment terms) but feels that it is too premature to write off invoice 0124. It would therefore make sense for her to reclaim £400 bad debt relief on her next VAT return in relation to invoice 0144 but she must write this invoice off in her accounts to create a bad debt expense. VAT of £400 should be claimed in Box 4 of her next return.

Note – a common error with the rules is that sometimes a business claims the relief too early by thinking that the earliest claim date is six months from the invoice date rather than due payment date. The earliest VAT return that Anne could claim bad debt relief on invoice 0144 is therefore the return that includes 30 April 2016.

Consider cash accounting scheme

Do not forget that one of the main advantages of the cash accounting scheme is that bad debt relief is automatic. Output tax is only declared on a VAT return when payment has been received from a customer although input tax cannot be claimed until a supplier has been paid. A business can use the scheme if it expects taxable sales in the next 12 months to be less than £1.35m (excluding VAT).

If a business uses the flat rate scheme (FRS), then it cannot use the cash accounting scheme but it can adopt the cash based turnover method, which means that the payment date is again relevant. However, see the final section of this article which highlights an unexpected cash windfall with the bad debt relief rules for FRS users.

The VAT only invoice – Simpson and Marwick case

If you act for any car repair businesses, or legal firms, it is possible that your clients will raise VAT only invoices, usually in relation to insurance work. Think about the situation where a VAT registered car owner is involved in an accident (his fault) where his vehicle repair is the subject of an insurance claim. The repair business will invoice the insurance company for the net amount of the job (let's say £3,000) and invoice the VAT amount (£600) to the business owner as a VAT only invoice – the latter business can claim input tax as a business expense (assuming it is not exempt or partly exempt). But what happens if the car repair business is never paid for the VAT only invoice?

The above question about bad debt relief on VAT only invoices has done the rounds in the tribunals – here is a summary of the outcome in the case of law firm *Simpson and Marwick v HMRC*:

- The First-tier Tribunal (FTT) ruled that the bad debt relief on a VAT only invoice was based on applying the relevant VAT fraction to the VAT in question ie £600 x 1/6 = £100 in the scenario considered above (TC00662)

- The Upper Tribunal (UT) strangely reversed this decision and decided that the bad debt relief in the case of a VAT only invoice was the VAT itself ie £600 ([2011]UKUT 498 (TCC)

- The Court of Session restored sanity and allowed HMRC's appeal ie giving the same conclusion that was reached by the FTT ([2013] CSIH 29 XA45/12.

The key issue (in my opinion) is that in the case of a car repair insurance job for £3,000 plus VAT where the VAT only invoice remains unpaid, the car repair business has still received consideration (£3,000 from the insurance company) for performing a standard rated service so output tax of £500 (i.e. £600 less £100) would appear correct. The decision of the UT effectively meant that our car repairer had earned £3,000 with no tax payable, which cannot be correct.

Flat rate scheme – tax windfall

If I use the FRS and only account for tax when I receive payment from my customers, then I have adopted the cash based turnover method. You might think that bad debt relief is therefore irrelevant because I never account for tax on a sale if I am not paid. However, a quirk of the FRS (good news) is that there is some bad debt relief for me to claim in Box 4 of my VAT return in the period when I write off an unpaid debt in my accounts.

Example 2

Steve uses the FRS and adopts a flat rate of 12% - he completes VAT returns on a calendar quarter basis and uses the cash based turnover method. He raised an invoice for £5,000 plus VAT on 31 December 2013 (30 day payment terms), which he wrote off as a bad debt on 30 September 2014.

Steve can claim £280 in Box 4 of his VAT return for September 2014 under the bad debt relief rules on the following basis:

* If he had been paid for the invoice, he would have collected £1,000 of tax from his customer and then included £720 on his VAT return through the FRS (£5,000 plus VAT x 12%).

* In the absence of payment from the customer, he can therefore claim the difference of £280 (£1,000 less £720) from HMRC under the bad debt relief rules.

Note – if Steve accounted for FRS tax with the basic turnover method (where VAT is usually declared based on the invoice date), his bad debt relief claim would be £1,000 on his September 2014 VAT return ie to reclaim the £720 he would have declared on his December 2013 return based on the invoice date plus the extra £280 windfall that is now due.

(HMRC VAT Notice 733, section 14)

Customers and unpaid purchase invoices

The bad debt relief rules also affect customers as well as suppliers. If a supplier has claimed bad debt relief on his VAT return, it is only fair that the regulations also require the customer to adjust his input tax claim if he has not paid a purchase invoice that is more than six months overdue for payment.

The regulations require input tax to be credited by the customer on the VAT return relevant to the date when the six month payment deadline becomes relevant (assuming the payment date is later than the time of the original supply, which is usually the case), but the good news is that input tax can again be reclaimed by the customer if he pays the invoice(s) in the future (VATA1994, s26A).

Example 3

ABC Enterprises Ltd received a purchase invoice dated 31 May 2013 from DEF Wholesalers Ltd for £5,000 plus VAT in relation to stock (60 day payment terms). The directors of ABC initially refused to pay the invoice because they thought the goods were faulty but eventually paid the invoice on 12 June 2014. ABC does not use the cash accounting scheme and claimed input tax of £1,000 on its June 2013 VAT return ie based on the invoice date.

ABC should have reversed the input tax claim on its March 2014 VAT return because the invoice was still unpaid on 31 January 2014 ie six months after the due payment date of 31 July 2013. However, the company can then reclaim input tax again on its June 2014 VAT return on the basis that the invoice was paid in this period. (HMRC Notice 700/18 – section 4)

Repayment of VAT on car repairs

Summary – The car repairs were supplies made by the repairers to the car owners and not the hire company.

U Drive Ltd ran a vehicle hire business. They paid insurance premiums to Parallel Insurance Services Ltd who provided cover under a fleet insurance policy.

If one of its hire vehicles was involved in an accident, U Drive would sometimes agree with the third party that they would arrange and pay for the car to be repaired rather than making an insurance claim. The repairer invoiced U Drive who paid the invoice including the VAT due. The contract to supply the repair services was between U Drive and the repairer.

When HMRC refused a repayment claim of £17,460 in September 2013, U Drive appealed to the First-tier Tribunal. The Tribunal decided that the repairers had supplied the repair services to the car owners and not to U Drive and so no VAT was repayable.

U Drive appealed to the Upper Tribunal.

Decision

The Tribunal concluded that, in economic reality, U Drive had simply agreed to pay for the repair of the car owner's vehicle; the supply was effectively made to the owners. The fact that U Drive had contracted to pay the repairers directly did not make them the recipient of any supply by the repairers and so no VAT was repayable.

U-Drive Ltd v Revenue and Customs Commissioners [2017] UKUT 112 (TCC)

Change of rate for the Flat Rate Scheme

Summary – It was the taxpayer's responsibility to check that the flat rate applied was the correct rate.

Hylton Hill is an estate agency partnership that was registered for VAT. They joined the flat rate scheme in July 2006 and had always used a flat rate of 11%.

Following an assurance visit on 5 February 2015, HMRC established that the wrong rate of VAT was being applied as the rate applicable to estate agent businesses had changed from from 4 January 2011 to 12%.

HMRC claimed that the partnership owed additional VAT as a result of the rate change stating that establishing the correct amount of VAT was the responsibility of the taxpayer and that the correct rate of VAT was clearly stated on the HMRC website.

On 18 June 2015 the partnership wrote to HMRC appealing the Assessment on the ground that it had not been notified in writing of the rate change in the four years in which it was effective and that HMRC had failed to check that the correct rate was being used. Following a review HMRC's view did not change.

The partnership appealed the assessment to the First Tier Tribunal on 3 December 2015. The appeal was late but HMRC accepted this.

The issue was whose responsibility was it to keep up to date with VAT rate changes?

- The partnership believed they should have been told in writing of any changes.
- HMRC argued that they had clearly made the information available on their website and in VAT Note 3 of 2010 and, in any event, it is for the taxpayer to check.

Decision

Neither party could confirm whether VAT Note 3 of 2010 was delivered but the Tribunal accepted that, through its website and guidance, HMRC had made available sufficient information on the change in rate. They found that a VAT registered trader has a responsibility to ensure it is paying the correct VAT.

The appeal was dismissed.

Hylton Hill v HMRC (TC05717)

Bureaux supplying self employed temporary workers

Summary – Payments by clients to cover commission and the work of non-employed temps to employment bureaux were both VATable supplies.

'Adecco' are a number of employment businesses that provided temporary staff to clients in return for payment. The payment covered the money to be paid on to workers for the work that they had done plus a commission element to be retained by Adecco. Between 1 April 2007 and 31 December 2008, Adecco accounted for VAT on the total amount paid by clients.

Adecco provided workers using one of three different arrangements:

1. Contract workers who were self-employed workers introduced to a client by Adecco. If the client accepts the worker, the client enters into a contract with the worker and Adecco only supplies introductory services to the client and is only liable for VAT on its introductory fee.

2. Employed temporary workers who it assigned to its clients on a temporary basis and accounted for VAT on the whole fee charged to the client.

3. Non-employed temps where the temp is not obliged to undertake the assignment even if accepted by the client. Adecco is an employment business for the purposes of Conduct of Employment Agencies and Employment Businesses Regulations 2003 (see below) and is classed as their 'employer' for various regulatory matters, including the working time regulations and payment of PAYE/NIC.

It was the VAT treatment of this third category of worker that was under dispute.

In Reed Employment Ltd v HMRC the First Tier Tribunal concluded that the employment bureau was making supplies of introductory services to clients in respect of the placement of non-employed temps. The bureaux was only required to charge VAT on its commission and not on the non-employed temps' remuneration. HMRC did not appeal against the decision in Reed.

Following this decision, Adecco looked to recover VAT that had previously been accounted for but HMRC refused the claims. One of the reasons given was that Adecco did not merely supply a service of introducing the non-employed temps to the clients but also supplied the non-employed temps' services, meaning that VAT was payable on the full amount paid by the clients.

Adecco appealed to the First Tier Tribunal. The appeal was dismissed. Adecco were not supplying introductory services but the work of the non-employed temps.

Decision

Referring to Airtours [2016] UKSC 21, the Upper Tribunal started by considering the contractual position, they moved on to consider whether that reflected the economic reality of the transaction.

There were contracts between:

- the temps and Adecco; and

- Adecco and its clients.

The temps could not work for the clients except through their agreement with Adecco so clearly they were supplying a temp to perform the work. In addition, Adecco was obliged to pay the temps irrespective of whether or not it received payment from clients.

The Tribunal concluded that the economic reality was that Adecco was supplying temps as opposed to merely providing introduction services.

The appeal was dismissed.

Interestingly, they stated:

> 'We hope that our decision is clear but we doubt that we have provided guidance — except at a very high level — that will enable the VAT liability of other employment businesses to be determined without a thorough analysis of the contracts and an assessment of the economic reality of the particular transactions.'

Adecco UK and others v HMRC [2017] UKUT 113 (17 March)

VAT surcharge – how are payments allocated?

Summary - The Upper Tribunal found that taxpayers could allocate payments to current periods rather than historic periods. This can and did have significant consequences under the surcharge regime.

QN Hotels Ltd is the parent company of three other companies. Each of the companies is separately registered for VAT purposes and they do not form part of a group VAT registration.

Each of the four companies made losses, at least between 2008 and 2011, and had difficulties paying their VAT liabilities such that they fell foul of the default surcharge regime. However, all VAT liabilities have now been cleared.

Under the default surcharge regime defaults occur if either VAT is not paid in full or a VAT return is not made by the due date. From the fourth default that a company makes, the surcharge will be calculated as 15% of the VAT that is overdue.

It does not matter how late the VAT is paid which means it may be in a taxpayer's interest for a VAT payment to be allocated to VAT that is not already overdue for payment, rather than to historic VAT liabilities; the default surcharge in respect of the historic liability will not be increased, but a surcharge liability for the later period may either be avoided entirely, or the amount of it could be substantially reduced.

To mitigate the effect of the surcharge regime, the companies sought to make payments of current VAT liabilities rather than historic ones but problems arose with the allocation of the payments. The taxpayers said that the default surcharges of £290,000 would not have arisen had HMRC allocated payments to current rather than historic VAT liabilities.

The taxpayers said the liability to VAT had arisen on making a supply. This constituted a debt, even though the taxpayer was not obliged to pay it until the last day of the month after the end of the period, and was entitled to offset input tax arising in the period. In essence, no principle prevented a taxpayer allocating a payment to a liability that would become due later.

The Upper Tribunal agreed that a taxpayer was entitled to allocate any payment made to the cumulative output tax that had already arisen on supplies in the current period, regardless of whether the due date for payment had arisen. Further, the tribunal agreed that the VAT could be reduced by a claim to input tax when the return is made.

The Tribunal also agreed that the taxpayer could allocate VAT payments for the current period whether or not they exceeded the cumulative output tax to that date. Any balance should be treated as a payment on account of the tax due to accrue. If HMRC were to accept such payments, it could not allocate them to historic liabilities.

The legislation supported the conclusion that VAT payments made in advance of the due date may be allocated by the taxpayer. Not only is it clear that payments can be made in advance of the due date, but such payments are effectively encouraged. Payments made even one day late potentially result in a default surcharge

However, if the taxpayer chose not to allocate payments to specific periods, HMRC could then allocate it to a historic debt.

The Upper Tribunal concluded that there were errors of law in the First Tier Tribunal's decision and set aside their decision They should have found that effective allocations could be made by the appellants in respect of VAT that was not yet due.

The Upper Tribunal remitted the case back to the First-Tier Tribunal to make findings in respect of the:

- amounts and dates of relevant VAT payments;
- allocations made by the appellants ; and
- determine the amount of surcharge that was due

Swanfield Ltd and others v CRC, Upper Tribunal (Tax and Chancery Chamber), 2 March 2017

Apportionment of overhead expenses

Summary – Supreme Court refer the case to the CJEU asking whether the taxpayer has a right to deduct any input tax for general overheads relating to sales involving exempt HP supplies.

Volkswagen Financial Services (UK) Ltd is a member of the Volkswagen Group and provides hire purchase finance to dealership customers wanting to buy vehicles under an HP contract.

Where a customer wishes to take advantage of the HP provided by Volkswagen Financial Services (UK) Ltd, the vehicle is bought by Volkswagen Financial Services (UK) Ltd and then supplied on to the customer under an HP contract. In doing so the company incurs input tax as part of its expenditure. VAT suffered on expenditure:

- that is directly attributable to taxable supplies is deductible;
- relating to exempt supplies is irrecoverable;

This appeal concerns the treatment of general business overheads which are not directly attributable to particular supplies and looks to establish if the input VAT is deductible against the output tax paid on the taxable supply of vehicles to customers.

HMRC argued that overheads are all attributable to the exempt supplies of finance and the input tax is therefore irrecoverable.

Volkswagen Financial Services (UK) Ltd argued that the residual input tax should be in proportion to the ratio of taxable transactions to the whole, which effectively splits the residual input tax 50/50 for HP transactions using their agreed special method.

A secondary issue raised by HMRC concerned whether a fall-back position on the amount of the apportionment was possible.

Decision

The Supreme Court has referred the case to the CJEU asking whether general overhead costs attributed to hire purchase transactions, consisting of exempt supplies of finance and taxable supplies of cars), have been incorporated only into the price of the taxable person's exempt supplies of finance, does the taxable person have a right to deduct any of the input tax on those costs?

Further, can it be legitimate in principle to ignore the value of the taxable supplies of cars (or their value) for the purposes of arriving at a special method under Article 173(2)(c) of Council Directive 2006/112/EC?

On the second issue, the Court dismissed the ground of appeal. HMRC did not attempt to rely on an alternative methodology before the First Tier Tribunal.

Volkswagen Financial Services (UK) Ltd v CRC, Supreme Court, 5 April 2017