Tolley®CPD

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Disclaimer

CONTENTS

Personal tax

A new benefit in kind exemption (Lecture B1071 – 5.47 minutes)

In his Budget on 22 November 2017, the Chancellor announced that, with effect from 6 April 2018, there will be no benefit in kind tax charge on electricity which employers provide for the purpose of charging employees' own electric vehicles. Surprisingly, this new exemption was not part of F(No2)B 2017.

It is understood that HMRC have confirmed to the Association of Taxation Technicians (ATT) that the Government's intention is to include the relief in the next Finance Bill which will be published towards the end of 2018. The legislation will therefore be retrospective.

In response, the ATT said:

> 'The delay in legislating for this exemption puts both employers and employees in an uncertain position because it will come into force before they see any of the details. It would be a pity if this initiative to increase the use of electric cars falls flat because some employers are unaware of how to apply it or promote it due to a lack of information. There is also the risk that employers and employees may not be aware of this initiative, which means it does not get used.'

As a result, they are urging HMRC to provide guidance on the exemption as soon as possible so that all parties can have certainty over the tax treatment of employer-provided charging from the start of 2018/19. This, they requested, should include a commitment to an effective date of 6 April 2018, together with details of any potential exclusions or conditions.

ATT went on to comment:

> 'Providing early clarification could accelerate employers' plans to install charging facilities and employees' (plans in) choosing to purchase electric vehicles.'

Contributed by Robert Jamieson

NOTE: Since recording HMRC has published draft guidance which includes updates to the Employment Income Manual for the changes expected to be made to the Income Tax (Earnings and Pensions) Act 2003 by Finance Bill 2019.

The exemption applies to charging facilities for all-electric and plug-in hybrid cars and vans and covers the cost of electricity, the cost to the employer of providing the charging facilities and any connected services.

The exemption does not apply to the reimbursement or payment of an employee's personal expenditure in respect of electric charging away from the employer's premises, for example at a motorway service station or at home.

Where an employer reimburses an employee's electricity costs for charging the vehicle other than on the employer's premises and the electricity is then used on a business journey, the employee may be entitled to Approved Mileage Allowance Payments (AMAPs) or Mileage Allowance Relief (MAR) (see EIM31205).

Electricity must be provided through a dedicated charging point for charging all-electric or plug-in hybrid vehicles and specifically designed for this purpose.

To be eligible for the exemption charging must be available to either all the employer's employees generally or to all the employer's employees generally at a particular location and the employee must be either the driver or a passenger.

The benefit will remain taxable if it's offered in conjunction with an optional remuneration arrangement. The exemption is a relevant exemption as defined in s228A(1)-(3) ITEPA 2003 (EIM44131).

Example

Mr and Mrs X work for different employers in a similar location and so take turns to drive each other to work. Mr X's employer spends £6,000 to install charging points in their office car park.

Mrs X's employer does not provide charging points at her workplace. When Mr X makes use of the charging facilities at his office's car park, the benefit of the electricity used, the use of the charging point and any connected services are exempt.

On days when Mrs X drives them both, the car is parked at Mr X's office. The use of the charging facilities remains exempt as Mr X is a passenger.

https://www.gov.uk/government/consultations/draft-guidance-reform-to-workplace-charging-tax-exemptions?utm_source=84787024-135c-4f8e-b784-88954b11495b&utm_medium=email&utm_campaign=govuk-notifications&utm_content=immediate

Intermediaries legislation – hypothetical contract

Summary – The Tribunal decided that under a hypothetical contract between Mr Daniels and the end construction company, Mr Daniels would not be an employee.

The MDCM Ltd is a company that provides construction management services with Mr Daniels and his wife being both directors and employees of the company.

This appeal concerns the contract with Solutions, recruitment agency, and Structure Tone Limited. If a construction company needed workers with Mr Daniels' expertise, they would contact Structure Tone Limited who in turn would contact Mr Daniels as director of MDCM Ltd. At this point Structure Tone Limited would not reveal the name of the construction company but would indicate a day rate, typically around £310, the location of the work and the likely length of the project.

If MDCM accepted the instruction, MDCM and Structure Tone Limited would enter into a contract in standard form and Structure Tone Limited would enter into a separate contract with the construction company at a higher day rate, for example £370.

The terms of the MDCM contract with Solutions in respect of Structure Tone Limited followed these same standard terms. In October 2012 Structure Tone Limited required a night shift manager for the construction project at Prospect House in London and contacted Solutions. Solutions provided Mr Daniels who started work on 26 October 2012 and continued working full time including through the Christmas period. On or around April or May 2013 the Prospect House project was finishing but Structure Tone Limited had need of a night shift manager at another project in London, Aldwych House. Structure Tone Limited asked Solutions and Mr Daniels whether he would like to move over to be the night shift manager for Alwych House and he agreed. He continued to work until 19 July 2013. However the Structure Tone Limited contract with Solutions was still treated as applying. At all times, Mr Daniel worked set shifts and reported to a project manager who was on site once a week for a brief period. Mr Daniels represented Structure Tone Limited as contact point for contractors. However, he did not participate in Structure Tone Limited staff meetings or functions.

Structure Tone Limited provided third party insurance for Mr Daniels whilst he was carrying out his duties on site. However MDCM took out its own insurance as required by the Solutions contract. Structure Tone Limited provided Mr Daniels with personal protection equipment being a high visibility vest, gloves and hard hat. He had access to the Structure Tone Limited computer on site but was not provided with a mobile phone and used his own when working on the site.

Decision

The First Tier Tribunal agreed with HMRC that the issue was whether Mr Daniels, on a hypothetical contract between Mr Daniels and Structure Tone Limited, would be regarded as an employee of Structure Tone Limited.

From their findings, the hypothetical contract could be summarised as follows:

- There was a contract for personal services as Mr Daniels could not provide a substitute to Structure Tone Limited (even if Solutions contract said he could);
- Mr Daniels was paid £310 a day and had to pay his own travel, hotel and other expenses but took no other financial risks;
- Structure Tone Limited provided safety equipment to Mr Daniels;
- Mr Daniels was not integrated into the Structure Tone Limited business
- Mr Daniels was not controlled any more than any other contractor and could refuse to work on another site;
- He could refuse to work on another site;
- There was no requirement on either party to give notice to terminate or entitlement to severance pay or pay in lieu;
- There was no sick pay or holiday pay.

Despite the lack of substitute and financial risk the Tribunal found that the nature of the payment arrangements, a flat rate per day with no notice period and no entitlement to any employee benefits are inconsistent with employment.

On balance they found that under the hypothetical contract required by the Intermediaries Legislation Mr Daniels would not be an employee.

The appeal was allowed.

MDCM Ltd v HMRC (TC06400)

Childcare voucher scheme

The childcare voucher scheme was due to close and be replaced by the childcare payments scheme (tax-free childcare) from 6 April.

There were concerns about problems with the operation of the new tax-free childcare accounts and so the government has confirmed 4 October 2018 as the date on which employer-supported childcare (the childcare voucher scheme) will now close to new entrants. This will allow more time for Tax-Free Childcare to bed in, for awareness to increase and for families to understand the support they can receive under the scheme.

www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2018-03-29/HCWS616

Delay granting EMI share options

The EMI scheme constitutes state aid and so EC approval is needed for it to operate, regardless of UK statute. Any aid given without the approval of the EC may be recovered as it is considered to be ‘unlawful state aid’ or ‘incompatible state aid’.

EMI state aid approval expired on 6 April 2018 and the government is in the process of applying to the EC for new approval.

What does this mean for companies and their employees?

In Employment-related securities bulletin No 27 (April 2018) HMRC said:

> ‘HMRC considers that the State Aid approval applies to the granting of share options and therefore that share options granted up to and including 6 April 2018 won’t be affected by this lapse of the approval.’

However, the EU or a National court could interpret this differently which could mean that options granted up to and including 6 April 2018 might become unapproved options overnight. Employees exercising options could find themselves facing large income tax and NIC bills that were not anticipated.

From 7 April 2018, share options issued under the EMI scheme should be considered to be unlawful state aid. In Employment-related securities bulletin No 27 (April 2018) HMRC are advising companies to consider delaying the grant of enterprise management incentive share options on or after 7 April 2018, until the EU has reached a decision on renewing state aid approval for such schemes. This implies that HMRC believe that they will eventually be able to negotiate renewed state aid approval but currently is giving no clue as to the timing of when this might happen.

Given that the UK government is seeking reapproval of the EMI scheme, it may be that any options granted between 6 April 2018 and EMI's reapproval may ultimately become eligible for the relief. When it does, the government will need to consider whether the approval can be applied retrospectively from 7 April and if so, whether specific legislation will be required to do so.

With the lack of media coverage of this issue, there could well be a number of share options that have been granted since 7 April 2018 that will require companies to account for both PAYE and NIC on a protective basis.

What about options exercised after 6 April 2018?

HMRC's statement indicates that there should be no impact on EMI options issued before 7 April 2018 as they believe that the state aid approval applies to the granting of share options only. They may be right. However, the relevant question is at what point in the EMI scheme, from granting of options to the acquisition of shares or beyond, does the company actually receive state aid?

The EC originally determined that state aid was conferred on a qualifying business on two grounds: the employer's NIC that may be saved (where the shares are RCAs and would otherwise create a NIC liability) and the ability for the company to grant options at a lower share price. A lower share price would increase the corporation tax relief given to the company, which is based on the difference between the market value of the shares and the consideration given. In both cases, it is not inarguable that the state aid is received at the moment of the grant of shares. No tax benefit is realised until the options are exercised. Also, the value of that benefit, if any, cannot be determined until that time. The EC alludes to the fact that economic benefit under EMI may accrue over time, saying that 'the value of such advantage is directly determined by business success and only when employees decide to exercise their options.'

Where EMI share options are exercised after 6 April 2018, the company may need to consider the value of the economic benefit it has received as a result of the EMI scheme, or at least that which it has received since the expiry of EC approval. Such amounts may include the entire value of the employers' NIC exemption (only for RCAs though) and potentially the value of the corporation tax deduction.

HMRC's statement does not address this issue. However, where there are significant amounts of tax relief for the company in terms of the NIC exemption and corporation tax deduction, it is a matter that should be discussed with the company. It should be remembered that the EC requires that compound interest is charged upon unlawful state aid.

The timing of the exercise of share options is ultimately in the hands of the employee. In some cases, it may be possible to persuade employees to wait until the situation has been clarified further before exercising EMI share options. Alternatively, it may be advisable not to claim reliefs until such a time as it has become clear what the EC position is with regards to EMI.

Adapted from Tolleys Guidance

Remittance basis users and the dividend tax credit

The dividend tax credit was abolished with effect from 6 April 2016 but what is the position for a remittance basis user who received a foreign dividend before 6 April 2016, one that qualified for a tax credit under the rules in ITTOIA 2005, ss 397A–397C, but which is remitted to the UK in 2016/17 or later?

Before 6 April 2016, it is clear that foreign dividends remitted to the UK could qualify for the dividend tax credit despite being treated as relevant foreign income. This is supported by the example in RDRM31160.

The commencement rules for the abolition of the dividend tax credit in FA 2016, Sch 1, para 73 state:

> "Subject to the following sub-paragraphs of this paragraph, the amendments made by this Schedule have effect in relation to dividends paid or arising (or treated as paid), and other distributions made (or treated as made), in the tax year 2016/17 or at any later time."

In the case of the remittance basis user, the key words are 'paid or arising (or treated as paid)'. Under the remittance basis, are the dividends 'treated as paid' in the year of remittance or are they just taxed in that year? There is no statutory deeming provision under which dividends remitted by remittance basis users are 'treated as paid' in the year of remittance. They are simply chargeable in that year under ITTOIA 2005, s 832(2). Therefore, it follows from the statutory wording that a foreign dividend paid overseas before 6 April 2016 but remitted on or after 6 April 2017 remains entitled to the tax credit.

HMRC has now confirmed that the remittance basis user is entitled to the dividend tax credit in these circumstances.

It may be necessary to review the 2016/17 Tax Returns of any clients who used the remittance basis to see whether they remitted any dividends that arose before 6 April 2016, with a view to amending them if the dividend tax credits have not been claimed. For details of how to report these dividends on the Tax Return, see the Foreign dividends guidance note.

Adapted from a summary produced by Tolley Guidance (18/04/2018)

Guide to the new rules for non-doms: Income Tax & CGT (Lecture P1073 – 9.23 minutes)

In 2015 the Government proposed a number of changes to the taxation regime for individuals who are UK resident but non-UK domiciled (the population commonly called "non-doms"). These measures became effective from 6 April 2017 thereby affecting non-dom clients from the 2017/18 tax year.

These notes will cover the main changes for income tax and CGT. The domicile changes for IHT will be covered in a separate article.

You should note that there have been no changes to the common law of domicile. Therefore the starting point in determining a client's domicile status continues to be to examine whether he has either a domicile of origin, dependency or choice in the UK.

The new regime only affects those who can establish that they are non-UK domiciled under general law.

Deemed domicile

Two populations of individuals who are non-UK domiciled under general law will be deemed to be domiciled in the UK for taxation purposes from 6 April 2017. These new "deemed-doms" will either be:

- "Long-term residents"; or
- "Formerly Domiciled Residents".

The effect of being deemed domiciled in the UK is that the individual is thereafter taxed on the same basis as someone domiciled in the UK under general law. For as long as he is UK resident, a deemed-dom will now pay UK income tax and CGT on his worldwide income and gains (with appropriate relief for any non-UK tax suffered). The remittance basis is denied.

Long-term residents

Individuals who are non-UK domiciled but who have been UK resident in at least 15 of the preceding 20 tax years will be deemed-dom.

The process to determine deemed domicile is:

- Identify the 20 year "look-back" period ending in the tax year immediately before that which you are testing. So if you are testing 2017/18, the look-back period always starts in 1997/98 and runs to 2016/17; then
- In that period, count how many of these tax years are years of residence.
- If you have any 15 or more years of residence, your client is deemed-dom. Deemed-dom is triggered at the start of the 16th year. If you don't have 15 years, test again next year. The process is the same but the "look-back" period will shift forward one year.

When counting your tax years, a "split year" will count as a year of residence as will any years of residence while the individual was a minor.

What this means from a practical perspective is that non-doms who were UK resident before 6 April 2003 and have been UK resident ever since, became deemed-dom on 6 April 2017. Non-doms who didn't become resident until after April 2003 cannot therefore trigger deemed-dom under the 15/20 test until 6 April 2018 at the earliest.

Formerly domiciled residents (FDRs)

FDRs are individuals who are non-UK domiciled under general law but who were born in the UK with a UK domicile of origin and who are resident in the UK. Some call these people "returning UK-doms".

FDRs will typically be British individuals who previously left the UK and acquired a foreign domicile either by choice or dependency, but who have since returned to live in the UK whilst still preserving their non-dom status under general law.

Anyone born in the UK with a UK domicile of origin will always be a FDR if he resumes residence in the UK irrespective of how many years he has lived abroad or whether he has any connections to the UK.

Deemed domiciled under both rules?

An individual could be deemed-dom both as a long-term resident and a FDR.

This could happen where an individual born in the UK to UK parents left the UK and settled permanently abroad thereby acquiring a non-UK domicile of choice. The individual later returned to live in the UK and has remained UK resident for over 15 years without his UK domicile of origin being resurrected.

In these cases the individual is deemed to be domiciled in the UK as a FDR (as this set of rules offers less by way of transitional tax reliefs!).

Consequential amendments

There are a veritable shed-load of consequential amendments to existing legislation ("knock-on rules") to consider.

Here are the 4 most important ones:

1) The "£2,000 rule":

Non-doms with less than £2,000 per annum of unremitted foreign income and gains have always been able to access the remittance basis without a claim (so no loss of personal allowances, no loss of CGT exemption and no exposure to the Remittance Basis Charge).

This will continue to apply even if the individual becomes deemed-dom. This decision is common sense as the tax at stake is thought to be small compared to costs of collection. It is the only time a deemed-dom will be able to access the remittance basis.

2) Effect on the Remittance Basis Charge (RBC):

The RBC continues to apply for those non-doms who claim the remittance basis and have lived in the UK for long enough to trigger the charge. However the £90,000 RBC which applied where a non-dom had been UK resident for 17 or more of the previous 20 tax years has now been rendered obsolete (having been superseded by the 15/20 rule which will treat the taxpayer as deemed-dom and thereby unable to use the remittance basis).

The £30,000 and £60,000 RBCs remain in place.

3) Capital gains tax rebasing:

Non-doms using the remittance basis only pay CGT on foreign capital gains if those gains are remitted to the UK. This benefit is now denied for deemed-doms.

However the Government accepted that it could be unfair to tax deemed-doms on capital gains that accrued before the new regime was implemented. Cue some relief in the form of 5 April 2017 rebasing.

Rebasing allows capital gains on foreign-situs assets held at 5 April 2017 to be calculated using the value of the asset at 5 April 2017 (rather than by reference to historic cost). Rebasing will accordingly have the effect of extinguishing capital gains on non-UK assets which accrued up to 5 April 2017. Valuation exercises may therefore need to be carried out.

However there is a (very large) sting in this seemingly generous tail.

Rebasing is only available to “qualifying individuals”. Qualifying individuals are those who:

- Became deemed-dom under the 15/20 rule on 6 April 2017; and
- Paid the RBC in any tax year (one year is enough) before 2017/18.

Rebasing is not therefore available to those individuals:

- Who will become deemed-dom under the 15/20 rule after 6 April 2017; or
- Who were born in the UK with a UK domicile of origin (ie, FDRs); or
- Who had previously avoided the RBC by not claiming to use the remittance basis.

Care must therefore be taken here as NOT ALL DEEMED-DOMS WILL BE ELIGIBLE FOR REBASING!

Rebasing applies on an asset-by-asset basis. Rebasing is automatic where applicable although taxpayers can elect to disapply the relief where it is not beneficial.

4) Mixed-fund “cleansing” relief

Practitioners with non-dom clients using the remittance basis will know what a nuisance the mixed fund ordering rules are. Try as we might to persuade our non-dom clients to keep their foreign income, foreign gains and clean capital in separate offshore accounts so that the source of their remittances can be evidenced, for a multitude of reasons this often doesn’t happen.

The consequence is that we often end up with money being held in one big offshore pot leaving the client exposed to the statutory mixed fund rules. Without delving into the complexities, these rules say that income is remitted before gains, and gains are remitted before capital. Basically if remittance basis users want to bring their money in to the UK, the government will do what they can to tax it at the highest possible rate.

But attitudes have softened over in Whitehall as the penny has dropped that we, as a struggling nation in need of any economic help we can get, might actually want to incentivise non-doms to bring their money to the UK for the general wellbeing of UK plc. So a 2-year window has opened during which non-doms can segregate their existing mixed funds (typically by hiving-off clean capital) into new foreign bank accounts such that it can later be remitted to the UK free of tax. The window closes on 5 April 2019.

"Mixed fund cleansing" is available to any non-dom to whom the remittance basis applied in any tax year before 2017/18 (other than FDRs who seem to be persona non grata).

This is a no-brainer. If you have a non-dom client who uses (or has ever used) the remittance basis and they have a bank account containing mixed sources, you should get them to clean it. All they need to do is a) identify how much of that bank account represents clean capital (most of the time this will be money in the account before they became UK resident or it could be money from gifts, inheritances or loans) and then b) get their bank to move this amount into a new account. Do this now as April 2019 will be here before you know it.

There is no restriction in the number of accounts which can be cleansed. There is also no minimum holding period for a new "cleansed" account. For example if a client wishes to access tax-free money from a mixed fund, the clean capital element can be hived-off into a new account on day one, those newly liberated funds can be remitted to the UK on day two and the now empty account can be closed on day three. Just make sure you give clear and unambiguous instructions to the bank as not all the staff in the local branch of Foreign Bank plc will be fully au-fait with the provisions of Schedule 8 Part 4 of FA (No 2) 2017…

Contributed by Steve Sanders

Guide to the new rules for non-doms: IHT (Lecture P1074 – 6.19 minutes)

Exposure to IHT is largely dependent on domicile. UK-doms are liable to IHT on their worldwide assets. Non-doms are only subject to IHT on assets situated in the UK. Foreign assets of non-doms are "excluded property" and are outside the scope of IHT.

Deemed domicile

The deemed-dom rules also apply for IHT. Individuals becoming deemed-dom will no longer have excluded property protection and their foreign assets will be exposed to IHT from the date deemed-dom is triggered.

Deemed-dom status has existed for IHT for decades. Individuals have historically been deemed-dom for IHT and thereafter fully within the UK IHT net once they had been UK resident for 17 or more of the 20 years ending with the transfer. This meant that individuals became deemed-dom for IHT from the start of their 17th consecutive year of residence. This has now been superseded by the 15/20 rule so individuals now become deemed-dom for IHT from the start of their 16th consecutive year of residence (thereby accelerating domicile status by 12 months).

Deemed-dom for IHT is lost once the taxpayer has 4 consecutive tax years of non-residence. This 4-year break is exclusive to IHT only. Strictly speaking 6 tax years of non-residence are required for deemed-dom to be lost for income tax and CGT although this point is largely of theoretical interest only as domicile status has no bearing on the income tax and CGT tax liability of non-residents.

FDRs are also deemed-dom for IHT although they have a one year "grace period". This means that FDRs will be deemed-dom for income tax and CGT from the tax year in which they trigger UK residence but for IHT purposes deemed-dom is not triggered until the following 6 April.

Therefore a FDR who comes back to the UK for a very short period will be treated as UK dom for income tax and CGT but non-dom for IHT. I suspect that there won't be too many in this position.

[PS: It is a little irritating that this seems to have been sold to us as a one-year grace period. It isn't. The grace period could be a matter of weeks depending on when the taxpayer arrives in the UK. For example, if a FDR becomes UK resident in March 2018, he is deemed-dom for IHT from 6 April 2018. By my counting, that is not one year...]

Excluded property trusts

One bit of welcome news is that it is "business as usual" for excluded property trusts.

Before April 2017, individuals who were likely to trigger deemed-dom for IHT under the 17/20 rule could transfer their foreign assets to a trust (typically an offshore one although this wasn't essential). No IHT would be due on the transfer being one of excluded property. Any CGT could be avoided by making a remittance basis claim (the gains could never then be remitted as no proceeds existed).

The trust would be non-UK dom by virtue of being established by a non-dom settlor. The trust assets would accordingly be outside the scope of IHT being foreign assets owned by a non-dom trust. The non-dom status of the trust would not change even if the settlor became UK dom, thereby offering ongoing IHT protection for foreign assets within the trust.

This planning continues to be available under the new regime (albeit that the arrangements now need to be put in place 12 months earlier). A deemed-dom can therefore continue to have access to his foreign assets via the trust whilst keeping those assets outside the scope of UK IHT. [There is no question of any reservation of benefit issues here as the original transfer was of excluded property.]

Perhaps not surprisingly the same courtesy has not been extended to poor old FDRs. Any foreign assets settled into trust by a FDR while they were domiciled outside the UK will cease to be treated as excluded property for any tax year in which the FDR is resident in the UK. So if the FDR dies while UK resident, the trust assets will fall into his estate.

UK residential property

From April 2017 UK residential property owned by a non-dom through a non-UK envelope - such as an overseas company or offshore trust - is no longer regarded as excluded property. Therefore if a non-dom individual dies owning shares in a non-UK company which in turn holds UK residential property, the value of the shares which is represented by that UK residential property will be chargeable to IHT. The residence status of the taxpayer is irrelevant.

This measure is intended to block historical planning by non-doms who protected their UK property interests from IHT by holding them via an overseas envelope. [The ATED, ATED-related gains and higher SDLT rates were intended to dissuade non-doms from using offshore structures to acquire UK residential property but many non-doms seem to have accepted these charges in order to secure IHT protection. This will no longer be the case.]

UK residential property held through an overseas company will be chargeable to IHT if:

- The company would be a "close" company were it UK resident (being one controlled by 5 or fewer shareholders or by its directors); and

- The individual has at least a 5% interest in the company.

Shareholders in large non-UK multi-national companies with UK property investments will therefore not be affected.

The rules apply to all UK residential dwellings regardless of whether the property is occupied, empty or let. There are exceptions for dwellings used as residential accommodation for schools, colleges, universities or the armed forces, or as children's homes, hotels, hospitals, hospices or prisons. Unlike the ATED, the IHT rules apply irrespective of the value of the property.

The residential property will include any land which is occupied or enjoyed with the dwelling (such as a garden or grounds). There is no relief if the property is the only or main residence of the individual.

The rules do not currently apply to commercial property. Where a property has mixed residential / commercial use - for example, a shop with a flat above it - only the value of the residential part will be subject to IHT.

To ensure compliance by non-UK Executors, HMRC has powers to prevent the sale of the UK property by imposing a legal charge on the property until any outstanding IHT liability has been paid.

Contributed by Steve Sanders

Wilful failure to deduct under PAYE

Summary - The crediting of an amount net of tax against a director's loan account did not amount to a deduction, so that the director was liable for the tax in circumstances where he had been aware of the wilful default.

Mr West was the sole director and shareholder of Astral Telecom. For a number of years, Mr West had drawn money from Astral during the year and this had been recorded in a director's loan account. The amount outstanding on the loan account was not extinguished at the end of each year so that it increased for several years. When Astral went into liquidation, the loan account of £129,150 was extinguished by the credit of the net amount of the director's remuneration after deduction of PAYE and NICs. The gross remuneration and tax deducted were entered in Mr West's tax returns. HMRC considered, however, that Astral was not liable to pay the outstanding PAYE amounts under the reg 72 so that Mr West was liable for these, as well as primary Class 1 NICs.

The issue was therefore whether the reg 72 applied. This depended on whether Astral had made the required deduction; and, if it had not, whether Astral's failure to deduct had been wilful and Mr West had been aware of this.

Decision

When deciding whether a deduction had been made, the Upper Tribunal found that the ratio in McVeigh [1996] STC 91 was applicable, as the facts of the case were similar to those in McVeigh. In both cases, the amount of the director's remuneration was set so that, after deduction of tax and NICs, it would equal the amount remaining due to the company on a director's loan account; that amount was credited to the loan account; and the appropriate records were made both for accounting and tax purposes, yet no tax was actually paid. The Upper Tribunal concluded that no deduction had been made by Astral.

Mr West contended that because he had believed that, as a matter of law, Astral had deducted tax, Astral had not deliberately failed to deduct and he could not have been aware of such a wilful failure. The Upper Tribunal found, however, that 'for a person wilfully to effect a particular legal outcome, it is not necessary for that person to be cognisant of the legal consequences of his or her actions. It is necessary only for that person intentionally or deliberately to put in train the various actions (or knowingly to fail to do so in the case of omissions) that in the event have the material consequences in law.'

HMRC v S West [2018] UKUT 100

Adapted from case summary in Tax Journal (20 April 2018)

Employee of several companies

Summary - Employees who received payments from one entity under contracts for employment with another, were actually employees of several companies.

The Grand was a former hotel in Folkestone where a number of companies carried on a business activity (e.g. catering and rental collection).

Approximately 100 people worked at the Grand as employees under contracts that did not identify any company as their employer. Each of these employees were paid weekly by Heritage Hotels, a company set up to manage credit card payments for one of the businesses conducted at the Grand. The employees' contracts of employment purported to be with 'The Grand' but no such entity existed.

The companies contended that not one person could be identified as the employer. They submitted that there could only be one person liable as an 'employer' for PAYE in relation to a payment. They therefore contended that The Income Tax (Pay As You Earn) Regulations, SI 2003/2682,reg 12 must be applied 'across the board' to treat all payers to the employees as employers for PAYE purposes.

HMRC considered that the companies were all liable for income tax under PAYE and NICs and it had allocated liabilities on a percentage basis by reference to the appellants' accounts. HMRC had also imposed penalties.

Decision

The Upper Tribunal rejected the companies' contentions referring to the First Tier Tribunal's statement that:

> 'It was accepted that all of the payments in question were made to employees and were payments made as part of their employment for these purposes.'

Reg 12 therefore did not apply, as the issue of whether there was a 'deemed employer' did not arise. The Upper Tribunal concluded that Heritage Hotels paid the employees as intermediary for their respective employers. HMRC's approach had therefore been correct.

Grand UK and others v HMRC [2018] UKUT 96

Adapted from Tax Journal (20 April 2018)

Capital Taxes

Surplus funds retained

Summary – The funds kept by the company following an oversubscription of shares represented a loan by the taxpayer to the company.

On two occasions, Dr Sidhu subscribed for shares in Balmoral Clinic Limited. On both occasions the subscriptions were oversubscribed. And Dr Sidhu received a letter stating that 10% of the monies paid over were allocated to buy shares with the remaining 90% representing a loan to the company. Share certificates were issued for 253 shares on 12 December 2005 and 102 shares on 3 May 2006,

Balmoral Clinic Limited commenced trading, providing private medical procedures and treatments, in June 2006 but by 30 September 2010, the company went into liquidation and Dr Sidhu lost her money.

On 10 January 2014, Dr Sidhu submitted a self-assessment return for 2012/13 with Capital Gains pages showing allowable costs and losses set against other income of £28,051. The return included the following additional notes, explaining the £28,051:

"253 ordinary shares subscribed for cash 1 December 2005 - Cost £25,000

"102 ordinary shares subscribed for cash 3 May 2006 - Cost £3,051"

Dr Sidhu subscribed £28051 for shares in Balmoral Clinic Ltd and made a negligible value claim under s24(2) TCGA 1992.

The Company's Statement of Affairs made on 4 April 2008 records that Dr Sidhu was a shareholder as to 2,855 shares and was a creditor in the sum of £25,695. HMRC argued that only £2,855 was subscribed for shares and that share loss relief was available on £2,855. The balance (£25,695) represented a loan to the Company, and as such was outside the scope of s24 TCGA 1992.

Decision

The First Tier Tribunal agreed with HMRC saying that the balance of the monies paid to the Company and retained by it was a loan, as described by the Company on several occasions, in contemporary documents. There was no evidence that Dr Sidhu did not wish the Company to consider the money as a loan and/or that she wanted the balance of her investment returned to her. Being interest free with no redemption date did not make the amount a share premium held by the company.

They rejected the argument that the loss constituted a trading loss, stating that this is an application of s33 ITTOIA 2005 where, in calculating the profits of a trade, no deduction is allowed for items of a capital nature.

The appeal was dismissed.

Dr Harmini K Sidhu v HMRC (TC06390)

IHT and DOTAS updated (Lecture P1075 – 14.28 minutes)

When DOTAS first appeared in FA 2004, it was noticeable that IHT did not feature in the list of taxes that were covered. In fact, the reason for this omission was sensible. If a taxpayer uses a planning arrangement to mitigate, say, a corporation tax or CGT liability, one would expect HMRC to make a more or less immediate decision about whether or not the ploy works. However, with IHT planning, it may be many years before the effectiveness of the scheme is determined – often only on the taxpayer's death. Thus it was initially thought inappropriate to include IHT.

Eventually, in 2011, regulations were introduced which required promoters to disclose arrangements involving relevant property trusts (eg. discretionary trusts) where the main benefit of the scheme was to avoid or reduce an IHT entry charge on the transfer of property to a trust. Schemes that were the same, or substantially the same, as those first made available before 6 April 2011 did not have to be notified.

The Inheritance Tax Avoidance Schemes (Prescribed Disclosure Of Arrangements) Regulations 2017 (SI 2017/1172) are replacing the previous rules with effect from 1 April 2018. As is well known, the DOTAS regime relies on 'hallmarks' to describe the avoidance arrangements that have to be disclosed. There have been wide-ranging consultations with stakeholders in recent years on how best to extend the scope of the very narrow current IHT hallmark with a view to making it more effective. It is believed that there have only been a few IHT disclosures to date, due mainly to the fact that the reporting requirement is so restricted. In other words, from an HMRC perspective, the hallmark has not been capable of providing them with information about IHT avoidance schemes. The wording of the latest updated version has been refined to take stakeholders' comments and concerns into account. The Government want to ensure that the new hallmark is appropriately targeted to catch IHT avoidance schemes, but not to catch:

- the straightforward use of reliefs and exemptions; and
- ordinary tax planning arrangements.

The crux of the new regulations is found in Para 4 that reads as follows:

> 'Arrangements fall within the description in this regulation if it would be reasonable to expect an informed observer (having studied the arrangements and having regard to all relevant circumstances) to conclude that condition 1 and condition 2 are met.

Condition 1 is that the main purpose, or one of the main purposes, of the arrangements is to enable a person to obtain one or more of the following advantages in relation to IHT:

1. Avoidance or reduction of a relevant property entry charge;
2. Avoidance or reduction of a charge to IHT under Ss64, 65, 72 or 94 IHTA 1984;
3. Avoidance or reduction of a charge to IHT arising from Ss102, 102ZA, 102A or 102B FA 1986 where there is no charge to income tax under Sch 15 FA 2004;

4. A reduction in the value of a person's estate without giving rise to a chargeable transfer or potentially exempt transfer.

Condition 2 is that the arrangements involve one or more contrived or abnormal steps without which the tax advantage could not be obtained.'

A particular complexity arises in relation to established retail IHT planning products which would potentially fall within the new hallmark but which accord with established practice accepted by HMRC – this may have happened through published material such as HMRC guidance notes or in some other way. Such products do not have to be disclosed if they continue to be sold and implemented after these regulations take effect, provided that they were first made available and entered into before 1 April 2018.

HMRC have confirmed that they will be publishing guidance 'in good time' prior to the relevant commencement date to explain:

- how the new DOTAS hallmark works;
- the conditions to be met in order for arrangements to be notifiable; and
- the circumstances for certain arrangements to be exempted from disclosure.

Contributed by Robert Jamieson

NOTE: This guidance has now been released (see below)

IHT DOTAS guidance

On 29 March HMRC published updated guidance to replace the IHT chapters (12 and 13) of HMRC's main DOTAS guidance, to reflect the new IHT hallmark was is effective from 1 April 2018. This will be incorporated into HMRC's guidance on the DOTAS regime and will replace the guidance previously in chapters 12 and 13.

The revised guidance:

- provides some background to the changes in the IHT hallmark;
- describes the new hallmark and explains how it works;
- gives details of the 2 conditions that must be met for the arrangement to be notifiable;
- explains how the established practice exception applies;
- gives examples of arrangements which are not notifiable, that might be notifiable, and that are notifiable

Cessation of grandfathering provisions

The provisions that excepted certain arrangements in place before 6 April 2011 will cease to apply from 1 April 2018. This means arrangements that would have been excepted from disclosure under the old hallmark will, from 1 April, have to be tested against the new IHT hallmark.

New 'established practice'

A new 'established practice' exemption will remove the need to disclose established IHT planning schemes entered into before 1 April that are 'substantially the same' as other arrangements HMRC has previously agreed.

Two conditions to be notifiable

Condition 1 is that the main purpose, or one of the main purposes, of the arrangements is to enable a person to obtain an IHT advantage in relation to one or more of the following:

(a) avoidance or reduction of a relevant property entry charge;

(b) avoidance or reduction of the charge on relevant property at the ten-year anniversary or at any other time, the charge on property leaving employee or newspaper trusts, and the charge arising in connection with close company transfers;

(c) avoidance or reduction of the charge on gifts with reservation of benefit, where there is also no pre-owned asset income tax charge; or

(d) reduction in the value of a person's estate without giving rise to a chargeable transfer or potentially exempt transfer.

Condition 2 is that the arrangements involve one or more contrived or abnormal steps without which the tax advantage could not be obtained. Whether arrangements are contrived or abnormal, or involve contrived or abnormal steps, has to be considered from the point of view of an 'informed observer'. The informed observer is not necessarily a tax practitioner, but is independent, has all the relevant information about the scheme and has sufficient knowledge to understand both the scheme and the relevant statutory context.

The guidance includes a number of useful examples of schemes that are not notifable. Including:

- A lifetime gift to a spouse or civil partner (Condition 2 is not met);
- Regular gifts out of income (Condition 2 is not met);
- Transfers of value equal up to the available nil rate band into trust, which may be repeated every seven years (Condition 1 is not met);
- Making a lifetime transfer to a bare trust for a minor beneficiary (Condition 1 is not met);
- Executing a will that leaves property to an exempt beneficiary such as the spouse or a charity (Condition 1 is not met);

- Executing a deed of variation to which s.142 IHTA 1984 applies to transfer assets on death to an exempt beneficiary (Condition 1 is not met);
- Disclaiming an entitlement under a will to which s.142 IHTA 1984 applies where there is an exempt residuary beneficiary (Condition 1 is not met);
- Purchase of shares that will qualify for business property relief after they have been owned for two years (Condition 1 is not met);
- Gift of land where the donor continues to use that land but pays full consideration for their use (Condition 2 is not met);
- A non-UK domiciled individual who is not UK resident transfers funds from a sterling denominated UK bank account into a US dollar denominated UK bank account, so that the bank account is left out of account under section 157 IHTA 1984 (Condition 1 is not met);
- A non-UK domiciled individual transfers non-UK situs property into a trust just before they become deemed domiciled in the UK. The individual can benefit from the trust (Condition 2 is not met);
- Immediately before a ten-year anniversary a distribution is made from a relevant property settlement to reduce the charge on the subsequent ten-year anniversary (Condition 2 is not met);
- Gift and Loan Trusts/Loan Trusts (Condition 1 is not met);
- Loans to companies or other entities from which the lender cannot benefit (Condition 1 is not met);

Arrangements that might be notifiable

Because conditions 1 and 2 have to be evaluated taking all relevant circumstances of those particular arrangements, or that proposal for arrangements, into account, there will be some arrangements and proposals where it is difficult to be definitive about whether they are notifiable. Where arrangements include multiple steps in order to achieve the intended tax advantage however, there becomes an increased likelihood that they may be notifiable, either by reason of the IHT hallmark or because they fall within the confidentiality or premium fee hallmarks:

Consider the example where arrangements are made to gift shares qualifying for business property relief into trust and subsequently sell the shares back to the transferor

In isolation the transfer of shares qualifying for business property relief into a trust, or the sale of trust assets by the trustees, would not meet condition 1. Where arrangements are entered into with the intention that all of these steps take place, the arrangements have the effect of placing cash into a relevant property trust, but without incurring a relevant property entry charge. As one of the main purposes of these arrangements is to reduce or avoid a relevant property entry charge it would be reasonable to expect an informed observer to conclude that condition 1(a) is met.

This can be contrasted to a situation where, for example, family company shares are transferred into trust for succession planning purposes, at which time there is no intention of the trustees selling those shares. If the trustees later took an independent decision to sell the shares it is unlikely that an informed observer would conclude these separate steps form part of a single overall arrangement, or to conclude that condition 1(a) was met.

It would not normally be possible to transfer cash into a relevant property trust without incurring a relevant property entry charge, which is what has been achieved. To achieve this outcome and to gain this tax advantage, contrived steps are necessary, that is the transfer or shares qualifying for relief followed by their sale back to the transferor rather than the simple transfer of cash that would be the non-contrived way of achieving the same result. Without these contrived steps the tax advantage would not arise. It would therefore be reasonable to expect an informed observer to conclude, considering the arrangements as a whole, that condition 2 was met.

Notifiable arrangements.

The guidance includes two examples of arrangements that are notifiable.

<u>1. Creation of a reversionary lease</u> - A person owning a freehold grants a lease to a trust or to their children. The lease starts in 21 years' time, longer than the person expects to survive. The person continues to live in the property until the sub-lease begins.

Condition 1: The arrangements avoid or reduce a charge to inheritance tax arising from the application of the gift with reservation of benefit rules. The person continues to benefit from the property, but the whole value of the property is no longer in the estate. If, in addition, no charge arises under Schedule 15 Finance Act 2004, it would be reasonable to expect an informed observer to conclude that this arrangement meets condition 1(c).

Condition 2: The creation of a lease which only takes effect several years in the future and which in the meantime allows the owner of the property to continue in occupation at no cost is a contrived and/or abnormal step. The tax advantage would not be achieved without this contrived or abnormal step. It is therefore reasonable to expect an informed observer to conclude that this arrangement meets condition 2 and is notifiable under this hallmark.

<u>2. Employee benefit trusts (EBTs</u>) A person owns an investment company with two part-time employees. The directors are that person and his two children. He is the sole shareholder and wishes to transfer the company to his children on his death. He creates an employee benefit trust and settles the shares on that trust. The trust excludes him and his children while he is alive and satisfies section 86 IHTA. His children can benefit after his death.

Condition 1: The arrangements result in a reduction in the value of the person's estate which does not give rise to a chargeable transfer or a potentially exempt transfer. It is reasonable to expect an informed observer to conclude that obtaining this tax advantage was the main purpose, or one of the main purposes, of these arrangements and therefore that condition 1(d) is met.

Condition 2: The use of an EBT in these circumstances is a contrived step. The purpose is to transfer the company shares to the children, but the tax advantage is obtained by using an EBT to achieve that outcome. The tax advantage could not be achieved without this contrived step. It is therefore reasonable to expect an informed observer to conclude that condition 2 is met and this arrangement is notifiable under this hallmark.

www.gov.uk/government/publications/disclosure-of-tax-avoidance-schemes-inheritance-tax

SDLT on cross-border transactions

There's no Stamp Duty Land Tax (SDLT) to pay on purchases of land and property in:

- Scotland from 1 April 2015 - you pay Land and Buildings Transaction Tax (LBTT)
- Wales on or after 1 April 2018 - you pay Land Transaction Tax (LTT)

HMRC has issued guidance on two situations where more than one tax may apply to a land transaction.

1. Multiple property transaction

When 2 or more property interests in different UK tax jurisdictions are purchased for a single agreed amount of consideration, either as a single transaction or a number of connected transactions (linked transactions). For example, one transaction involving the purchase of a shop in Wales, a shop in Scotland and a shop in England.

2. Single cross-border property transaction

The purchase of a single property that includes land on both sides of the English-Welsh or English-Scottish border. For example, a field that's split by the border. Land that is on either side of the English-Welsh border may be registered as a single HM Land Registry title (a cross-title transaction) or as 2 or more titles. Land in Scotland is always registered separately.

What happens?

The total consideration must be apportioned on a just and reasonable basis, to arrive at the appropriate consideration for the part in each tax jurisdiction.

www.gov.uk/guidance/stamp-duty-land-tax-cross-border-transactions

Higher rate of SDLT on residential property

Summary - Higher rate SDLT applied to a residential property acquired with a view to increasing the capacity of a bed and breakfast business.

Goode Cuisine Company Limited bought a property, intending to expand its bed and breakfast business. The company claimed relief from higher rate SDLT under para 5B Sch 4A FA 2003 arguing that it intended exploiting the property 'as a source of income in the course of a qualifying trade'.

HMRC considered that the higher rate applied, arguing that the use of the property did not fall within the definition of qualifying trade (para 5B(3)). They argued that the second condition of 'offering the public the opportunity to make use of, stay in or otherwise enjoy the dwelling as customers of the trade' would not be satisfied, as the carrying out of a bed and breakfast business necessarily implied that the property would no longer be a dwelling.

Decision

The First Tier Tribunal concluded that, although the property was a dwelling when acquired, it was not going to be a dwelling by the time it was converted for the purposes of a bed and breakfast business.

The Tribunal accepted that the drafting of para 5B suggested that relief was only available to properties occupied as dwellings but referred for instance to the fact that the title of para 5B (although not conclusive) referred to 'trades involving making a dwelling…' However, the FTT also noted that if the intention of Parliament had been that the property should remain a dwelling, it was 'odd' that this was not expressly stated as a pre-condition for the relief. Given the ambiguity of the provisions, the tribunal referred to Hansard and concluded that HMRC's interpretation was correct.

NOTE: This case will be relevant to any company purchasing residential property with a view to carrying on a trade. If the trade means that the property is no longer a dwelling, the higher rate of SDLT will apply.

Goode Cuisine Company Limited v HMRC (TC06416)

Adapted from case summary in Tax Journal (20 April 2018)

Administration

Problems filing CIS returns online

Summary - A combination of health problems and the inability to file online was a reasonable excuse for CIS defaults.

BTN Flooring Ltd submitted its CIS returns late for the nine months between April and December 2016 resulting in penalties from HMRC. Prior to this time, all returns had been submitted on time.

The company secretary was unwell, suffering from cardiology problems, anxiety and stress which resulted in hospital appointments. There were problems setting up the company for online filing because HMRC took several months to send an activation code. The secretary called HMRC numerous times but was 'invariably cut off or not given the information she needed'.

Decision

The First Tier Tribunal judge accepted that the company secretary had tried to comply with the law. They decided that her 'total IT illiteracy, coupled with the real, practical difficulties that online filing presented her, given her good intentions and state of anxiety' formed a reasonable excuse. The judge cancelled the penalties and the taxpayer's appeal was allowed.

BTN Flooring Ltd v HMRC (TC06323)

Rental income while non resident

Summary – The taxpayer has a reasonable excuse for not filing their tax return while non UK resident and HMRC had wasted everyone's time.

Mark Beardwood registered for self-assessment in 2001. On 25 February 2010 he submitted a "Leaving the United Kingdom" form P85 to HMRC advising he would be leaving the UK for 18 months to work in Vietnam and would not be receiving any rental income.

Later in 2010 he and his wife let their UK home for a short period. Before receiving any rent Mark Beardwood notified HMRC of the change and completed a form NRL1 Application to register as a non-resident landlord. This form was received by HMRC on 23 August 2010. In 2010/11 he received rent totalling £3,802 to be split equally with his wife. Which was clearly below his personal allowance and so no tax was due.

HMRC issued penalty assessments totalling £1,600 as the return was more than a year late. Copies of the actual notices were not provided so the Tribunal had no opportunity to check the date of issue, the amount levied, and to what address they had been sent.

Mr Beardwood said that in December 2012 he was advised of a late filing penalty for the year 2010/11 totalling £1,600. He said that during this time he was non-resident (P85 submitted), he received minor income for a short let, but below the level required by HMRC Website to submit a tax return. He claimed that he received no correspondence from HMRC requesting a tax return for year 2010/2011.

He claimed that the first correspondence that he received from HMRC was after he had submitted his tax return for the year 2011/12 in 2013 when he rented out his UK residence and did incur UK income tax. He also claimed that the HMRC website in the 2010/11 listed the basis on which a tax return had to be submitted. He did not fall into any of the categories advised. HMRC's 2010/11 own website advice was not to submit a tax return.

Decision

The Tribunal accepted that Mark Beardwood had not received communications from HMRC during the period and was totally unaware that HMRC required a return from him for 2010/11.

The Tribunal considered that he had given reasonable priority to complying with his duties in regard to tax, and had conscientiously sought to ensure that his returns were accurate and made timeously. He was aware that HMRC guidance said that they may require a return from him but he had not received one. He was also aware that the level of his UK income for 2010/11 was such that he had no tax liability for that year and so was not expecting a return. In the circumstances the appellant had acted reasonably. In December 2012, once he became aware that a return was required by HMRC he took steps to complete one. Unfortunately because of his near 3 year absence from the UK his gateway password had expired. He eventually received a new password from HMRC on or around 27 April 2013 and submitted his return on 9 May 2013.

The Tribunal concluded that the appellant has established that he had a reasonable excuse for the late submission of his self-assessment tax return for the period ended 5 April 2011.

The appeal was allowed in full.

NOTE:

> This was a case that the Tribunal considered should never have come before it. The appellant had notified HMRC of his departure from the UK, filled in a form NRL1for the 5 casual letting, and also notified HMRC of his address in Vietnam. He also consulted the HMRC web-site (something HMRC regularly criticise taxpayers for not doing) and concluded, not unreasonably, that he did not need to complete a tax return.
>
> Nothing would have been gained by the issue and completion of the return, no tax was at stake, and another HMRC department had already realised that the appellant's wife, who was in very similar circumstances, should not be penalised.

Mark Richard Beardwood v HMRC (TC06357)

Late filed corporation tax return

On 20 March 2016 Bells Financial Services Ltd was issued with a notice to file a company tax return for its accounting period 1 March 2015 to 29 February 2016. HMRC imposed penalties for its late submission.

The company appealed against the late filing penalties arguing that:

- no notice was received requiring the company to file a return;
- the company was unable to file the return despite several attempts;
- accounts for the period were filed at Companies House in time, but HMRC’s website said that no returns were due;
- it is unfair for the to be penalised for a clerical error which caused HMRC website to say no return was due when the HMRC system does not have safeguards to say what the correct dates should be;
- they had a reasonable excuse because HMRC’s website is not set up to deal with accounting years ending on a leap year;
- no tax was payable.

HMRC said that the only reason the company had failed to file the return online was because it had tried to do so for an accounting period ending on 28 February 2016 but HMRC systems would not accept such a filing because 2016 was a leap year.

Decision

The First Tier Tribunal accepted that the notice to file was delivered and that the return was filed late. However, the penalty notices had not been issued properly. The first penalty, referring to Khan Properties (TC6225), the judge said a determination made by a computer rather than an officer authorised by HMRC was invalid.

The judge considered whether the company had reasonable excuse for the late return in case the decision was overturned in an appeal. HMRC did not dispute that the company attempted to file online in time. They say that the reason why the online filing was unsuccessful was because the company wrongly tried to file a return for an accounting period ending on 28 February 2016. HMRC’s software would not accept such a filing. If it is true that HMRC’s software would not accept a filing for the correct accounting period, then the judge had no hesitation in holding that the company had a reasonable excuse for not filing on time. Such an excuse would last until HMRC reprogrammed its system to accept a valid return. There was no accounting period of more than 366 days here.

The taxpayer's appeal was allowed.

Bells Financial Services Ltd v HMRC (TC06326)

The background to RTC and how it works (Lecture P1071 – 6.16 minutes)

Introduction

In recent years HMRC has turned its spotlight to what it believes are the billions of pounds of UK tax remaining uncollected as a result of the "Dark Arts" supposedly practiced by UK tax advisers in the area collectively called "Offshore Matters".

The Government has now introduced the Requirement to Correct (RTC) regime in Finance (No. 2) Act 2017 that requires irregularities in relation to offshore matters to be disclosed to HMRC. From that point, back tax can be assessed and collected.

Anyone failing to comply with the RTC will fall into the "Failure to Comply" regime that brings with it some very harsh penalty sanctions. These will be covered in Part 2 of these notes.

The Common Reporting Standard

The RTC has been brought-in on the back of the Common Reporting Standard (CRS). The CRS is a global standard commissioned by the OECD for the automatic exchange of financial account information between governments. The CRS is the latest weapon of the G8 and the G20 in its fight against worldwide tax evasion.

The CRS requires all financial institutions including banks, brokers, asset managers and insurance companies operating in a CRS participating jurisdiction to gather certain information about their customers and report it to their local tax authorities. This information will include bank interest, dividends and income from insurance products together with asset lists, account balances and proceeds from the sale of financial assets.

The home tax authority will then pass that information to the tax authority in which the customer is – or appears to be – resident. The tax authority receiving the data will then use the information gathered to tackle tax avoidance in its own state. One only wonders why it has taken them all so long.

Around 100 countries have so far signed up for the CRS. Many have been implementing the CRS since September 2017 (including the UK, the EU states, the Isle of Man and the Channel Islands). Others will start implementing the CRS in September 2018 (including Canada, Japan even the historic financial black-hole of Switzerland).

The United States has not signed-up for CRS preferring instead to use its "home-brand" being the Foreign Account Tax Compliance Act (FATCA). The FATCA was enacted in 2010 to target non-compliance by US taxpayers using foreign accounts and as our American cousins tell us that it does a very similar thing to the CRS, they have decided not to join-in. Many financial institutions are already FATCA compliant.

The Requirement to Correct (RTC)

Following the introduction of the CRS, a vast amount of information about UK taxpayers' overseas bank accounts, asset portfolios and trust interests has been pouring into the Government's inbox. Armed with all this data, it is now far easier for HMRC to identify any non-compliance by taxpayers within its jurisdiction in relation to their offshore tax affairs.

The CRS therefore puts HMRC in a far better position to ask relevant questions of the taxpayer in order to uncover previously undisclosed income and gains. We should accordingly expect a significant increase in the number of HMRC enquiries in relation to overseas matters.

The RTC is a statutory obligation for taxpayers with overseas matters to correct any errors or omissions with regard to their historic UK tax position. This is irrespective of whether such errors or omissions have arisen as a result of a genuine mistake, due to careless or negligent conduct or due to deliberate omissions or under-declarations.

"Offshore matters" has a wide definition and includes any connection to:

- Income arising in a territory outside the UK; or
- Assets situated or held in a territory outside the UK; or
- Transfers of assets to a territory outside the UK; or
- Activities carried on wholly or mainly in a territory outside the UK.

Errors that should therefore be disclosed under the RTC include such things as:

- Non-disclosure by a UK resident taxpayer of non-UK income/ foreign capital gains;
- The incorrect categorisation of remittances by non-domiciled taxpayers (including the incorrect treatment of a mixed fund);
- Basic compliance issues with offshore trusts such as failing to disclose UK source income or NRCGT gains;
- Non-disclosure by a UK domiciled settlor of non-UK assets into an offshore trust;
- Forgetting about a 10-year anniversary charge for UK situs assets where the offshore trust has a UK domiciled settlor; and
- The incorrect treatment of capital distributions from an overseas trust or the use of trust assets giving rise to a CGT change in the hands of a settlor or beneficiary.

This is not an exhaustive list but it does emphasise that the RTC is not the preserve of the itinerant tax-avoider and that the RTC is just as likely to extend its reach to a practitioner whose client has made a relatively minor omission in relation to offshore matters.

Sch 18 FA (No. 2) 2017 obliges taxpayers to notify HMRC if tax which is linked to offshore matters is undeclared and/or outstanding. The RTC applies only to tax non-compliance before 6 April 2017. Taxpayers are required to correct matters on or before 30 September 2018, this being the date by which the remaining participating countries will adopt the CRS and will thereafter provide information to HMRC.

Some commentators have compared the RTC to the Liechtenstein Disclosure Facility (LDF) under which taxpayers were given an opportunity, for a limited period, to voluntarily disclose details of previously undeclared income and gains with the promise of a much lower penalty (and a much shorter "look-back" period) than would otherwise be the case.

The RTC is however different to the LDF as it is not a 'facility' available for a limited period but is instead more of a legislative “warning” about the perils of non-compliance by a certain date. Anyone failing to comply with the RTC will be subject to the Failure to Comply regime.

Taxes affected

The RTC applies to any person with potentially undeclared UK income tax, capital gains tax or inheritance tax. It does not apply to corporation tax. The RTC accordingly affects individuals, trusts, partnerships and companies acting as non-resident landlords.

The RTC does not apply to non-resident capital gains tax (NRCGT) payable by companies.

Ways of making a correction under the RTC

Taxpayers can correct any offshore tax non-compliance on or before 30 September 2018 in a number of ways:

- Using HMRC’s digital disclosure service as part of the Worldwide Disclosure Facility or any other service provided by HMRC as a means of correcting tax non-compliance (this is the option recommended by HMRC and the one it expects most taxpayers to use);
- Informing a HMRC Officer in the course of an enquiry; or
- Any other method agreed with HMRC (for example in the case of a failure to notify by delivering the appropriate return or in the case of an incorrect return by making the required amendment).

Contributed by Steve Sanders

RTC: failure to correct & the penalty regime (Lecture P1072 – 9.48 minutes)

Introduction

There are eye-watering financial penalties for taxpayers who fail to correct any ‘relevant offshore tax non-compliance’ by 30 September 2018. This draconian penalty regime is clearly a “carrot” being dangled by HMRC to incentive taxpayers to disclose any anomalies sooner rather than later. It’s the equivalent of the slipper now or the cane later.

It is important to note here that Failure to Correct (FTC) penalties will be levied for the failure to correct, not for the original offence or behaviour which triggered the tax liability. The FTC penalty regime from 1 October 2018 therefore stands in place of the ‘traditional’ penalty regime which would have applied had the error been disclosed under the RTC.

Failure to Correct (FTC) penalties

The new FTC penalties are far more punitive than the existing penalties for late or incorrect returns or for failure to notify.

There is a tax-geared penalty of between 100% and 200% of the tax not corrected under the RTC. The starting point here is a 200% penalty which can be reduced to no lower than 100%. This is the new standard.

Penalties will be reduced within this range to reflect the taxpayer's co-operation with HMRC, the seriousness of the failure to correct, whether the disclosure to HMRC was unprompted and the quality of that disclosure. Those affected will therefore have to pay the tax outstanding, and then pay at least the same amount of the tax again, and then pay interest on top. And there is more….

A potential additional penalty of 50% of the above standard penalty if HMRC can show that assets or funds had been moved in an attempt to avoid having details reported to HMRC under exchange of information agreements. This can therefore increase the penalty to an eye-catching 300% of the tax. But it doesn't stop there….

An additional "asset-based" penalty of up to 10% of the value of the asset connected to the failure. This is capped at 10 times the potential lost revenue which now increases the possible penalty to a staggering 1300% of the uncorrected tax! This is only levied in 'serious cases' where the tax at stake is over £25,000 in any tax year and the taxpayer was aware he had an offshore compliance failure and took no steps to correct it. And then for good measure…

A potential reputational damage penalty of "naming and shaming" offenders on a public website. Again this is reserved for cases where taxpayer was aware he had an offshore compliance failure and where over £25,000 of tax per investigation is involved. Naming and shaming can also apply if a taxpayer has had 5 or more penalties levied for offshore tax non-compliance. This penalty is clearly aimed at those for whom the embarrassment of being publicly associated with tax cheats is more of an inventive to comply than the slap-on-the-wrist fine. Naming and shaming will extend to the publication of the disgraced taxpayer's address (or registered office) thereby giving the miscreant no place to hide.

Penalties are payable within 30 days of the issue of the penalty notice.

The above penalties will apply to everyone, so the assumption that the FTC penalty regime is reserved for the "hard-core tax avoiders" lurking among us is misplaced. The same penalties will therefore apply to those who are found to have tax liabilities relating to offshore matters which have arisen as a result of careless behaviour or innocent oversights (rather than something more conscious or blatant).

There is some solace in that penalties for innocent errors will probably be punishable only by the standard penalty, but this is still a minimum of 100% of the tax found to be due. Practitioners may therefore think that a targeted review of these issues in respect of their clients' pre-April 2017 tax returns would be a good use of their time.

The FTC penalties will apply not only to current and future tax years, but to all offshore irregularities, no matter when they occurred as long as the period in question is still within the assessment time limits.

Under discovery rules, this is 4 years for non-careless behaviour, 6 years where there is a loss of tax due to careless conduct and 20 years for deliberate action.

However the RTC provisions have extended HMRC's enquiry window for taxpayers with overseas affairs. HMRC now has until 5 April 2021 to assess any tax in respect of overseas matters which was due at 5 April 2017. This effectively extends the above assessment time limits to 8, 10 and 24 years respectively.

The carrot in this equation is that taxpayers who correct any errors or omissions by 30 September 2018 in accordance with the RTC will be dealt with under the existing penalty regime. This means that careless errors which result in an unprompted disclosure - and by the way, the mere existence of the RTC is not a “prompt” for disclosure purposes - could therefore result in a penalty being mitigated to zero. There is therefore a huge incentive for taxpayers to find and correct any offshore irregularities now before the failure to correct regime kicks-in in a few months time.

No penalty will be chargeable where the taxpayer has a “reasonable excuse” for failing to correct the position. In this case the tax (plus interest) will remain payable but any penalty will be waived.

What is “reasonable” is typically narrow and will follow existing models and established principles from case law. However recent Tribunal decisions have suggested that acting under professional guidance is evidence of the taxpayer having taken ‘reasonable care’, hence it would be reasonable to expect a penalty to be cancelled in these circumstances.

HMRC has therefore suggested that taxpayers should engage a suitable professional to undertake a detailed review of their offshore affairs before 30 September 2018 to ensure that a) they have submitted tax returns for all years up to and including 2016/17 for which they owed tax on offshore income or gains and b) all tax returns previously submitted are correct and complete.

However, care must be taken here because Sch 18 para 23 of the Finance (No. 2) Act 2017 specifically states that any advice that is ‘disqualified’ will not be taken into account when considering grounds for a penalty appeal. ‘Disqualified advice’ includes any advice given by any person who received any consideration when helping the taxpayer enter into the offshore arrangements in the first place. As the existing tax adviser, accountant or lawyer may therefore have provided ‘disqualified advice’, commissioning the service of a third party is generally advised.

This seems harsh for taxpayers who previously acted responsibly in relation to their overseas matters and took proper advice from a reputable adviser. It is now suggested that to protect themselves from a FTC penalty, these people now need to pay for refreshed advice before 30 September from a different person to that who gave them perfectly good advice in the first place. Whether this will lead to the tactical “swapping” of clients between tax advisers remains to be seen. In an ironical twist of fate it could be that while tax authorities are exchanging information, tax practitioners are exchanging clients.

At the very least advisers should make sure their clients are aware of the RTC and offer the option of a third party review (even if the practitioner is not aware that a particular client has any offshore assets – in these cases, now might be a good time to fess-up).

Also note that where a practitioner – on behalf and with the consent of his client – has taken a position on the UK tax treatment of an offshore issue which arose before April 2017 and there is some doubt about the technical argument, a “non-tax” disclosure should be considered to HMRC before 30 September 2018. Any tax which falls-out of any subsequent discussions would not therefore be exposed to the FTC penalties.

Post April 2017 offshore non-compliance

The above FTC penalties are “historical” in that they only apply to a person who had any offshore non-compliance to correct at the end of the 2016/17 tax year.

Errors in relation to offshore matters for periods after 6 April 2017 should be disclosed to HMRC in the normal way (typically via an amendment to the tax return within the amendment window or otherwise by means of a disclosure to HMRC followed by a discovery assessment).

Any penalties for these errors will be levied under the existing “non-FTC” rules which we all know and (now) love.

Example 1:

Danesh is UK resident but is non-UK domiciled and uses the remittance basis. He has two overseas bank accounts from which he periodically remits money to the UK. The banks are both situated in a CRS participating territory. The banks will provide personal and financial information about the accounts and the account-holder to the local tax authorities who will in turn notify HMRC in the UK under the CRS. HMRC will check the information acquired via the CRS against Danesh’s UK tax returns.

Danesh checks his remittances for all years up to and including 2016/17 and remembers that a remittance of £100,000 in 2015/16 which he had knowingly failed to report was actually an income remittance giving rise to a tax charge at 45% (ie, £45,000).

Danesh discloses this to HMRC in September 2018. HMRC finds that the error was deliberate but not concealed. The disclosure is unprompted so the penalty is 20% of the tax lost being £9,000.

However if Danesh did not disclose this error but it was subsequently discovered by HMRC as a result of data supplied to them under the CRS, the FTC penalty regime will apply. Danesh will therefore suffer a penalty of between 100% and 200% of the outstanding tax liability (so somewhere between £45,000 and £90,000).

As Danesh seems to have been aware of the error during the RTC period and the tax exceeds £25,000, a 10% asset-based penalty could also be charged (the asset in this case being the bank account from which the unreported sum was remitted). He could also be “named and shamed” on a public website.

Example 2:

A non-domiciled taxpayer settled assets on trust in December 2004. The trust is non-UK resident. The settled funds were invested in non-UK assets. In 2006 the Trustees invested some of the settled funds in a UK residential property. A principal charge of £10,000 arose in December 2014 in respect of the UK property. Due to an innocent oversight by the Trustees, no IHT 100 was filed and no inheritance tax was paid.

If the Trustees discover this error as part of a RTC review and disclose this voluntarily to HMRC, it is likely that the penalty will be attributed to careless behaviour and will be reduced to nil.

However if the error is not disclosed under the RTC but is discovered as part of a HMRC enquiry after a CRS data exchange, the penalty is between 100% and 200% of the tax.

The total exposure could therefore be:

	£
Tax	10,000
Penalty (say 110% after appropriate mitigation)	11,000
Interest at 3% since June 2015 (approx.)	1,000
	22,000

Final thoughts

Finally here remember that the FTC penalties above only apply to unreported errors in respect of “offshore matters”. Errors in relation to UK matters with no offshore connection do not fall within the FTC regime.

We are therefore faced with a slightly odd (some would say unfair) situation that a careless oversight in relation to the non-reporting of some offshore income could be punished with a penalty up to 200% of the tax, while a more deliberate and serious error in relation to the conscious concealment of (say) a UK gain, will suffer a much less punitive penalty under the traditional penalty regime.

We all know that the government must be seen by the electorate to be taking action against the evils of offshore tax evasion, but this regime could very severely punish the unwary.

Detailed HMRC Guidance on RTC is given at:

https://www.gov.uk/guidance/requirement-to-correct-tax-due-on-offshore-assets#penalties-and-other-sanctions-for-not-correcting-on-or-before-30-september-2018

Contributed by Steve Sanders

Disclosure of appeal documents to third party

Summary - The Upper Tribunal denied Aria its application for non-disclosure of the appeal document to a third party.

Mr Corfield, a reporter for a technology and science news website had applied to the Upper Tribunal for copies of Aria's notice of appeal, the associated grounds of appeal and HMRC's response.

Aria had then applied under rule 14 of the Tribunal Procedure (Upper Tribunal) Rules, SI 2008/2698, ('the UT rules') for the disclosure not to be made.

Decision

The Upper Tribunal referred to Guardian News [2012] EWCA Civ 420 as authority for the proposition that 'the open justice principle is a constitutional principle to be found not in a written text but in the common law' and noted that the Upper Tribunal has the same rights as the High Court (under the Tribunals, Courts and Enforcement Act 2007 s 25).

The Upper Tribunal added that although the civil procedure rules (CPR) do not apply to proceedings in the Upper Tribunal, they do provide 'helpful guidance' (BPP Holdings [2017] UKSC 55). The Upper Tribunal observed that there is no equivalent to CPR 5.4C in the Upper Tribunal rules, but that there is also nothing that prohibits the Upper Tribunal from allowing a person who is not a party to the proceedings to have access to documents that have been filed and are in the Upper Tribunal records.

The Upper Tribunal concluded that it has 'an inherent power to grant a third party access to any documents relating to proceedings that are held in the Upper Tribunal records and has a duty under common law to do so in response to a request by an applicant unless the Upper Tribunal considers, on its own motion or on application by one or more of the parties, that any documents or information in them should not be disclosed to other persons.'

Aria had not demonstrated that allowing The Register access to the appeal documents would lead to unfairness or cause Aria harm. In particular, the Upper Tribunal did not accept that Aria's bank and suppliers were likely to withhold payments or restrict credit because Aria was engaged in an appeal in the Upper Tribunal.

Aria had appealed to the Upper Tribunal against a decision of the FTT.

Aria Technology v HMRC [2018] UKUT 111 (10 April)

Summary adapted from Tax Journal (20 April 2018)

Deadlines

1 May 2018

- CT due for periods ended 31 July 2017 for SMEs not liable to pay by instalments.
- £10 daily penalties apply to late online self-assessment tax returns for the year ended 5 April 2017 to a maximum of £900.
- New VAT fuel scale charges apply.

3 May 2018

- Filing date for printed form P46(Car) for quarter ended 5 April 2018.

7 May 2018

- Electronic filing and payment of VAT liability for quarter ended 31 March 2018.

14 May 2018

- Quarterly corporation tax instalment for large companies depending on year end.
- EC sales list for quarter ended 31 March 2018 due (paper form).

19 May 2018

- PAYE/NIC/CIS/student loan repayment due for month ended 5 May 2018.
- File monthly construction industry scheme return.

21 May 2018

- File online monthly EC sales list.
- Submit supplementary Intrastat declarations for April 2018.

22 May 2018

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

31 May 2018

- 2017/18 P60s to employees.
- Accounts to Companies House for private companies with 31 Aug 2017 year end.
- Accounts to Companies House for public companies with a 31 Nov 2017 year end.

- CTSA returns filed by companies with accounting periods ended 31 May 2017.

News

HMRC to revise large business risk review process

Following consultation on updating its business risk review (BRR) process for large businesses, HMRC has accepted the need to expand the current risk categories from just two (low risk/non-low risk), into a range which distinguishes more clearly between low and high risk. It will pilot a revised BRR later this year across a defined group of taxpayers, incorporating new risk categories and other changes, with a view to rolling out an enhanced version more widely in 2019/20.

Key recommendations the government will adopt include:

- changing the BRR's binary 'low risk/ non-low risk' categories to more accurately reflect the differences across the large business population;

- the BRR process should take more account of tax risk management work already required by large businesses, such as the senior accounting officer (SAO) provisions and the publication of tax strategies;

- the enhanced BRR should provide taxpayers and HMRC with a clear set of actions and timelines which need to be regularly updated and discussed between the two parties; and

- further investigation is needed to ensure consistency in allocating a certain risk rating and, in particular, a low risk rating should only be provided to large businesses that adhere to the OECD's 'tax control framework' or have similar controls in place.

Tax Journal (23 March 2018)

Spotlight 43: SDLT avoidance: misleading advertising

HMRC added spotlight 43 in March 2018, concerning an Advertising Standards Authority ruling on misleading claims made about SDLT schemes by their promoter, Fiducia Wealth and Tax.

HMRC complained to the Advertising Standards Authority about misleading advertising by a tax avoidance scheme promoter, CDP Tax & Wealth Limited, which trades as Fiducia Wealth and Tax (Fiducia). The Advertising Standards Authority agreed with HMRC and ruled that the claims made by Fiducia are misleading and must be withdrawn.

The scheme advertised by Fiducia claims to use government approved statutory rules that are within the tax legislation and reduce SDLT bills on residential property purchases by 60%. In practice, no SDLT is paid on the purchase and Fiducia keeps the balance of 40% as its fee.

HMRC's understanding of the scheme is that:

- certain types of land transactions are exempt from SDLT
- one of these exemptions prevents mortgage providers incurring SDLT when they take a 'security interest' in a property as security for a mortgage
- Fiducia is selling a scheme which seeks to misuse this exemption through a complex series of transactions, so that no SDLT is paid

HMRC said such arrangements fell under the meaning of avoidance. Claims that they did not have to be disclosed under the disclosure of tax avoidance schemes (DOTAS) were correct only if they did not fall within one of the DOTAS hallmarks.

www.gov.uk/government/publications/tax-avoidance-schemes-currently-in-the-spotlight

Employer Bulletin (April 2018)

Simplifying PAYE Settlement Agreements (PSAs)

Remember that from the start of the 2018/19 PSAs will be agreed between the employer and HMRC and will remain in place for subsequent tax years unless varied or cancelled by the employer or HMRC. This means that employers will no longer have to renew their PSAs annually so long as this enduring agreement remains accurate. P626s will form the basis for the first enduring agreement. The P626s will invite employers to renew on the basis of the PSA that was in place for the tax year 2017/18 and should be received by the end of April 2018. Alternatively, employers will be able to set up an enduring PSA based on different criteria to the PSA agreed for 2017/18, if this is more appropriate. Employers will still be required to provide an annual calculation.

Diesel Supplement Increase and Introduction of the Real Driving Emissions 2 Standard

From 6 April 2018, the diesel supplement for the car and fuel benefit charge will increase from 3% to 4% for all diesel cars that are not certified to meet the Real Driving Emissions 2 (RDE2) standard.

The diesel supplement will continue to apply to cars using diesel only (not diesel hybrids) and registered on or after 1 January 1998, which do not have a registered Nitrogen Oxide (NOx) emissions value. It will also apply to models registered on or after 1 January 1998, which have a registered NOx emissions value which exceeds the RDE2 standard.

For the tax year beginning 6 April 2018 only:

- use the appropriate percentage for 'Fuel Type A – All other cars' when calculating the cash equivalent for diesel company cars which are RDE2(Euro 6d) compliant.
- use 'Fuel Type A – All other cars' when reporting diesel company cars which are RDE2 (Euro 6d) compliant on forms P11D or P46car.

Where employers have registered to payroll the car and fuel benefit charge for an RDE2 (Euro 6d) compliant diesel car, they should:

- calculate the cash equivalent using the appropriate percentage for ‘Fuel Type A’ and
- enter this amount in ‘Box 182’ of the Full Payment Submission (FPS),
- enter ‘A’ in ‘Box 177’ on the FPS.

Termination payments made on, or after, 6 April 2018

Remember, changes to the taxation of non-contractual payments in lieu of notice (PILONs) came into effect from 6 April 2018. All payments in lieu of notice on, or after 6 April 2018 are chargeable to income tax and Class 1 National Insurance Contributions (NICs), whether or not they are contractual payments. Detailed guidance can be found in the Employment Income Manual.

Foreign Service relief on termination payments has been removed for UK residents from 6 April 2018. Employees whose employment terminated on, or after, 6 April 2018 and who receive a payment or benefit in connection with that termination will not be eligible for tax relief in respect of any period of foreign service undertaken as part of their office or employment if they are UK resident for the tax year in which their employment is terminated. Seafarers remain eligible for Foreign Service relief. Detailed guidance can be found in the Employment Income Manual.

Pension Contribution Increase

From 6 April 2018 minimum pensions contributions for employers and their staff will increase from 2% to 5% and then to 8% in April next year.

Student Loans

From 6 April 2018 the repayment thresholds are:

- Plan 1 £18,330
- Plan 2 £25,000

Payroll software should now have been updated to include a new student loan plan type box on the Full Payment Submission (FPS) you send to HMRC. This box is mandatory. Employers must complete this box for all employees who have a student loan, selecting either plan 1 or plan 2 depending on your employee’s student loan plan type.

New National Insurance Number letter

From April 2018, HMRC are changing the format of the letter we use to tell our customers their National Insurance (NI) number. This is the letter that is sent automatically to entitled teenagers just before their 16th birthday and to customers who ask for a reminder of their NI number.

The purpose of the letter is solely to tell/remind our customers of their NI number and let them know what it should be used for. The letter is not proof of someone's identity and is not proof of their address. The new letter will no longer contain a date of issue as NI numbers do not change.

The new letter will also contain other useful information about HMRC services, like the Personal Tax Account.

https://www.gov.uk/government/publications/employer-bulletin-april-2018

Payments on account for disposals of residential property

HMRC is seeking views on a new scheme for making payments on account of Capital Gains Tax when disposing of residential property. The changes will mainly affect those disposing of a second home or rental property. They will not apply where the gains are not chargeable to CGT so where the gains are covered by private residence relief.

Currently CGT is accounted for and paid as part of the annual self-assessment cycle. However, HMRC are proposing that from April 2020, a payment on account of CGT will need to be made when a residential property is sold or otherwise disposed of. The payment will be credited against the person's income tax and capital gains tax liability for the tax year.

Payment will be due within 30 days of the completion of the disposal. A special payment on account return confirming the disposal and the amount payable will also need to be sent to HMRC at the same time.

The existing CGT payment on account system for non-residents disposing of UK residential property will be extended from April 2020 so that a payment will be due where a person also makes self-assessment returns to HMRC.

The consultation closes on 6 June 2018.

https://www.gov.uk/government/consultations/capital-gains-tax-payment-window-for-residential-property-gains)

Apprenticeship levy too complicated

The think tank Reform has published a report that assesses the first year of the apprenticeship levy.

The report states that the apprenticeship levy is ' too complicated for employers' and has 'diminished the quality of apprenticeships', with 40% of the new apprenticeships being low-skilled jobs designed by employers as apprenticeships 'in name only', while still allowing employers to qualify for subsidies.

The report recommends:

- abandoning the target of 3m apprenticeships by 2020, so as to focus on apprenticeship quality instead;
- introducing a new internationally-benchmarked definition of an apprenticeship;
- removing the requirement for 10% employment co-investment towards the cost of training apprentices, to avoid employers disengaging from apprenticeships;
- replacing the existing HMRC digital payment system with a simpler 'apprenticeship voucher' model; and
- making the exam regulator Ofqual the only option for quality assuring at the end-point assessments for apprentices to ensure standards are maintained over time.

Adapted from Tax Journal (20 April 2018)

‘Manage and register pension schemes’ service

From 8 May 2018, HMRC’s new ‘Manage and Register Pension Schemes’ service will be open for applications to register new pension schemes and register as a pension scheme administrator on the new service and from April 2019, scheme administrators will be able to use the new service for reporting, and practitioner access will become available between 2019 and 2020.

The new service will:

- provide a new digital platform to manage and register pension schemes;
- provide a digital account for all pension schemes and reporting;
- issue all HMRC notifications regarding registration through the new service;
- hold details of existing schemes, administrators and practitioners following migration from the existing Pension Schemes Online service.

Existing scheme administrators not planning to apply to register a new pension scheme, will continue to manage old schemes using the Pension Schemes Online service for the time being.

The April 2018 newsletter gives some guidance on the following areas:

- Retirement annuity contract and deferred annuity contract scheme administrators
- Authorising a practitioner to act for your scheme from 8 May 2018

Later in the year HMRC will add additional Phase One features so that administrators can edit scheme administrator details including the ability to remove pension scheme administrator from the new service

Phase Two

During Phase Two HMRC are planning to:

- introduce pension scheme reporting on the service;
- add pension scheme practitioners so they can use the new service to support pension scheme administrators with their reporting requirements;
- issue penalties and assessments for pension schemes through the new service;
- migrate existing pension schemes and scheme administrators (who have not already used Manage and Register Pension Schemes) from the current Pension Schemes Online service to the new service;
- issue you with notifications, notices and letters through the service.

www.gov.uk/government/publications/pension-schemes-manage-and-register-pension-schemes-service-newsletter-april-2018

Business Taxation

Undeclared restaurant income

Summary – Cash taking were understated for income tax, national insurance and VAT but the taxpayer's action was found to be negligent and careless rather than deliberate and concealed.

Shah Aziz carried on a restaurant business as a sole trader from 1 February 2007 to cessation on 31 March 2016. His accountant carries out the business' accounting and tax work using the cash accounting paperwork, including cash books and daily reports of takings prepared by Mr Aziz. The daily cash ups are carried out at the close of each day's business. The front sheet records the cash and card receipts for the day and the meal bills and card receipts are attached.

HMRC visited the restaurant as part of its Restaurant Task Force in 2013 investigating potential under-declared income. Test purchases had been carried out in accordance with the procedures set out by the taskforce which officers completing a record of their visits to note the food ordered and the cash payment made by the officer, and to record the number of staff and customers present in the restaurant at the time of the visit, any takeaways leaving the premises and any other orders overheard. The meal bill for each test purchase was to be left on the table following payment in cash. Twenty-one test purchases took place on seven days in 2013 of which 12 were later found not to be included in the daily cash ups. Subsequent detailed checks relating to the year ended 5 April 2013 resulted in HMRC establishing that the daily reports failed to include all of the sales for which meal bills were retained in the addition of total sales.

Subsequently, HMRC raised assessments based on guidance issued by the restaurants taskforce to use merchant acquirer data in order to determine the gross card takings and then to use this figure to find the gross takings for the years 2012 to 2015 to collect income tax, National insurance and VAT.

Mr Aziz appealed.

Decision

The First Tier Tribunal found that there was a pattern of careless additions of daily takings and inadequate record keeping in the financial years ended 5 April 2013 and 5 30 April 2014. They also found that the use of cash ups to determine the card to cash split used by HMRC was reasonable given that it had already been established that there were careless additions, systems and record keeping errors in the taxpayer's data. They considered that the cash ups on three days in 2013 and 2015 were a sufficiently representative sample and free from bias. The fact that HMRC had cross-checked their findings by reference to gross profit percentages, supported this basis.

HMRC had claimed that the under-declarations were 'deliberate and concealed' but the Tribunal said that Mr Aziz was negligent in allowing the cash and meal bills to be removed in the relevant periods, and he was careless in the management of his daily reporting and record keeping.

As the owner of the business he has sole responsibility for the business's accounting records for tax purposes, and a duty to ensure that these were accurate and complete. However, his behaviour has been proved to be negligent and careless rather than deliberate, and on this basis the penalty should be charged within the penalty range of 15% to 30%. The penalty assessments were varied with Mr Aziz being liable to penalties at the rate of 19.5%.

Shah Aziz v HMRC (TC06405)

Debits on deemed loan relationships

Summary – HMRC were correct to disallow debits in relation to a swap-related tax avoidance scheme as the 'unallowable purpose' provision applied to the deemed loan relationships.

Travel Document Service and Ladbroke Group International were both companies in the Ladbroke group of companies. Travel Document Service was a subsidiary of the group's parent company and owned Ladbroke Group International.

In 2008, they took part in a tax avoidance scheme devised by Deloitte involving a swap (and the novation of loans. Travel Document Service entered into the swap with the principal operating company of the group (LBG) over the shares the former held in Ladbroke Group International. The key to the scheme had been the reduction in the fair value of Travel Document Service 's shareholding in Ladbroke Group International, as a result of the latter taking on indebtedness of more than £253m under the novations.

Travel Document Service claimed debits against trading profits in excess of £253m in the case of TDS, Ladbroke Group International £12m on the basis of the provisions concerning 'loan relationships', then contained in FA 1996.

HMRC disallowed the debits, relying on the 'unallowable purpose' provision in FA 1996 Sch 9 para 13.

On appeal, the First Tier Tribunal, and subsequently the Upper Tribunal, ruled that para 13 applied to a deemed loan relationship and held that Travel Document Service's tax avoidance scheme had had an unallowable purpose throughout the period and the debits were not allowed.

The taxpayers appealed to the Court of Appeal.

Decision

Reading the relevant provisions naturally, para 13 applied to deemed loan relationships. So far as 'repos' were concerned, any problems that might arise with applying para 13 to those did not warrant the conclusion that Parliament did not want para 13 to operate in relation to deemed loan relationships generally; nor did s 91D's use of 'unallowable purpose'. The Court concluded that both the First Tier and Upper Tribunals were right to take the view that para 13 applied to deemed loan relationships.

A company had an 'unallowable purpose' if its purposes included one that was 'not amongst the business or other commercial purposes of the company' (see para 13(2)). A tax avoidance purpose was not necessarily fatal.

It was to be taken to be a 'business or other commercial purpose', unless it was 'the main purpose, or one of the main purposes, for which the company is a party to the relationship' (see para 13(4)). It was the company's subjective purposes that mattered. There was no question of Travel Document Service having had the tax advantage in mind when it had acquired the shares, it had evidently been intending to use them in the tax avoidance scheme during the currency of the swap. The hoped-for gain had been large, both in absolute terms (more than £70m) and relative to the apparent value of Travel Document Service (some £280m).

Securing the advantage had become a main purpose of holding the shares. The prospective advantage was of such significance in the context that gaining it had to have become a main purpose of holding the shares, as well as of the swap and the novations.

On balance, the court agreed with HMRC that the materials before the Fist Tier Tribunal did not justify the attribution of any of the debits claimed by Ladbroke Group International to anything other than the 'unallowable purpose'. Ladbroke Group International had never supplied particulars of what loan(s) it had claimed would have been made to it at what rate(s) of interest and for what period(s), had it not adopted the Deloitte scheme. No such details had, for example, been given in Ladbroke Group International ‘s notice of appeal to the First Tier Tribunal.

Both appeals were dismissed.

Travel Document Service and Ladbroke Group International v HMRC (Court of Appeal [2018] All ER (D) 138 (Mar))

Were acquisition expenses deductible?

Summary – The Upper Tribunal decided four preliminary issues in relation to the acquisition of leasing partnerships by Investec.

The First Tier Tribunal had to consider three leasing transactions undertaken by leasing partnerships purchased by Investec. In each of the transactions, Investec had acquired an interest in a partnership entitled to lease receivables, and become a partner in that partnership, with a view to the partnership realising the receivables and making distributions to Investec.

HMRC had disallowed expenditure claimed by Investec in relation to its acquisition of the partnership interests on the grounds that:

- it was capital expenditure not revenue expenditure; and, alternatively,
- even if it was revenue expenditure, it was not incurred wholly and exclusively for the purposes of Investec's trades (as opposed to the trades carried on by the leasing partnerships).

Decision

Agreeing with the First Tier Tribunal, the Upper Tribunal found that, although the transactions involved the acquisition of partnership interests and the making of capital contributions, they were short-term, recurrent transactions that had the character of trading transactions, so that the expenditure incurred by Investec was revenue in nature.

Again agreeing with the First Tier Tribunal, the Upper Tribunal found that Investec's ultimate objective in making the capital contributions was to profit from distributions in its financial trades. However, it was also 'inescapable' that the capital contributions were made by Investec at least partly for the purposes of the partnerships' trades, which used the monies for their leasing businesses. The expenditure was therefore not incurred solely for the purpose of Investec's financial trade.

Finally, the Upper Tribunal found that the First Tier Tribunal had been correct to hold that profits, which had been taxed in the hands of the leasing partnerships, did not fall to be taxed again in the hands of Investec, applying FS Securities (1964) 41 TC 666.

HMRC v Investec Asset Finance [2018] UKUT 69

Tax Journal (13 April 2018)

Public register of overseas entity beneficial ownership

Following consultation, BEIS has published a response document setting out how the government plans to implement the register. The main elements may be summarised as follows:

- all legal forms which can hold properties will be within the scope of the new register, except for trusts, which are covered by HMRC's new trust registration service;
- all leases of registrable duration will be within scope;
- the definition of beneficial owner for the new register will be aligned to the definition of people with significant control (PSC) in the PSC regime (with appropriate adaptations for overseas entities) and will require the same information as the PSC regime;
- overseas entities will be given more than one year in which to comply, with the precise length of time to be confirmed;
- the compliance regime, including the requirement to keep information up to date, will be backed up by criminal offences;
- the government's preferred frequency for updates to the register, likely to be less than two years, will be set out in the draft legislation;
- overseas entities without a valid registration number, who buy property after the law comes into force, will assume beneficial interest but not legal title;
- for government procurement, only preferred suppliers will be required to provide beneficial ownership information as a condition of being awarded the contract; and
- entities unable to give information about their beneficial owners will be asked to provide information about their managing officers.

www.gov.uk/government/consultations/property-ownership-and-public-contracting-by-overseas-companies-and-legal-entities-beneficial-ownership-register

The new General Data Protection Regulation

The new EU General Data Protection Regulation (GDPR), which replaces the Data Protection Act, will come into force on 25 May 2018. The GDPR aims to give individuals increased control over how organisations use their data and looks to ensure that data protection law is almost identical across the EU. The new Regulation will affect every organisation that processes the personal information of EU residents and despite the fact that the UK is leaving the EU, we will still need to comply.

Failing to comply with the rules could result in organisations being fined up to 4% of annual global turnover or €20 million, whichever is greater.

The Information Commissioner's Office, who are responsible for enforcement of GDPR in the UK, prepared a useful document Preparing for the General Data Protection Regulation (GDPR) 12 steps to take now which was summarised in our Accounting and Auditing notes last month and is repeated here:

Step 1: Awareness

Ensure that everyone in the firm is aware that GDPR is the law and will be enforced from 25 May 2018.

Step 2: Document the information in your possession

The firm should document what personal data is in its possession, where it came from and who they will share it with. In practice, this could prove a challenge so an 'action plan' may be needed as to who will do this task and when.

Step 3: Communicating privacy information

Firms must review their current privacy notices and instigate a plan for making any necessary changes in time for 25 May 2018.

Step 4: Individuals' rights

Firms should ensure their procedures cover all the rights individuals have, including how someone's personal data would be deleted or provide data electronically.

Step 5: Subject access requests

Procedures should be updated so they incorporate how the firm will deal with subject access requests within the new timescales and provide any additional information.

Step 6: Lawful basis for processing personal data

Firms should identify the lawful basis for their processing activity within the GDPR, ensure it is documented and that privacy notices are updated to explain it.

Step 7: Consent

Firms should review how they seek, record and manage consent and whether any changes are needed. Where existing consents do not meet the GDPR standard, they will have to be amended accordingly to comply.

Step 8: Children

Systems may need to be put into place to verify individuals' ages and to obtain parental or guardian consent for any data processing activity in respect of children.

Step 9: Data breaches

Procedures need to be in place which are GDPR compliant which detect, report and investigate a personal data breach.

Step 10: Data Protection by Design and Data Protection Impact Assessments

Firms will need to familiarise themselves with the ICO's code of practice on Privacy Impact Assessments as well as the latest guidance from the Article 29 Working Party and then work out how, and when, to implement them within the firm.

Step 11: Data Protection Officers

Someone in the firm must take responsibility for data protection compliance and assess where this role will sit within the organisational structure and governance arrangements. Firms should also consider whether they will be required to formally designate a Data Protection Officer. Data Protection Officers will be needed in the case of:

- Public authorities;
- Organisations which engage in large-scale systematic monitoring; or
- Organisations that engage in large-scale processing of sensitive personal data.

Step 12: International

Where an organisation operates in more than one EU member state, firms will have to determine the lead data protection supervisory authority and document this.

Tax relief for tangible fixed assets using accounts depreciation (Lecture B1072 – 10.34 minutes)

The Office of Tax Simplification (OTS) recently published a detailed corporation tax computation review ('Simplification Of The Corporation Tax Computation'). As part of the research for this report, capital allowances were flagged up as an area of considerable complexity at almost every meeting between the OTS and businesses or their advisers.

A major source of this complexity turns out to be the uncertainty that exists around the various 'boundaries' for the relief – for example, the difficulty in determining whether a given asset qualifies for capital allowances and, if it does, at what rate writing down allowances should be applied.

Businesses also feel, the OTS found, that there is a disproportionate administrative burden in classifying assets when claims are made, with specific reference to the value of the tax relief. Other feedback received by the OTS indicated that businesses were often unclear about the broad policy intention of the capital allowances code, given that the tax rules are not consistent with commercial reality as reflected in business accounts.

In order to reduce the current burden and to create what hopefully will be a simpler system, the OTS concluded that the issues relating to the ‘boundaries’ for capital allowances relief and the Government’s policy objectives are the areas that should be addressed. The OTS therefore proposed a number of practical steps towards simplifying the present capital allowances regime, but they also considered some broader and more radical approaches including, in particular, the replacement of capital allowances with accounts depreciation (which would of course extend their scope in the process).

The Chancellor’s response on 14 August 2017 to the corporation tax review included a request that the OTS investigate in greater depth the problems of using accounts depreciation instead of capital allowances. The scope of this further review has now been agreed. The OTS say that their main aim will be ‘to explore the impact and challenges of moving to accounts depreciation, as a potentially simpler system, with a view to setting out various options as to how this may be achieved and their impacts’. The work, the OTS confirm, ‘will need to set out who might be better off or worse off (the “gainers and losers”), including ways in which such a change could be made revenue-neutral, and the benefits and challenges involved including implementation and transitional issues’. This assignment will also incorporate a consideration of options that distinguish businesses by size and sector.

Here are some of the consultation questions which the OTS would like contributing businesses to answer:

- Businesses submitting corporation tax or income tax returns base these returns on accounts prepared under one of several alternative accounting regimes (eg. FRS 102 or FRS 105) depending on the nature and size of the business. If tax relief is given for depreciation, what are the implications of businesses preparing their accounts under differing accounting regimes?

- Within each acceptable accounting regime, businesses apply accounting policies that may be mandatory or judgemental. When did the business last change the accounting policy to tangible fixed assets? What depreciation rates/asset lives are used in the business?

- There are various components of depreciation (eg. recognition, costs, revaluations, impairments, life, residual value). Would any of these present particular issues if depreciation is used to provide tax relief for capital expenditure?

- Although accounts prepared in accordance with GAAP form the basis for determining taxable profits and tax-allowable losses, HMRC may on occasion challenge the application of GAAP. In some respects, corporation tax has moved closer to an accounts-based approach (for example, because of the intangibles regime introduced in FA 2002). What do examples such as this indicate about the merits or drawbacks of a depreciation-based regime for relief for capital expenditure on tangible fixed assets?

- In general, the fewer adjustments to accounts depreciation that are necessary to arrive at the tax-deductible figure, the greater is the potential tax simplification. This implies that assets currently not qualifying for capital allowances would, if depreciated, attract relief. However, some adjustments would still be necessary, for example to ensure that capital expenditure would continue to be based on cost (rather than valuation) and to exclude certain assets such as land and dwellings. What adjustments to accounts depreciation do businesses consider may be necessary and yet consistent with delivering simplification?

- Would a depreciation-based approach present particular issues for sole traders and partnerships submitting income tax returns?

- Overall would the use of accounts depreciation make preparation of the tax return simpler or more complex? What features of such an approach would tend to greater simplicity or complexity compared with the present system?

- The current capital allowances regime has timing incentives for capital expenditure such as the annual investment allowance. Assuming that such a timing incentive remains desirable, a means of preventing a double deduction (ie. for depreciation and the allowance) would be necessary. Would this significantly compromise any potential simplification benefits of a depreciation-based approach?

- Should businesses be differentiated by size or in any other way when considering whether accounts depreciation as the basis for capital expenditure relief is or is not a simplification? If so, what distinctions would be appropriate?

As you can see, it is unlikely to be a straightforward exercise.

Contributed by Robert Jamieson

R&D expenditure credits (Lecture B1073 – 9.49 minutes)

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

In order for a company to be classified as medium-sized, it must have fewer than 500 employees; and either:

- turnover not exceeding €100,000,000 (just under £88,000,000); or

- gross assets total in its balance sheet not exceeding €86,000,000 (just under £75,500,000).

Such a company may still be a very substantial enterprise.

Any company that does not meet the test above is classified as large. Large companies used to enjoy a less generous super-deduction. However, in FA 2013, it was confirmed that large companies could claim an alternative form of R&D tax relief. This is known as an 'above the line' (ATL) credit. The ATL regime, which was originally optional, replaced the super-deduction framework for all large companies from 1 April 2016 onwards.

A key feature of the ATL credit, which is officially referred to as an 'R&D expenditure credit', is that it is treated as a taxable receipt and is paid net of tax to companies with no corporation tax liability. Effectively, it is like a form of grant.

Cl 19 F(No2)B 2017 amends S104M CTA 2009 by increasing the rate of the credit from 11% to 12% in relation to qualifying expenditure incurred on or after 1 January 2018. For an example of how the relief works, see the illustration below.

Illustration 1

Frederick Industries plc is a large company for R&D relief purposes.

On the assumption that Frederick Industries plc has incurred qualifying R&D expenditure of 1000 during its year ended 31 December 2018, the company's corporation tax computation would appear as follows:

Turnover	6000
R&D expenditure	(1000)
R&D expenditure credit (12%)	120
Other allowable expenditure	(2000)
	———
Taxable profits	3120
	———
CT @ 19%	593
R&D expenditure credit	(120)
	——
Tax payable	473
	——

Contributed by Robert Jamieson

VAT

Digital versions of newspapers and zero-rating

Summary – The digital versions of newspapers were not zero-rated under Sch8 Group 3 Item 2 VATA 1994.

News Corp is the representative member of a VAT group that publishes The Times, The Sunday Times, The Sun and The Sun on Sunday. The issue was whether the daily digital versions of the titles were zero-rated.

News Corp contended that the purpose of zero-rating newspapers was to disseminate knowledge and information, to aid literacy and to further the democratic process. Those features 'were as true of the digital editions of the titles as they were of the print editions'.

Decision

The First Tier Tribunal observed that it was accepted by both parties that the digital editions constituted supplies of services. It added that, under the CJEU's case law, zero-rating must be interpreted strictly; and found that to extend Group 3 item 2 beyond the supply of goods (newsprint newspapers) to cover the supply of services (digital newspapers) would be an impermissible expansion of the zero-rating provisions. The First Tier Tribunal was 'minded to accept' that the digital editions of the titles did serve the same general purposes as the newsprint editions but a purposive construction could not be used to give effect to a perceived wider policy in a case where the words used by Parliament did not bear that meaning. Similarly, the 'always speaking' principle did not mean that Parliament must have intended the legislation to be interpreted in a way that kept pace with technological developments. The principle could not be used to extend the scope of zero-rating.

Finally, the First Tier Tribunal found that applying a different VAT treatment (standard rating) to the digital editions of the titles from that applicable to the newsprint editions (zero rating) did not offend the principle of fiscal neutrality. Although both editions were similar, the principle of fiscal neutrality could not operate to extend the scope of zero-rating from its original application to goods to include services.

News Corp UK & Ireland v HMRC
Adapted from Tax Journal (23 March 2018)

Checks for online marketplace sellers

From 15 March 2018 new legislation allows HMRC to hold online marketplace operators, jointly and severally liable for the unpaid VAT of overseas sellers operating on your marketplace where:

- an overseas seller has not registered for UK VAT;

- the operator of the online marketplace, knew or should have known that the seller should be registered for UK VAT.

HMRC has issued guidance on the checks that online marketplace operators must carry out on their sellers.

Online marketplaces

HMRC define an online marketplace as a website (or any other means by which information is made available over the internet) that anyone - including the online marketplace operator - can use to offer goods for sale.

You operate an online marketplace if you control access to it, or its contents. This applies even if the online marketplace:

- isn't established in the UK

- sells its own goods over the internet

Overseas sellers

These are sellers who sell goods stored in the UK to UK consumers but don't have a business establishment in the UK. Overseas seller can be based outside the EU and sell goods to a UK consumer, prior to importing them into the UK.

Checks online marketplace operators need to make

Operators must:

- Check the seller's VRN on the EUROPA website and investigate any discrepancies. Operators should carry out reasonable due diligence checks on new sellers setting up accounts on their website to be sure that they've registered for UK VAT, and should carry out checks on each one;
- Display a verified VRN on their website within 10 days of being given it. Operators should also take reasonable steps to remove any VRNs that are displayed on their online marketplace within 10 days becoming aware that that they're wrong;

Not allow an overseas seller to continue to trade on their marketplace if they don't have a VRN and they're either advertising or offering goods for sale or trading on their marketplace and haven't provided them with a valid VRN after 60 days of trading. Operators must tell HMRC when they identify and remove a seller who hasn't met their VAT obligations.

How HMRC will apply the 'knew or should have known' test

HMRC will consider a number of factors including:

- if there was any information held or an operator should have reasonably requested that would help decide whether the seller should have registered for VAT;

- how much due diligence you've taken, including the checks you've made.

HMRC notifications for sellers who fail to meet VAT requirements

HMRC will issue operators with a joint and several liability notice when it identifies any seller on their marketplace that isn't meeting its VAT requirements. Operators will not be assessed for the seller's VAT if they stop the seller from selling goods on their online marketplace within the time specified in your liability notice.

Notification of the 'knew or should have known' test for overseas sellers

HMRC will send operators a notification if they decide that the 'knew or should have known' test applies to an overseas seller who was still selling goods, but failing to account for VAT, on their marketplace 60 days after they had enough knowledge to make that decision.

HMRC will:

- explain why the 'knew or should have known' test applies;
- specify the amount of unpaid VAT that the operator has been made jointly and severally liable for;
- send the operator a VAT assessment.

Challenging HMRC's decision

Operators can:

- ask for the decision to be reconsidered by the assessing officer;
- ask for an independent review;
- appeal the assessment.

www.gov.uk/guidance/vat-online-marketplace-seller-checks

R&C Brief 3/2018: Changes to VAT exemption for cost-sharing groups

This brief and the related VAT information sheet explain the immediate changes that are taking place in HMRC's policy following recent ECJ judgments.

The Brief applies to UK businesses in the finance, insurance and other sectors who have implemented a cost share group, or are thinking of implementing one, and have relied on HMRC's published guidance in the Cost Sharing Exemption Manual, CSE1000 to CSE3000.

What is the Cost Share Exemption?

The cost sharing exemption applies when two or more organisations (businesses or otherwise) with exempt or non-business activities join together to form a cost share group. Which is a separate, independent entity, set up to enable its members to supply themselves with certain qualifying services at cost and exempt from VAT.

As a result a 'co-operative self-supply' arrangement is created. Because the group is a separate taxable person from its members, it's able to make supplies for VAT purposes to its members. This exemption allows small providers who can't afford to acquire assets on their own account to benefit from the same overall VAT position as larger providers who can afford to purchase the assets themselves. Thus the more members of a group there are, the greater the potential savings and lower the costs per member of operating the relevant group.

The exemption applies only in very specific circumstances and won't cover all shared service arrangements.

Immediate effects of the judgments

The exemption is restricted to members who engage in the exempt activities in the following Exemption Groups in Schedule 9 of the VAT Act 1994, with effect from the date of issue of this brief.

Exemption groups:

- postal service (Group 3)
- education (Group 6)
- health and welfare (Group 7)
- subscriptions to trade unions and professional bodies (Group 9)
- sport (Group 10)
- fund raising by charities (Group 12)
- cultural services (Group 13)

Housing associations can continue to apply the exemption for the time being until HMRC gives more guidance.

HMRC policy will be amended to restrict the exemption to members located in the UK. It'll no longer be permitted to apply the exemption for transactions with members located in other EU member states. The exemption has not been permitted for members located outside of the EU, and this will remain the position.

An exemption won't be permitted where an uplift has been charged on transactions for transfer pricing purposes. It'll remain the position that the CSE won't be permitted in any other case where exact reimbursement can't be evidenced.

www.gov.uk/government/publications/revenue-and-customs-brief-3-2018-changes-to-the-vat-exemption-for-cost-sharing-groups

www.gov.uk/government/publications/vat-information-sheet-0218-impact-on-existing-cost-share-groups-following-changes-to-hmrcs-policy

Building to be used solely for a relevant charitable purpose

Greenisland FC was formed in 1995 based in County Antrim and is a not-for-profit community-based sports club registered with the Charity Commission for Northern Ireland as a charity. The land it occupies is leased from Carrickfergus Council, now Mid and East Antrim Council.

In 2010 the club began a project to build a new clubhouse, a multipurpose facility for use by the community. Before the work commenced Greenisland FC issued a certificate to the builder that the building was intended for use solely for a relevant charitable purpose and therefore the builder could zero-rate the supplies under item 2(b), Group 5, Schedule 8 VATA 1994.

After construction had been completed HMRC enquired into the VAT liability of the construction works and as a result of its enquiries decided that the construction should have been standard rated. Accordingly HMRC issued a penalty for £53,101 calculated at 20% of the cost of construction amounting to £265,505.00.

On appeal, the club argued that if they were wrong about the zero rating and the work was standard-rated, it had a reasonable excuse pursuant to section 62(3) VATA1994.

Decision

The Tribunal found that the clubhouse was used by many local groups with no preference given the football club. If Greenisland FC wanted to hire the facility and it was already booked, it would be unable to do so. They found that Greenisland FC was not operating a business at the clubhouse. In 2017 the clubhouse was extensively used for an After Schools Club, karate classes, a Womens & Toddlers group, a Ladies Keep Fit, Irish Dancing classes as well as a church on Sundays and several birthday parties. The Tribunal was satisfied that the requirements of Note 6(b) were met and that the club was correct to consider the works to be zero rated and to issue a zero rating certificate to the builder.

Additionally, the club carried out research and consulted two professional people before issuing the certificate. They therefore had a reasonable excuse for having given it.

The appeal was successful on both grounds.

Greenisland FC v HMRC (TC06321)

Clarity on VAT after Brexit

The House of Commons European Scrutiny committee has issued its report on 'VAT: EU proposals for reform and the implications of Brexit'. The report looks at the European Commission's four main legislative proposals for the 'definitive' VAT system, involving:

- a single VAT area;
- flexibility for member states to reduce VAT rates;
- exemptions for small businesses from certain VAT obligations; and
- increased co-operation between tax administrations to combat VAT fraud.

The report notes continuing opposition to the proposals among some member states, meaning the timetable for adoption of the new legislation and its entry into force remains highly uncertain. If, however, the UK is under an obligation to continue applying EU VAT law during a transitional period from March 2019 onwards, the 'definitive' system for cross-border supplies might have to be implemented in the UK. In this regard, the committee is concerned about the implications of the UK's loss of its veto over tax-related proposals when it exits the EU on 29 March 2019 and doubts the government's general safeguards against the application of unwanted EU legislation during the transition will be effective. The committee expressed its concerns about 'the inability, or unwillingness, of the government to share a detailed proposition for the mitigation of VAT-related barriers to trade flows between the UK and the EU as and when the UK leaves the single EU VAT area'.

In particular, the committee asks the government to keep it informed on progress made in negotiations around how to ensure VAT is collected on goods imported into the UK via the border with Ireland, and calls by some member states to end the reverse charge mechanism for business-to-business supplies, while attempting to prevent missing trader fraud.

On reduced rates, given the Commission's proposal is explicit on the new VAT rates system not taking effect until 2022 at the earliest, the committee asks why the Treasury is undertaking a 'mapping exercise' to identify how the proposal could impact on the UK's current reduced or zero-rates, if the the post-Brexit transitional period is to last for only 'around two years'.

Similarly, in relation to the exemptions for small businesses, the committee asks the government 'urgently' to clarify its apparent assumption that these measures may apply in the UK from 2022 onwards.

The report asks why the government is opposed to joining the EU's transaction network analysis (TNA) project for automated analysis of trade flows to detect VAT fraud. During the post-Brexit transitional period, while the UK remains subject to EU law, the government would remain bound by the obligation to share information with EU countries.

publications.parliament.uk/pa/cm201719/cmselect/cmeuleg/301-xxii/30102.htm

Tolleys Tax Guidance

Supplies of silver ingots?

Summary – The Tribunal found that bank account transactions in respect of silver bars did not represent payment to Quality Engines Direct Ltd from a customer, or payment by Quality Engines Direct Ltd to a supplier.

Quality Engines Direct Ltd renovated and restored road vehicle engines, operating from a garage in Oldham. Its shareholders are Mr Rafiq (with 25 shares), Mr Rafiq's father (with 75 shares) and Mr Rafiq's mother (with the remaining 75 shares).

HMRC interviewed Mr Rafiq and became aware of two invoices to Microring Limited for what was said to be silver “scrap bars”. The first invoice was dated 5 February 2016 and was in the gross sum of £177,660. The second invoice was dated 26 February 2016 and was in the gross sum of £182,714.

Mr Rafiq said that Quality Engines Direct Ltd did not trade in silver. He explained that he was selling the business and had been approached by somebody called Mr Healey who offered to purchase the shell company for £5,000. Mr Healey immediately treated Quality Engines Direct Ltd as his own and made payments into Quality Engines Direct Ltd’s bank account through a company called Microring Limited.

Quality Engines Direct Ltd’s bank account revealed the following transactions:

- Credit on 5 February 2016 from Microring of £177,600.
- Debit on 8 February 2016 to Progress-Consul 7 of £175,417.40.
- Credit on 26 February 2016 from Microring of £182,714.40.
- Debit on 1 March 2016 to Progress in the sum of £180,000.

In early February 2016, two heavy crates arrived at Quality Engines Direct Ltd’s premises. These were unsolicited and so Quality Engines Direct Ltd’s did not sign for them. Mr Healey subsequently rang to ask if the loads had arrived. Mr Rafiq said that he was not accepting them for Mr Healey and required them to be removed. They were then removed. HMRC did not accept these explanations and concluded that the silver was supplied by Quality Engines Direct Ltd.

Quality Engines Direct Ltd appealed.

Decision

The Tribunal accept that the Invoices were not genuine as they were wholly different to the company’s genuine invoices. The use of a different email address and logo were particularly striking.

They accepted that the Silver arrived unsolicited, that he told Mr Healey to remove it and that he said that he could not use the company in this way. They also accepted that the movements in Quality Engines Direct Ltd ‘s account represented Mr Healey using Quality Engines Direct Ltd for his own purposes. The Tribunal were concerned that Mr Rafiq was repaying the funds to a party he had never heard of, without satisfying himself as to whether or not there was a risk of involving himself or Quality Engines Direct Ltd in money laundering or other fraudulent activities. They concluded that it was sufficient that, whatever the true purpose of these receipts and payments were, they did not represent payment to Quality Engines Direct Ltd from a customer, or payment by Quality Engines Direct Ltd to a supplier, in respect of the Silver.

The Tribunal held that Quality Engines Direct Ltd did not make supplies of the Silver.

The appeal was allowed.

Quality Engines Direct Ltd (TC06403)

Hot takeaway food

Summary – Food kept in a bain-marie maintaining its temperature at 56°C was hot food and so standard rated for VAT.

Pegasus (Manchester) Ltd sells produces and sells takeaway food from an outlet in the Arndale market in Manchester, providing African and Caribbean cuisine such as rice, wraps and curries which it describes as “healthy foods, freshly prepared”, in a retail unit in the Arndale market. The food is prepared on-site, in a kitchen in the market on a floor below the retail unit from with the food is sold. Food is prepared from 6am in the morning and, each morning, a single batch of food is prepared for sale. During preparation, the food is cooked to 99-100C. The food is edible once cooked. Having been prepared, the food is cooled in the kitchen, in the pans in which it was cooked, using a fan to accelerate the cooling process. Once the food has been cooled to approximately 19-20°C, it is placed into gastronorms, which are containers designed to fit into the bain-marie used in the retail unit. Temperature checks of the food are taken in the kitchen. At 11am, when the retail unit opens, the gastronorms are taken up to the retail unit and placed in a bain-marie, which is a water-based container powered by electricity and kept at 56°C. The company claimed that the intention of the business is not to sell hot food because the nature of the food sold is such that it does not taste good when hot. Instead the intention is to sell healthy food that is freshly prepared.

HMRC submitted that, as the cooked food is kept in a bain-marie with a constant temperature of 56°C, the food is hot as it will be at a temperature above ambient room temperature, and kept hot as it is stored in an environment which provides, applies or retains heat.

Decision

The First Tier Tribunal found that the company’s purpose in heating the food could not be to comply with the relevant food safety legislation as this legislation required heating to 63°C and they only heated to 56°C to prevent the food drying out. As no other reason was given for the food being heated, the Tribunal concluded that the food’s temperature was raised to the ambient temperature from 19-20°C by being kept at the ambient temperature for at least one hour after cooling to 19-20C and then heated using the bain-marie to 56°C. The food therefore was clearly kept above the ambient temperature (ie: hot) after its temperature had risen above the ambient temperature (ie: been heated).

They found that the food was hot as defined in the relevant legislation when it was supplied to the customer and that the food had been heated for the purposes of enabling it to be consumed hot and also that the food is kept hot after being heated, so that the supply of the cooked food is a standard-rated supply for VAT purposes.

The appeal was dismissed.

Pegasus (Manchester) Ltd v HMRC (TC06382)

Cross border services - Place of supply of services (Lecture B1074 – 29.17 minutes)

There are two general rules that will apply unless one of the exceptions covered later applies:

1. If a UK business is selling a service to an overseas business customer (B2B sale) then no UK VAT is charged because the place of supply (country where VAT is payable) is where the customer belongs. If the customer is established in more than one country, it belongs in the country of the establishment most closely connected to the supply. Often this is the establishment the supplier contracts with unless the actual scope of work is agreed and controlled by a different establishment.

This principle applies irrespective of whether the customer is in the EU or otherwise.

If the customer is in the EU, and assuming the service in question is 'taxable' in that country, then the customer will deal with the VAT on its own return by doing a reverse charge calculation if it is VAT registered.

If the customer is not VAT registered, the supplier may well be obligated to register in that country and charge the customer the local rate of VAT.

2. If a UK business is selling a service to a customer who is not in business (B2C) then the place of supply is the UK and we charge the same rate of VAT on our invoice to the customer as we would if we were invoicing someone in the UK. A non-business customer belongs where they are normally resident or where their permanent address is located.

Supplies of services – exceptions to the general rule

There are 3 sets of exceptions. The first applies irrespective of the type of customer, the second only applies if the supply is to a business customer and the third only applies if the supply is to a non-business customer.

1. If a client makes a supply to a foreign customer, you need to identify firstly if it is to a business or non-business customer.

2. If it is to a business customer, look through lists 1 and 2 only. If the supply is listed, use the rule in the list, if not use the general rule.

3. If the supply is to a non-business customer, look at lists 1 and 3 only. If the supply is listed, use the rule in the list, if not use the general rule.

List 1- Exceptions to general rule – all services, irrespective of customer

<u>Services relating to land</u>

The following supplies are treated as made in the country in which the land is situated

(a) the grant, assignment or surrender of any interest in or right over land,

(b) the grant, assignment or surrender of a personal right to call for or be granted any interest in or right over land,

(c) the grant, assignment or surrender of a licence to occupy land or any other contractual right exercisable over or in relation to land (including the provision of holiday accommodation (including beach huts, chalets, caravan, houseboat or tent held out as holiday accommodation or suitable for holiday or leisure use), seasonal pitches for caravans and facilities at caravan parks for persons for whom such pitches are provided and pitches for tents and camping facilities)

(d) the provision in an hotel, inn, boarding house or similar establishment (whether with or without the provision of facilities) of sleeping accommodation or of accommodation in rooms which are provided in conjunction with sleeping accommodation or for the purpose of a supply of catering,

(e) any works of construction, demolition, conversion, reconstruction, alteration, enlargement, repair or maintenance of a building or civil engineering work, and

(f) services such as are supplied by estate agents, auctioneers, architects, surveyors, engineers and others involved in matters relating to land.

Passenger transport

The transport of passengers (or luggage and motor vehicles accompanying passengers) is treated as being made in the country where the transportation takes place and in the case of more than one country, in proportion to the distances covered in each. However, transport which takes place outside the territorial jurisdiction of a country takes place wholly in that country if:

- it takes place in the course of a journey between two points in the country (whether or not as part of a longer journey involving travel to or from another country), and

- the means of transport used does not stop (except in emergency) or put into land in another country in the course of that journey.

A pleasure cruise is regarded as transport of passengers and all services provided as part of the cruise follow the place of supply rules given here. This includes a cruise wholly or partly for education or training.

Short term hiring means of transport

The short term hire of a means of transport is to be treated as made in the country where the transport is put at the disposal of the customer.

Short term is a continuous period not exceeding 30 days, unless the transport is a vessel, in which case 90 days.

Where such a supply is effectively made in the UK but the services are to any extent effectively used and enjoyed in a country that is not a member state, then the supply is treated as made to that extent in that other country. Similarly, where such a supply would be treated as made in a country that is not a member state, but the supply is to any extent effectively used and enjoyed in the UK then the supply is treated as made to that extent in the UK.

Restaurant and catering services

Supplies of restaurant and catering services, other than EC on-board restaurant and catering services (see below) are made in the place where they are physically carried out.

EC on-board restaurant and catering services

The provision of restaurant or catering services on board a ship, train or aircraft in connection with the transportation of passengers during an intra EC journey is treated as made in the country where the relevant point of departure (that is the first place in the journey at which passengers can embark) is located.

An intra EC journey is more formally referred to as an "intra EC passenger transport operation" which starts and ends in EC member states, and does not stop in a place outside the EC for embarkation or disembarkation.

A return stage of a return passenger transport operation is regarded as a separate passenger transport operation. A return operation is one that takes place in more than one country but is expected to end in the country in which it began, and the return stage is the stage which ends in the final destination and begins with the last stop in a place at which there has not been a previous stop during the operation.

Hiring of goods

Hiring of goods other than means of transport is covered by the basic rule. However, if a supply is treated as made in the UK, but the goods are to any extent effectively used and enjoyed in a country that is not a member state then the supply takes place to that extent in that country.

Similarly, if the supply is treated as made in a non EC state, but the goods are to any extent effectively used and enjoyed in the UK then the supply is treated as made in the UK to that extent.

List 2 - Exceptions for supplies made to a relevant business person

Some supplies have separate rules for when they are made to a relevant business person.

When made to any other person they fall under the normal rules.

Electronically supplied services

This place of supply rule has an effective use and enjoyment adjustment as described above.

The services affected are :

(a) website supply, web-hosting and distance maintenance of programmes and equipment,

(b) the supply of software and the updating of software,

(c) the supply of images, text and information, and the making available of databases,

(d) the supply of music, films and games (including games of chance and gambling games),

(e) the supply of political, cultural, artistic, sporting, scientific, educational or entertainment broadcasts (including broadcasts of events), and

(f) the supply of distance teaching

List 3 - Exceptions for supplies made other than to relevant business persons

Intermediaries

A supply of intermediary services is treated as made in the same country as the supply to which it relates. Supplies affected by this rule are supplies to persons who are not relevant business persons consisting of the making of arrangements for a supply by or to another person or of any other activity intended to facilitate the making of a supply.

Transport of goods

The supply of transport of goods to a person who is not a relevant business person is treated as made in the country in which the transportation takes place, or if in two countries, in proportion to the distances travelled in each. If a journey takes place partly outside the territorial jurisdiction of a country takes place wholly in that country if:

- it takes place in the course of a journey between two points in the country (whether or not as part of a longer journey involving travel to or from another country), and

- the means of transport used does not stop (except in emergency) or put into land in another country in the course of that journey.

This rule does not apply to the transport of goods between two member states (see below).

Intra- community transport of goods

A supply of the transport of goods from one member state to another to a person who is not a relevant business person is treated as made in the country where the transportation begins.

Ancillary transport services

When made to a person who is not a relevant business person, these services are supplied where the service is physically performed. Services covered by this rule include loading, unloading, handling and similar activities.

Valuation services

These services are treated as supplied where physically performed, when supplied to a non-business customer. This includes the valuation of goods and the carrying out of work on goods.

Electronic services

The supply by a person who belongs in a country which is not a member state (other than the Isle of Man which is treated as part of the UK for VAT purposes) of electronically supplied services (as defined above in list 2) to a person who is not a relevant business person, but belongs in a member state is treated as made in the country where the recipient belongs.

Cultural, artistic, sporting and scientific services

Services relating to cultural, artistic, sporting, scientific, educational, entertainment or similar activities (including fairs and exhibitions) and ancillary services relating to such activities, including services of organisers of such activities – supplied where activity takes place

Long term car hire

Car hire exceeding 30 days is treated as made where the customer belongs.

There is no special rule for B2B long-term car hire, so this follows the general rule for B2B supplies and therefore is also treated as made where the customer belongs.

Exception for certain services to non-business customers located outside EU

Some services supplied to non-business customers outside the EU are supplied where the customer is located:

- transfers and assignments of copyright, patents, licences, trademarks;
- the acceptance of any obligation to refrain from pursuing or exercising (in whole or in part) any business activity or any rights within the above paragraph;
- advertising services;
- services of consultants, engineers, consultancy bureaux, lawyers, accountants and similar services; data processing and provision of information (excluding any services relating to land);
- banking, financial and insurance services (including reinsurance), other than the provision of safe deposit facilities;
- the provision of access to, and of transport or transmission through, natural gas and electricity distributions systems and the provision of other directly linked services;
- the supply of staff;

- the letting on hire of goods other than means of transport;
- radio and television broadcasting services; and
- electronically supplied services.

Note – in the case of the final four 'bullet point' categories, a UK VAT charge would still apply if an overseas resident was 'enjoying' the services in the UK.

Example – an American tourist hiring a camera to use on his UK holiday. Equally, a UK VAT charge would not apply if a UK resident acquired the service in question from a UK supplier but with the intention of 'enjoying' the service outside the EU.

Example – accountancy services

A UK VAT-registered accountant prepares UK income tax returns for two clients. One is based in Annemasse, France and the other just across the border in Geneva, Switzerland.

Neither client is VAT-registered in their respective countries.

On which of these invoices (if any) should the accountant charge UK VAT?

The supplies are to non-business customers. The customer in France should be charged UK VAT at 20% as they are in the EU.

The supply to the customer in Switzerland is treated as made where the customer is located (based on the exceptions above). It is outside the scope of UK VAT, but the accountant will need to get advice on whether there is an obligation to register in Switzerland and to charge the client Swiss VAT.

Example – car hire

One of your clients runs a car hire business. They rent to businesses and individuals.

A French family enquires by email about renting a car for the Summer holidays (6 weeks) which they will pick up in Greater London, drive around the UK (and possible take it to Eire) then drive back to Greater London to return it before heading back to France.

Where does this supply take place for VAT purposes? Because this is long-term car hire (more than 30 days) it takes place where the customer belongs (i.e. France).

The client would need to register in France (if not already registered there) and charge the client French VAT at the appropriate rate. They may feel that the compliance cost of doing this will outweigh the benefit of accepting the business from this customer.

Contributed by Malcolm Greenbaum

Cross-border services – reverse charge (Lecture B1075 – 16.11 minutes)

Services – some basic principles

VAT is chargeable in the country where the supply takes place for VAT purposes. The only question is whether the supplier charges it directly, or whether the customer accounts for it locally (i.e. using reverse charge).

There are a number of possibilities.

1. If both supplier and customer are in the UK and the supply takes place in the UK for VAT purposes, the supplier charges the customer VAT in the normal way

If the supply takes place in a different country for VAT purposes (i.e. under a special rule), VAT would be accounted for in that country. If the customer has a business or fixed establishment in that country, it would have to account for the VAT under reverse charge.

If not, the supplier would have to register in the foreign country and charge the customer the foreign VAT.

2. If the supplier is in the UK but the customer is outside the UK, then if the place of the supply is the UK, the supplier must charge UK VAT.

If the supply takes place where the customer belongs, if the customer is a business customer, it must account for the VAT under the reverse charge. The supplier has no foreign VAT obligation in this situation. If the customer is not a business customer, the supplier must register for VAT in the country where the supply takes place and charge the customer appropriately.

If the service is electronic, or is a telecommunication or broadcasting service, the supplier can register with HMRC for its Mini One-Stop Shop (MOSS) service and file a special return to account for the foreign VAT with HMRC which will then pay the foreign tax authorities.

3. If the supplier is outside the UK (either inside or outside the EU, it does not matter) and the customer is a business customer in the UK and the place of supply is the UK, the customer must account for the VAT under the reverse charge procedure.

If VAT registered, the customer accounts for output VAT in Box 1 and then recovers this as appropriate in Box 4.

If not VAT-registered, the value of the services received count as turnover in calculating if the customer turnover has exceeded the registration limit. If it requires the customer to register then VAT will be reported on later supplies received after registration as above.

If the supplier is outside the UK and the customer is not a business customer then the supplier must register in the UK and charge the VAT if the place of supply is the UK.

These rules apply the same way across the EU so, for example, if you or your client supplies services where the place of supply is another EU country, and the customer is not a business customer in that country, you/your client must register for VAT (there isn’t usually a turnover threshold in this situation) and charge the customer the appropriate amount of VAT in that country.

Example – B2B supply

A UK-based VAT registered management consultant raises a sales invoice to a Germany company for work carried out from its UK offices.

The sale is outside the scope of VAT – the place of supply is Germany. The supplier records the sale in Box 6 of its VAT return (outputs) and also includes it on a quarterly EC Sales List (calendar quarter basis).

If it is VAT registered, the German customer will apply the reverse charge and declare output tax (value of invoice multiplied by German rate of VAT i.e. 19%) and claim the same amount back as input tax assuming the business is not exempt or partly exempt and the service is not partly used for non-business or private purposes.

The customer also records the net amount of the invoice in both Box 6 and Box 7 (outputs and inputs) but nothing is entered in Boxes 8 and 9 because the sale is for services and not goods.

If the German company was not VAT registered in Germany, the supply is still B2B and the reverse charge would still apply. The German company would add the value of the service to its own taxable supplies to see if this pushed it over the VAT registration limit in Germany which would require it to register there.

Example – B2C supply

The management consultant from the previous example completes some work for a charity in, say, Italy that does not make business supplies and is not VAT registered.

This is a B2C sale covered by the general rule, so the supplier charges 20% UK VAT to the customer, even though the charity is based outside the UK.

Rationale for reverse charge

Cross-border reverse charging was introduced to try to create a level playing field between using domestic or foreign service-providers.

If a business could not recover all the VAT it was charged, it might be tempted to use a foreign supplier that would charge it a smaller rate of VAT than a domestic supplier.

Reverse charging the supply means that the same rate of VAT would apply (to a VAT registered customer) irrespective of where the supplier was located.

Example

A partially exempt business with an input recovery rate of 60% has received two tenders for professional services which will be performed in the UK:

1. From a UK supplier, who will charge £10,000 plus 20% VAT;

2. From a supplier in Luxembourg who will charge £10,000 but will not charge VAT.

If the business used the UK supplier it would be charged £12,000 in total, but would recover (60% x £2,000) £1,200 VAT, giving a net cost of £10,800.

If it used the Luxembourg based supplier, it would be charged £10,000 but would then have to account for £2,000 output VAT in box 1 of its VAT return. It would only be able to recover £1,200 input VAT in box 4, and so would pay HMRC £800 of net VAT, making its total cost £10,800 – the same as if it used the UK supplier.

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