Tolley®CPD

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Personal tax

TV personality loses IR35 appeal (Lecture P1311 – 14.54 minutes)

Summary – A former footballer provided punditry services to Sky through his personal service company in such a way that if the services were provided under a contract directly between the footballer and Sky, he would be regarded as an employee of Sky.

McCann Media Limited is the personal service company of Neil McCann, a former Scottish Premiership footballer. After retiring as a player, he moved into punditry, providing services to British Sky Broadcasting Ltd (Sky) through this company. Neil McCann was the only person who provided services on behalf of McCann Media Limited under the Sky Contracts

Concluding that the arrangements fell foul of IR35, HMRC issued various determinations and notices to McCann Media Limited for some £210,000 in respect of the tax years 2013/14 to 2017/18 in relation to PAYE and NICs.

The company has appealed.

Decision

The First Tier Tribunal started by considering the contracts that existed between Sky and McCann Media Limited. These were standard contracts with no bespoke terms. Under these contracts, services were provided by Neil McCann. There was a clause stating that there was a right to propose "other employees or sub-contractors" to perform the services but Sky had the right to assess their suitability. The contract included restrictive covenants preventing services being provided to other television, radio, media, print and betting organisations. The contract also included non-solicitation and non-compete clauses.

The Tribunal moved on to consider the 'hypothetical' contract between Sky and Neil McCann and whether, by removing the personal service company, there would have been a contract of employment. The Tribunal found that such a hypothetical contract would include the actual Sky contracts as well as a Non-Disclosure Agreement signed by Neil McCann.

The Tribunal concluded that the required level of mutuality of obligation existed. Under the contracts, Neil McCann was entitled to an agreed annual fee, payable monthly irrespective of the amount of work actually requested by Sky or agreed to by Mr McCann. It was not significant that Sky did not have an absolute right to dictate the dates on which Neil McCann agreed to work.

Secondly, the Tribunal concluded that Sky did have a sufficient degree of control. For each game, Sky selected which pundits to use from their pool of experts and determined the roles to be performed within their agreed format. Although Neil McCann provided his own expertise, this was considered a neutral factor.

Looking at the bigger picture, the Tribunal concluded that Neil McCann was not in business on his own account. He did not provide his own equipment, he experienced minimal risk with no opportunity to profit. This was very different to the Adrian Chiles case. Neil McCann had no management agent to whom he paid a percentage of revenue, had no personal assistant, had no other clients and had little control over the work that he performed.

The Tribunal concluded that a hypothetical contract would be consistent with a contract of employment.

The appeal was dismissed.

McCann Media Limited v HMRC (TC 08435/V)

COVID-19 diagnostic tests

Under general rules:

- employees would be subject to income tax on the cash equivalent of employer-provided coronavirus tests, with employers are subject to Class 1A NICs; and

- employer-reimbursed coronavirus diagnostic tests would be subject to income tax for employees and Class 1 NICs for both employers and employees.

For 2020/2021 and 2021/22, the government introduced an income tax exemption and NICs disregard for such tests. These are now being extended to cover 2022/23.

To be eligible for the exemptions and disregards, a relevant coronavirus diagnostic test is defined as a test which can detect the presence of a viral antigen or viral ribonucleic acid specific to severe acute respiratory syndrome coronavirus 2 (SARS-CoV-2) and does not include antibody tests.

https://www.gov.uk/government/publications/income-tax-exemption-and-national-insurance-contributions-disregard-for-employer-provided-and-employer-reimbursed-covid-19-diagnostic-tests-measure-n

Termination was the trigger **(Lecture P1311 – 14.54 minutes)**

Summary – A settlement payment made by a bank to a former employee was taxable as a termination payment, and not a non-taxable payment relating to a discrimination claim.

Following an investigation by the bank regulator, looking into the manipulation of interbank offered rates, DB Group Services (UK) Limited entered into a negotiated settlement under which it was required to pay a penalty of £600 million and terminate the contracts of several employees, including Shivani Mathur.

On 30 April 2015, she received a letter terminating her contract and requiring her to sign a settlement agreement under which she was offered £82,135 in return “for the termination of” her contract.

Shivani Mathur took her case to the Employment Tribunal, finally reaching an agreement under which but she received £6 million. Not prepared to accept any risk in relation to the tax position of the Settlement Payment, her employer applied PAYE to all but £30,000, paying over £2,677,460 to HMRC.

Shivani Mathur sought repayment of the PAYE deducted in her tax return.

On 30 January 2020, following an enquiry into that return, HMRC issued a final closure notice in which the HMRC officer amended her tax return in line with his decision, which was:

> "The payment of £6,000,000 you received following the termination of your employment with the Bank is chargeable under s401 ITEPA 2003 except for an element of £44,000 which I can accept as being in relation to your discrimination claims during employment and therefore unrelated to the termination."

The £44,000 was allowed because that was the top of the upper band for the most serious cases for Employment Tribunal awards relating to injury to feelings.

Shivani Mathur appealed, arguing that the payment was unrelated to her employment being terminated. Rather, the payment arose from negotiations relating to the discrimination and victimisation she had experienced while employed. She argued that her employer agreed to the settlement so as to avoid bad press.

Decision

The First Tier Tribunal found that the settlement payment was not received in consideration of the termination, nor was it received directly in consequence of the termination.

However, the payment was received *indirectly* in consequence of, or otherwise in connection with, the termination. Her termination was what triggered her claim to the Employment Tribunal and was the reason that she was able to negotiate so successfully. While employed, Shivani Mathur had been reluctant to take any formal action against the bank for discrimination. It was the termination that convinced her otherwise.

Consequently, the First Tier Tribunal agreed with HMRC. The settlement agreement referred to termination payments which, with the exception of the £30,000 and exempt legal cost, was chargeable to income tax as employment income in accordance with under s.403 ITEPA 2003.

Shivani Mathur v HMRC (TC 08419/V)

Oppenheimer wins residency battle **(Lecture P1311 – 14.54 minutes)**

Summary – A taxpayer was treaty-resident in the Republic of South Africa as the centre of his personal and economic relations were located there.

Jonathan Oppenheimer is a fourth generation South African, born in Johannesburg. His great-grand father established the De Beers diamond mining company, now known as Anglo American plc, whose headquarters are in the UK.

He was educated in England and at the age of 18, his parents bought him a London flat, held in trust. He travelled in America, where he met his future wife, returned to South Africa for National Service and then in 1993, moved to London to undertake an internship with Rothschild Bank.

In 1994, he married and the couple moved into his London flat. He worked for De Beers in London for a year before moving initially to Zimbabwe and then on to South Africa where they lived in a house that they had constructed.

The couple had three children, all born outside the UK. Having decided to educate their children in the UK, in 2007 the couple moved to England, acquiring a substantial home to live in while retaining the South African home. They spent their time between these two properties as well as other properties that they owned in the US.

Jonathan played sports in various countries and belonged to clubs in both South Africa and England. He voted in South Africa, and not England. His main doctor and dentist where in South Africa. He provided details of where he worked as well as a summary of day counts as he moved between countries.

Believing that Jonathan Oppenheimer was UK tax resident, HMRC sought to recover some £10 million in tax relating to the period between 2010/11 and 2016/17.

Jonathan Oppenheimer accepted that he was resident and ordinarily resident in the UK for some years and under the statutory residence test for the years from 2014/15. However, he claimed that he was also resident in South Africa and maintained a permanent home there. He argued that under the UK's tax treaty with South Africa, he should be treated as tax resident in South Africa

Decision

To be treated as treaty-resident in a country, the First Tier Tribunal needed to decide whether Jonathan Oppenheimer's personal and economic relations, were in South Africa or the UK. If the 'centre of his vital interests' could not be determined, there was a 'tiebreaker' issue to deal with that took into account his nationality and 'habitual abodes'.

Having considered a vast amount of information covering all aspects of Jonathan Oppenheimer's way of life, his employment, investments and movement around the world, the First Tier Tribunal found that his 'centre of vital interests' was more likely to be South Africa than the UK. Although he spent significant amounts of time in the UK because of schooling, and in the US because of his wife, he could and did return to South Africa for 'important meetings and other matters including family, business, philanthropic, political and social activities. It was a normal, regular and important part of his life.'

Further, if the tie-breaker clause was applied, his stays in both South Africa and the UK were both 'part of the settled routine of his life and were of sufficient frequency, duration and regularity' to constitute having 'habitual abodes' in both countries. Consequently, as a South African national, he was deemed treaty-resident in South Africa.

Jonathan Oppenheimer's appeal was upheld.

Jonathan Oppenheimer v HMRC (TC08443/V)

Gift aid **(Lecture P1312 – 16.42 minutes)**

Gift aid is the term given to the relief available to individuals in respect of qualifying donations to a charity or other body treated as a charity. Bodies treated as charities include the Trustees of the National Heritage Memorial Fund, English Heritage, The National Endowment for Science, Technology and the Arts and Community Amateur Sports clubs (although for the latter membership fees cannot be qualifying donations).

Points to note about gift aid:

- There is no minimum or maximum size of donation;
- No requirement that donations be recurring;
- The person making the payment must make a gift aid declaration;
- Gift aid only applies to gifts of money and does not cover things like release of loans. There is a relief which applies for gifts of shares, securities and land. A special option relates to donations of assets via charity shops under the retail Gift Aid scheme;
- There are anti-avoidance provisions which provide for the removal or withdrawal of the income tax relief on donations which are 'tainted donations'.

Basic process

The following steps cover how the gift aid process works in basic terms:

- The donor makes a voluntary donation and completes a gift aid declaration;
- The charity receives the money, puts in a claim for gift aid from HMRC and receives gift aid back representing 25% of the net donation;
- If the donor is a higher rate taxpayer, they can claim higher rate tax relief and this operates by way of extension of the basic rate band.

A donor may elect to treat a qualifying donation as having been made in the previous tax year. This election has to be made on or before the submission of the self-assessment return for that previous year and, in any event, by 31 January following that year. This effectively limits carry-back to donations made between 6 April and 31 January because even if no self-assessment return is submitted, the time-limit is still the same.

If the donor's tax income tax and capital gains tax liability for the year is less than the total tax deemed to have been deducted from qualifying donations, the donor's entitlement to certain personal reliefs is restricted as much as is necessary to increase the liability so that it equals the deemed tax deductions.

Those reliefs are:

- personal allowance;
- married couples' allowance;
- blind persons' allowance; and
- relief for payments to trade unions.

If the tax liability falls short, even after making such restrictions, then an assessment will be issued on the donor to collect the shortfall.

A donation to charity is a qualifying donation if:

- It is a payment of money;
- It is not subject to any condition as to repayment;
- It is not made under a payroll deduction scheme;
- It is not deductible in calculating the individual's income from any source;
- It is not conditional on, or connected with, the charity's acquisition of property from the individual or a person connected with the individual;
- It is not by way of waiver of the individual's entitlement to sums due to the individual from the charity in respect of an amount advanced to the charity and in respect of which the donor has obtained social investment tax relief;
- No benefits are associated with the donation other than those within the de minimis limits;
- A gift aid declaration is given.

It is important to note that from 6 April 2017, the condition that a gift aid declaration must be given by the individual is relaxed to allow gift aid declarations to be made by intermediaries acting on behalf of either the donor or the charity. This allows independent fund raisers to work more effectively.

Gift aid can only be claimed on donations, and one area where HMRC are looking very closely at this is fundraising. Ticket and other associated sales do not qualify. A 'required' donation is not a donation and HMRC are not happy with 'minimum' donations either. A 'suggested' donation might be a donation but it depends on expectation. There must be absolutely no obligation to make a donation, without impact if no donation is forthcoming, and HMRC may want to look at the evidence to support this contention. Split treatment may work, so £x entry fee with optional donation above this.

Linked to this, a qualifying donation must not have the result that the donor or any person connected with him receives any benefit which exceeds specified limits. This prohibition on benefits is not limited to benefits provided by the charity concerned. In *St Dunstan's v Major (HMIT)* (1997) Sp C 127, a bequest of a sum of money to a charity as a result of the variation of a deceased's will was held not to be a qualifying donation for Gift Aid purposes because, as a consequence of that bequest, there was a benefit in the form of a saving in inheritance tax.

Two limits are specified; a variable one and an absolute one. If either one is breached the donation will not qualify. These limits are:

1. (the variable limit) the total value of the benefits associated with the donation (if made on or after 6 April 2019) must not exceed:
   - 25% of the amount of the donation (where the donation is £100 or less); or
   - £25 plus five per cent of the excess over £100.

2. (the absolute limit) the total value of the benefits associated with the gift and any associated with previous qualifying donations made by the donor to the same charity in that tax year, must not exceed £2,500

For gifts made before 6 April 2019, the variable limits were 25% of the donation (for donations of £100 or less); £25 for donations between £100 and £1,000; and 5% of the donation in other cases. The absolute limits have remained unchanged.

To prevent exploitation of these limits by receiving benefits of less than £2,500 for a period of less than a year, the benefits received may be annualised for these purposes. Where:

- a benefit associated with a donation relates to a period of less than 12 months;
- a benefit consists of a right to receive benefits at intervals over a period of less than 12 months; or
- the benefit is one of a series of benefits received at intervals and associated with a series of donations made at intervals of less than 12 months,

both the value of the benefit and the amount of the gift are to be taken to be the 'annual equivalent' of their actual value or amount for purpose of applying the limits

In addition, where a single benefit, i.e. one which is not one of a series, is associated with a donation which is one of a series of donations made at intervals of less than 12 months, the amount of the donation is also to be taken as the 'annual equivalent' of its actual amount for these purposes.

How is this benefit valued? If it is something which is sold on the open market, then HMRC are going to look at the sale price to non-members or the value of a discount where applicable. HMRC do accept some items have nil value such as voting rights, literature, priority bookings, token items, acknowledgements. Specific events may be harder to value but often there will be a value due to the same provision being made to third parties.

Issues arise with value of benefits where there are charity auctions since HMRC believe that where the retail value of an item bought in a charity auction exceeds the benefit limits, you cannot claim gift aid. It may be possible to split the donor's payment to be split between an amount to 'buy' the item and a donation amount (with the latter then qualifying for gift aid) but then the value of the item must be made clear to bidders before each item is sold. If an item is not commercially available or unique, the benefit for gift aid purposes is the amount it fetches in the auction.

For the purposes of determining whether benefits associated with a donation are within the limits above, no account is to be taken of benefits which comprise the right to admission to premises and property, to which the public are normally admitted on payment of a fee, where that right is a 'relevant right of admission'. A right of admission, for these purposes, is the right of the donor or members of his family to be admitted to premises or property, which are open to the public on payment of an admission fee, either without payment or at a reduced fee.

Such a right is a 'relevant right of admission' if the following conditions are satisfied:

- the opportunity to make a donation and obtain the right of admission is available to the public generally;

- the admission is granted for the purpose of viewing property which is preserved, maintained, kept or created by the charity for its charitable purposes. The property concerned is not exhaustively defined, but specifically includes buildings, grounds or other land, plants, animals, works of art (but not performances), artefacts and property of a scientific nature and either:
  - the right of admission applies during a period of at least 12 months and at all times when the public can obtain admission (except for up to 5 days per 12-month period when special events are to take place); or
  - members of the public could purchase the same right of admission and the donation is at least more than 10% more than it would cost the public to gain the same rights.

Sponsored challenges cause some issues. All 'sponsorship' payments are eligible for gift aid if the participants pay the cost of the challenge themselves.

Here is an example from HMRC:

> *A donor signs up for a sponsored bike ride in Vietnam which costs £1,500 for flights and support costs. The charity asks the donor to raise £2,500, of which £1,000 goes to the charity.*
>
> *The deposit or registration fee that participants pay in advance of a sponsored challenge is not eligible for Gift Aid.*
>
> *If a sponsor is connected to the participant, their donations only qualify for Gift Aid if the participant pays the full cost of the trip. This ensures that all the sponsorship money raised goes to the charity.*

A 'connected person' is:

- *a wife, husband or civil partner;*
- *a brother, sister, parent or grandchild;*
- *the wife, husband or civil partner of a relative;*
- *a company under the control of the donor, or under control of connected persons.*

HMRC recognises that a charity or CASC are not expected to check whether a participant and their sponsors are connected. However, you should take reasonable steps to ensure that Gift Aid payments are not received from people or companies connected to a participant. You can do this by including an explanation in any event literature and on the sponsorship form.

The retail Gift Aid scheme allows charity shops to sell goods on behalf of donors. Money raised does not automatically qualify for Gift Aid but charities need to explain to owners of donated items that they will act as agent to sell the goods if the owner then gives the sale proceeds to the charity as a gift aid donation. The key issue is that the charity must notify the donor of the value of the goods sale, with template letters being available to enable this. The scheme was relaxed in certain cases so that the letters only have to be issued once the net sales have reached £20 or every three years, whichever comes first.

Volunteers can be reimbursed for the costs they have to incur and once that volunteer is paid, they can pay it back to the charity as a qualifying gift aid payment. You cannot claim gift aid if the volunteer simply chooses not to claim their expenses.

Finally, there can be issues with schools giving access to educational services or facilities on payment of a 'donation' which is not, of course, a donation. If parents or relatives are asked to make 'voluntary contribution' payments to a school or school charity, which are linked to the provision of services or facilities to related pupils, they are not charitable donations. Payments made for the following are not eligible for Gift Aid:

- tuition fees;
- school holidays;
- extra-curricular activities;
- lessons;
- educational trips;
- tickets for a school production.

This is because these payments are not voluntary gifts, and a student receives a benefit paid for by a relative. Donations made to an appeal or for a specific charitable purpose of the school, may be eligible for Gift Aid. Donations must not be linked to the provision of any benefit to a student related to a donor. Donations given for the following will usually qualify for Gift Aid:

- non-uniform days;
- sponsored events;
- building appeals;
- equipment appeals.

Head teachers may not charge parents for any school trip that is part of the national curriculum. However, the head teacher may ask for a voluntary contribution towards a trip. You must not discriminate against the children of parents who do not contribute. Voluntary contributions are eligible if:

- they're non-refundable even if the trip does not go ahead or if their child does not go on the trip;
- any benefit (for example, travel costs, trip insurance, cost of entry) does not exceed maximum levels of allowable benefit for the donation;
- the school tells parents that the contribution is not compulsory.

There is a relaxation of the gift aid provisions where there are small donations of £30 or less under the Gift Aid Small Donations Scheme (GASDS). From 6 April 2017, this can also be used for donations made using contactless technology, such as a contactless credit or debit card. This cannot be used to cover part of a larger gift or for donations where a valid gift aid declaration has been made. The tax relief is the same as for normal gift aid donations.

The charity or CASC does not need to know the identity of the donors or collect Gift Aid declarations. The conditions are that the organisation must:

- have claimed Gift Aid in the same tax year as you want to claim a top-up payment;
- not have incurred a penalty on a Gift Aid or GASDS claim in the current or previous tax year.

The maximum amount of small donations that can be treated in this way is the lower of £8,000 or 10 times the amount received in gift aid donations. Records of the donations must be kept including the denomination of coins and notes, the date the money was collected and confirmation that no individual donation was greater than £30.

It is important to keep the proper records. Charities need to keep records to show how much has been received from each donor who's made a declaration. Charities must keep sufficient records to show that their tax reclaims are accurate. In other words, they must keep records that enable them to show:

- an audit trail linking each donation to an identifiable donor who has given a valid Gift Aid declaration;
- that all the other conditions for the tax relief are satisfied, for example provision of benefits.

If a charity does not keep adequate records it may be required to pay back to HMRC the tax reclaimed, with interest. It may also be liable to a penalty under the Self-Assessment rules.

Gifts of assets

Although gift aid is only due on cash gifts, an individual may also claim an income-tax deduction in respect of gifts to charities of 'qualifying investments'.

Broadly, the relief is available where the individual disposes of the whole of the beneficial interest in the qualifying investment to a charity otherwise than by way of a bargain made at arm's length, either by way of an outright gift or by a sale at an intentional undervalue.

Relief, which has to be claimed, is given by deducting the 'relievable amount' in the calculation of the individual's net income for the tax year in which the disposal is made. This relief for income tax is in addition to the capital gains tax relief for gifts of shares, securities and other assets to charities. No gift aid can be reclaimed by the charity.

A 'qualifying investment' is defined as:

- Shares or securities listed or dealt on a recognised stock exchange;
- Units in an authorised unit trust;
- Shares in an OEIC;
- Interest in an offshore fund;
- Qualifying interests in land.

A qualifying interest in land is a freehold or leasehold interest in UK land or equivalent.

The disposal must be of the whole of the person's beneficial interest in the qualifying investment. This would mean, for example, that a freeholder granting a lease to a charity out of his freehold interest would not have satisfied this condition, as he would still have retained the freehold reversion. However, in this situation, and that of a leaseholder granting a sub-lease, it is to be regarded as the disposal of the whole of a beneficial interest in a qualifying investment, i.e. the leases or sub-lease itself.

In the case of an outright gift, the relievable amount is the value of the benefit to the charity plus the incidental costs borne by the individual donor in making the gift less any benefits received by the donor as a consequence of the disposal. If it is a sale at undervalue, the value is the excess of the value of the benefit to the charity over the consideration given. If the calculation gives a negative value then no relief is available.

The value of the benefit to the charity is measured at the time of the disposal or immediately afterwards, whichever produces the lower value. This value is normally the market value of the qualifying investment, but is replaced by the acquisition value where this is lower than market value in cases where:

- the qualifying investment (or anything from which it is derived) was acquired by the individual disponer within the previous four years;
- that acquisition was made as part of a scheme, arrangement or understanding, (whether enforceable or not); and
- one of the individual's main purposes of entering into the scheme was to obtain this relief or an increased relief.

In cases where relief is claimed on gifts of qualifying interests in land, relief to be withdrawn where a 'disqualifying event' occurs at any time within the 'provisional period' which begins on the date of the disposal to the charity and ends on the fifth anniversary of the normal self-assessment filing date in respect of the tax year in which the gift was made, i.e. five years and ten months after the end of the tax year in which the disposal took place. Where such an event occurs, the donor, and in the case of joint owners of land, each owner who is also an individual is treated as never having been entitled to relief and relief previously granted will be withdrawn by such assessments and adjustments as are necessary.

A disqualifying event occurs if, without giving full consideration in money or money's worth, the donor, or, in the case of jointly-owned land, an owner who is an individual, or a connected person becomes entitled to an interest in all or part of the land or is party to an arrangement where he enjoys some right in relation to all or part of the land. This does not apply if the interest comes via inheritance.

Contributed by Ros Martin

Capital taxes

Disputed CGT proceeds (Lecture P1311 – 14.54 minutes)

Summary - The proceeds to be used in the capital gains tax computation on the disposal of company shares were those stated in the sale and purchase agreement. The debt that was repaid from those proceeds was not deductible.

Michelle McEnroe and Miranda Newman each owned 50% of Kingly Care Partnership Ltd. The company owed just over £1 million to Allied Irish Bank.

During the tax year ended 5 April 2014, Michelle McEnroe and Miranda Newman sold the company with the sale and purchase agreement stating that the consideration for the 100% share ownership was £8 million plus an earn out element.

On the day of the sale, the buyer's solicitors transferred £8 million to their solicitors, who transferred funds to Allied Irish Bank to clear the loan outstanding. The balance of £6.9 million was transferred to the taxpayers' solicitors, who after deducting the professional fees paid £3.3million to each of the taxpayers.

Michelle McEnroe and Miranda Newman submitted their tax returns showing consideration for the shares as 50% of the £6.9 million, rather than the £8 million stated in the contract. They argued that the debt repayment should be deducted from the taxable proceeds.

HMRC enquired into the tax returns, later issuing closure notices stating that the correct consideration to use was 50% of the £8 million (plus the earn outs).

The taxpayers appealed to the First Tier Tribunal, arguing that the buyer had paid £6.9 million for the shares and £1.1 million to repay the bank debt. As they never received the full £8 million, the cash relating to the bank debt was not intended to be treated as consideration for the shares.

The appeals were joined.

Decision

The only issue to resolve was whether the total proceeds on sale of the shares to use in the capital gain tax calculations should be £8 million, or £8 million less the bank debt.

The First Tier Tribunal did not disagree that the buyer paid £6.9 million for the shares and £1.1 million to clear the bank debt.

The First Tier Tribunal found that the full chargeable consideration was £8 million, as specified in the sale and purchase agreement. Although the contract alluded that the debt would be cleared, it did not specify how this was to be done. The contracts did not refer to the £8 million being anything other than consideration for the shares. The contracts were clear.

The taxpayers' appeals were dismissed.

Michelle McEnroe and Miranda Newman v HMRC (TC08444)

Company not acting as agent (Lecture P1311 – 14.54 minutes)

Summary – With no evidence to prove that payments were made by his company on his behalf, enhancement expenditure on building works reflected in the state of the property at sale was not deductible in arriving at his property gain.

Peter Lowe had acquired an interest in a property and in 2007, he sold that interest for £2 million. He held only a 50% interest in the relevant freehold titles, with the other 50% interest being held by Mr Almond, his business partner. Mr Lowe and Mr Almond also owned 50% each of the shares in a company called Hadee Engineering Co Ltd. Peter Lowe sought to deduct expenditure incurred on building works that had been undertaken.

HMRC did not dispute that the amounts had actually been paid; nor did they dispute that the expenditure in question was reflected in the state or nature of the property at the time of disposal. The problem arose because the evidence provided to support the building cost deductions consisted of building quotes addressed largely to Mr Lowe personally, while the invoices issued by the builders were largely addressed to Hadee Engineering Co Ltd.

Peter Lowe argued that the payments made by Hadee Engineering Co Ltd were made on his behalf and so deductible in arriving at his personal gain. He had the legal obligation to pay for them as the works were undertaken for a property belonging to him. He argued that his company had incurred the costs on his behalf and effectively recharged them back to him by through a debit to his Director's Loan Account, or by him receiving less remuneration in the future.

However, HMRC disagreed, challenging that the expenditure incurred by Mr Lowe had not been "incurred by or on behalf of" him by Hadee Engineering Co Ltd, as required by s38(1)(b) TCGA 1992.

Decision

The Upper Tribunal found that there was no evidence that Peter Lowe had suffered the cost of Hadee Engineering Co Ltd's payments. Agreeing with HMRC, the Upper Tribunal found that it was conceptually possible for Hadee to conclude that paying for the costs of building work on land it did not own was in its business and commercial interests. If it reached such a conclusion, it could quite properly pay for the works without declaring a dividend, debiting Mr Lowe's loan account or treating the sum as a payment of remuneration to Mr Lowe

With neither party providing any authority on how the phrase "incurred by or on behalf of" should be interpreted, the Upper Tribunal agreed with the First Tier Tribunal. For the phrase to be met, Hadee Engineering Co Ltd needed to act as Mr Lowe's agent, which it did not.

The appeal was dismissed.

Peter Low and Civic Environmental Systems Ltd v HMRC [2022] UKUT 00084 (TCC)

Normal gifts out of income – using trusts (Lecture P1314 – 19.34 minutes)

The statutory provision

By virtue of S21 IHTA 1984, a transfer of value is an exempt transfer if, or to the extent that, it is shown that:

- it represented part of the transferor's normal expenditure;
- taking one year with another, it was made out of income; and
- the transferor was left with sufficient income to maintain his usual standard of living.

It is up to the transferor to demonstrate that he has satisfied all three conditions in connection with any given transfer.

Normal expenditure

'Normal' is taken to mean habitual and thus requires a pattern of giving to be demonstrated. In relation to this, it can reasonably be argued that the first in a series of life assurance premium payments qualifies. Where there is initially no evidence of any regular commitment, HMRC Inheritance Tax are prepared to accept that expenditure is normal once it has occurred three times – in such circumstances, the first two payments are also retrospectively eligible for relief. However, this view has been modified following the decision of Lightman J in the case of Bennett v CIR (1995), where it was accepted that an elderly lady, whose trust income suddenly enjoyed a considerable increase following the sale by her trustees of some private company shares to a plc, could make a resolution to give the resulting additional trust income to her sons such that this resolution was a qualifying S21 IHTA 1984 gift (even though the elderly lady died just one year after executing the authority). During this 12-month period, the sons received only two payments.

In his judgment, Lightman J said:

> 'In my view, in the context of S21 IHTA 1984, the term "normal expenditure" connotes expenditure which at the time it took place accorded with the settled pattern of expenditure adopted by the transferor.
>
> The existence of the settled pattern may be established in two ways.
>
> 1. An examination of the expenditure by the transferor over a period of time may throw into relief a pattern, e.g. a payment each year of 10% of all income to charity or members of the individual's family or a payment of a fixed sum or a sum rising with inflation as a pension to a former employee.
> 2. The individual may be shown to have assumed a commitment, or adopted a firm resolution, regarding his future expenditure and thereafter complied with it. The commitment may be legal (e.g. a deed of covenant), religious (e.g. a vow to give all earnings beyond the sum needed for subsistence to those in need) or moral (e.g. to support aged parents or invalid relatives). The commitment or resolution need have none of these characteristics, but nonetheless be likewise effective as establishing a pattern, e.g. to pay the annual premiums on a life assurance qualifying policy gifted to a third party or to give a predetermined part of his income to his children.

> For expenditure to be "normal", there is no fixed minimum period during which the expenditure shall have occurred. All that is necessary is that on the totality of evidence the pattern of actual or intended regular payments shall have been established and that the item in question conforms with that pattern. If the prior commitment or resolution can be shown, a single payment implementing the commitment or resolution may be sufficient. On the other hand, if no such commitment or resolution can be shown, a series of payments may be required before the existence of the necessary pattern will emerge. The pattern need not be immutable; it must, however, be established that the pattern was intended to remain in place for more than a nominal period and indeed for a sufficient period (barring unforeseen circumstances) in order for any payment fairly to be regarded as a regular feature of the transferor's annual expenditure. Thus a "death bed" resolution to make periodic payments "for life" and a payment made in accordance with such a determination will not suffice.
>
> The amount of the expenditure need not be fixed in amount nor need the individual recipient be the same. As regards quantum, it is sufficient that a formula or standard has been adopted by application of which the payment (which may be of a fluctuating amount) can be quantified, e.g. 10% of any earnings whatever they may be or the costs of a sick or elderly dependant's residence at a nursing home. As regards the payees, it is sufficient that their general character or the qualification for benefit is established, e.g. members of the family or needy friends.
>
> There is no need . . . for the expenditure to be reasonable or that the expenditure is such that an ordinary person might have incurred in similar circumstances, though the existence or otherwise of this characteristic may be relevant in deciding whether the evidence establishes the necessary pattern. The fact that the objective behind the expenditure is tax planning, e.g. to prevent an accumulation of income in the hands of the transferor liable to IHT on his death, is no impediment.
>
> What is necessary and sufficient is that the evidence should manifest the substantial conformity of each payment with an established pattern of expenditure by the individual concerned – a pattern established by proof of the existence of a prior commitment or resolution or by reference only to a sequence of payments.'

Other matters

The word 'income' is not defined in IHTA 1984, although it does specifically exclude the capital element of a purchased life annuity. Nor would it include receipts of a capital nature. It is generally taken to mean the transferor's disposable income after tax and after all living expenses. In the view of HMRC Inheritance Tax, an individual's income must be determined in accordance with accountancy rather than income tax rules.

One example which can commonly arise of an item taking advantage of the normal expenditure exemption is, as Lightman J points out, where a husband takes out a policy which assures his life for the benefit of his wife or children – with such a policy, the proceeds on maturity do not pass through the estate of the deceased husband whose life was assured and thus do not attract IHT (rather they go directly to the wife or children who are set out in the policy as the beneficiaries).

Although the capital sum in such circumstances cannot be taxed, the husband is deemed, if he pays the premiums, to have made a transfer of value to his wife or children every time that he makes a payment.

However, he will usually be able to establish that the payment does not represent a chargeable transfer because it can be exempted under the normal expenditure out of income provisions. This is obviously of particular importance where the children are the beneficiaries.

There are two further points which should be made in connection with this exemption:

1. The exemption can be used in conjunction with the annual exemption (and not simply instead of it). Thus a transfer of £10,000 to a discretionary trust could be covered as to £4,000 by the normal expenditure exemption and as to £6,000 by the annual exemption for the present tax year and the previous one.

2. The Inheritance Tax Manual makes it clear that, where there is a gift of an asset other than cash, the donor must have bought the property out of his income in order to make the gift. Note that the word 'income' refers to current income and so the S21 IHTA 1984 exemption will not normally apply if the gift is made from a source which, although originally income, has been retained for some time and which has therefore acquired a capital nature. If the retained income has been invested in a form which yields income, it is generally deemed to have become capital. However, the sums may remain income if they were temporarily invested in order to accumulate sufficient funds for a specific future event. Where the gift is made from a current account which includes capital receipts (from the sale of shares, for example), HMRC Inheritance Tax say that they will not normally make further enquiries in order to determine whether the gift was made from income. It is sufficient that it could have been made from income.

In the context of 2. above, it should be noted that the decision in McDowall v CIR (2004) is relevant. A number of gifts to the taxpayer's children were made out of a deposit account which contained substantial surplus income. HMRC Inheritance Tax challenged their right to relief under S21 IHTA 1984 following the death of the donor by arguing that, where the money is transferred from a current account to the taxpayer's deposit account, it lost its character as income. This argument was rejected. The Special Commissioners concluded that the payments were made out of retained income which had remained income in character rather than capital. Their judgment contained the following sentence:

> 'It was identifiably money which was essentially unspent income and which had been placed on deposit but not invested in any more formal sense.'

Do not overlook the important fact that clients who have surplus disposable income can make lifetime gifts of cash to settlements without incurring an entry charge.

Example

Alan has surplus disposable income of at least £500,000 each year after his bonuses are taken into account. He therefore creates a series of discretionary trusts and pays this income into the trusts. Because Alan's transfers are exempt by virtue of S21 IHTA 1984, these gifts do not affect his cumulative lifetime total so that each settlement should have a

full IHT nil rate band. It is assumed that they are not related settlements under S62 IHTA 1984.

It will be sensible to transfer no more than the current nil rate band into each trust so that no exit or 10-year anniversary charges are payable – any interest income can always be stripped out in advance of a 10-year anniversary.

Alan must not be a beneficiary of the trust, given that the gift with reservation (GWR) rules would apply even though the initial transfer was exempt – see Para IHTM14231 of the Inheritance Tax Manual.

Contributed by Robert Jamieson

Additional dwelling supplement repayment refused

Summary – A refund of Additional Dwelling Supplement was denied as the taxpayer had not lived in his initial first property in the 18 months before buying the property in Scotland.

Elvis Mohammed owned a property in England where he lived with his family. His employer required him to move to Brazil where he worked for four years.

When he returned to the UK, he was required to live and work in Scotland. In February 2015, he signed the lease on a property that he then occupied. On 29 March 2019 he bought this property from his landlord and submitted his LBTT tax return. As he owned two properties, he paid Additional Dwelling Supplement on his Scottish property which totalled £14,120.

With his family settled in Scotland, in November 2020 he sold his first property and claimed a repayment of the Additional Dwelling Supplement paid. However, Revenue Scotland refused his claim, stating that the property in England had not been his main residence in the 18 months before buying the property in Scotland.

Decision

The Tribunal sympathised that Elvis Mohammed was not able not live in his English main residence due his work being in Scotland.

However, the wording in legislation was clear and, as he had not satisfied the 18 month rule, his reclaim was denied. Unfortunate as it was, the Tribunal stated that it had no jurisdiction to consider fairness. The fact that his work prevented him living in his English property in the 18 months prior to the purchase of his Scottish property was of no relevance.

The appeal was dismissed.

Mr Elvis Ricardo Anthony Mohammed v Revenue Scotland [2022] FTSTC 4

Administration

Information not reasonably required (Lecture P1311 – 14.54 minutes)

Summary – No useful purpose would be achieved by ordering that HMRC's information notice should be complied with prior to the appeal hearing that had already been made against discovery assessments already issued.

Jack and Panayiota Yerou, a married couple, owned shares in Ascot Sinclair Associates Limited. Jack Yerou was the sole director and his wife was the company secretary.

In July 2012, the wife transferred shares to her father-in-law who was resident in Cyprus.

Between 2013 and 2016, the company paid dividends, with the father-in-law receiving the following amounts:

- 2013 - £460,000;
- 2015 - £210,000;
- 2016 - £240,000.

The majority of these dividends were either used to pay for school fees or returned as a loan to his son, Jack Yerou.

In February 2018, HMRC opened enquiries into the couple's 2016/17 tax return, later issuing information notices to both the husband and wife. HMRC believed that either the transfer of assets abroad or settlements legislation applied.

HMRC issued discovery assessments for each of the years 2013/14 to 2016/17. The couple appealed these discovery assessments.

In 2019, the couple appealed information notices issued, arguing that the information sought was not reasonably required for the purpose of checking their tax position. They argued that HMRC had already had enough information to determine the tax liability as they had issued discovery assessments for the years concerned. Requesting further information was unreasonable.

Decision

The First Tier Tribunal found that it was clear that:

- by raising the discovery assessments, HMRC had already concluded that tax was due;
- the appellants disagreed and have appealed believing no tax was payable;
- HMRC were now seeking to check the taxpayers' tax position, rather than establish whether there had been an understatement.

The issue to decide was whether the information requested was reasonably required to check this tax position.

The Tribunal stated that it seemed very unlikely that the parties would come to any agreement as to their tax position even if the requested information was provided before Tribunal proceedings were substantively underway. Consequently, the Tribunal did not consider that any useful purpose would be achieved by ordering that the information notice be complied with. The information was not reasonably required.

The Tribunal concluded by saying:

> "Whilst it will often be desirable for matters to be resolved without recourse to the Tribunal, the appellants in this case have effectively demonstrated that they do not wish to facilitate an early resolution to the disputes."

Jack George Yerou and Panayiota Yerou v HMRC (TC08410)

Estimated tax geared penalty for non-compliance

Summary – Despite the fact that a penalty should have been tax based, the Upper Tribunal imposed a higher than usual penalty for failure to provide information requested by HMRC.

AML Tax (UK) Limited was incorporated in 2009 as a tax and accountancy practice. The company is part of an informal group of companies based in the Isle of Man known as the Knox Group who acted in relation to certain tax avoidance schemes. The shares in these companies are held by the trustees of various related trusts with the companies sharing the same office in the Isle of Man

HMRC opened enquiries into the company's returns for 2014 and 2015. Despite issuing a Schedule 36 information notice, the company failed to deliver this information and so HMRC issued a fixed failure to comply penalty of £300, followed by daily penalties and a second £300 fixed penalty.

HMRC believed that, as a result of the company's failure to provide the information requested, the amount of tax that the company had paid, or was likely to pay, was significantly less than it would otherwise have been. Consequently, HMRC applied to the Upper Tribunal for a higher tax geared penalty to be imposed under paragraph 50 Schedule 36. HMRC provided evidence that the tax at risk was £1.34 million.

AML Tax (UK) Limited argued that the tax paid was not significantly less than should have been and that the penalty sought was inappropriate.

Decision

The Upper Tribunal rejected the company's arguments that HMRC's belief was unreasonable as there was no logical link between the documents requested by HMRC and the tax argued to be payable. To the contrary, the documents requested were the necessary first step to establishing the facts. The Tribunal concluded that there was no excuse as to why the company had not complied with the request that only made the non-compliance more serious.

There is no limit on the amount of the penalty which may be imposed by the Upper Tribunal but in deciding the amount of the penalty, the Upper Tribunal must know the amount of tax which had not been, or was not likely to be, paid by the company. Due to the lack of information provided, it was difficult to estimate this figure. The Tribunal used the £56,040 daily penalties due as their starting point, taking the view that the amount should be at least £100,000 but could have been up to £4 million. Ultimately the Tribunal set the penalty payable as £150,000.

HMRC v AML Tax UK Limited [2022] UKUT 00081 (TCC)

Overpayment relief (Lecture P1313 – 13.03 minutes)

When a taxpayer has paid insufficient tax, most advisers will understand the situations where HMRC can collect the additional tax. If there is no open enquiry, then it is a question of whether a discovery assessment can be raised and over what period.

The position is not as flexible where there has been an overpayment of tax. There is the possibility of claiming 'overpayment relief' (previously this was called 'error or mistake relief') but it is much more limited in application that the ability of HMRC to collect underpaid tax.

The legislation was amended for claims made on or after 1 April 2010 and is found in Sch.1AB TMA 1970 for income tax and capital gains tax and Para.51 Sch.18 FA1998 for corporation tax.

This applies where a taxpayer has paid tax (and this includes tax under a contract settlement) which he subsequently believes is not due. The taxpayer can make a claim for the tax to be repaid or the assessment (if applicable) to be discharged. The claim must be a standalone claim and cannot be made in a self-assessment return.

The claim must be made within four years of the end of the relevant tax year, which is relatively short deadline. The case of *Lauricella* [2012] TC02218 found that an out of time claim cannot be made. Additionally, the Court of Appeal (in the case of *R&C Commrs v Raftopoulou* [2018] BTC17) found that the provisions of s118(2) TMA1970 did not apply in the case of overpayment relief. This provides that a time limit is not to be treated as missed provided that the taxpayer had a reasonable excuse for missing the deadline and any failure is remedied without unreasonable delay once the reasonable excuse ceases to exist. The reason it does not apply in relation to overpayment relief is because the claim is a voluntary act and not a requirement.

Taxpayers have also tried to claim repayment of tax under common law where the claim has been outside the time limit (most recently in *Wallace v R&C Commrs* [2018] BTC2) but the High Court held that this regime sits in parallel with common law and cannot be superseded by it.

There are a number of circumstances where HMRC are not required to give effect to a claim to overpayment relief.

These are as follows:

- Where the amount paid is excessive by reason of:
    - A mistake in a claim, election or notice;
    - A mistake in making/giving or not making/giving a claim, election or notice;
    - A mistake in allocating expenditure to a pool or in bringing a disposal value into account for capital allowances purposes; or
    - A mistake in making or not making an allocation of expenditure or bringing into account or not bringing into account a disposal value for capital allowances purposes.
- Where the taxpayer can take other action in order to obtain relief
- Where the taxpayer could have taken action but a time-limit has expired and where the taxpayer knew, or ought reasonably to have known that relief was available
- Where the grounds for the claim have already been put to a court or tribunal or to HMRC in appealing against the amount determined by a tribunal
- Where the taxpayer knew, or ought reasonable to have known, of the grounds for the claim before the latest of:
    - the date on which an appeal in the course of which the grounds could have been put forward was determined by a court or tribunal;
    - The date on which the taxpayer withdrew a relevant appeal to a court or tribunal; or
    - The end of the period in which the taxpayer was able to make a relevant appeal to a court or tribunal.
- Where the amount paid, or is to be paid, as a result of proceedings brought by HMRC enforcing the payment or in accordance with an agreement between the taxpayer and HMRC settling such proceedings
- Where the amount paid, or liable to be paid, is excessive by reason of a mistake in calculating the taxpayer's liability to income tax or capital gains (other than a mistake in a PAYE assessment or PAYE calculation) and the liability was calculated in accordance with the practice prevailing at the time.

The final one of these is probably the most controversial. This point was discussed recently in a case involving top slicing relief. This relates to a technical issue with the arguments being led by Tim Good in what amounts to something of a crusade. His view has been that the calculation of top slicing as undertaken by HMRC has been wrong for many years. A case involving Mariana Silver was lost by HMRC in the FTT and the legislation was then changed with effect from 11 March 2020. HMRC have been trying to apply that legislation retrospectively, but his case shows that this is not correct. It is likely the case will be appealed by HMRC but Tim Good is suggesting that advisers review all cases involving top slicing relief and make claims for repayment under the overpayment relief provisions for all

cases which are still in time. It is also likely (in his view) that HMRC will reject such claims on the basis that the HMRC computer was preparing calculations following practice generally prevailing until the decision in the Silver case (which was 19 April 2020). However, he first notified HMRC that their calculation was incorrect on 9 August 2017 so there may need to be further litigation to decide when HMRC's incorrect calculations ceased to be 'practice generally prevailing'.

Special relief

Before 1 April 2011, if a taxpayer had no statutory way of reducing an excessive assessment or displacing a determination because the time limit for submitting a return had passed, HMRC would in some cases be prepared not to recover the full amount due. This practice was known as 'equitable liability'. This was a non-statutory process and so it was a replaced with 'special relief'.

With an excessive assessment, taxpayers may be better to put in a late appeal application if they can argue they had a reasonable excuse for not having appealed within the time limit. However, if HMRC have issued a determination where a taxpayer has not submitted a self-assessment return, there is no right of appeal and the determination can only be superseded by submission of the return. If this is not done in time, the taxpayer is stuck with the figures as assessed unless they can claim special relief.

Special relief applies only to amounts charged in HMRC determinations for income tax self-assessment or corporation tax self-assessment where no other statutory remedy is available. There is no time limit for claiming special relief and the claim is not automatically excluded (as it would be for overpayment relief purposes) if:

- the taxpayer knew, or ought reasonably to have known, that they had some other means of correcting an overpayment or over-assessment, but they failed to use those other means within the relevant time limit, or

- HMRC have already taken court action to recover amounts due under a determination (unless the person was present or was legally represented during the proceedings, or an agreement was reached to settle the proceedings).

The conditions to claim the relief are:

- it would be unconscionable for HMRC to seek to recover the amount which has been charged by a determination, or refuse to repay it if it has already been paid;

- the person's tax affairs are otherwise up to date or satisfactory arrangements have been made to bring them up to date as far as possible; and

- the person has not previously claimed special relief or sought equitable liability, whether or not relief was given (this condition may be disregarded in exceptional circumstances).

The part which is often difficult to understand is whether it would be unconscionable for HMRC to collect the tax. The easiest way to think of this is that there is evidence that the tax is not due and the reason that this was not sorted out before was because the taxpayer was disadvantaged in their dealings with HMRC.

The HMRC guidance on this point gives some circumstances where it may apply:

- the taxpayer was suffering from a temporary or sporadic illness, including mental illness, and consequently find it particularly difficult to engage with the tax system;

- they had not received notices or other communications for reasons outside their control; or

- they are insolvent and pursuing the amount in the determination would be to the detriment of other creditors.

The taxpayer must explain why it would be unconscionable for HMRC to collect that tax and it is not going to apply where someone has just been lax in dealing with things. In practical terms, it is unlikely that it will be shown that HMRC's actions are unconscionable unless it can be clearly proven that the tax payable is excessive but that is not the only test.

In relation to the affairs being up to date, it applies to all taxes and any other issues which HMRC have responsibility for administering and also applies to the affairs of any partnership of which the individual is a member or any company they have controlled. A matter will still be outstanding even if the person has a reasonable excuse for not dealing with it.

It is important to note that penalties for late delivery of a return will remain payable even where the claim is successful, but surcharges and interest will be reduced to reflect the amount of tax due after the relief has been applied.

Contributed by Ros Martin

Penalty mitigation – special reduction **(Lecture P1315 – 12.55 minutes)**

This article will consider the provisions relating to special reduction – the ability to reduce certain penalties, including to below the statutory minimum. When advisers are dealing with a case where there are, or may be, penalties charged by HMRC, advisers should also consider the other sessions on penalty mitigation, as appropriate.

Overview

HMRC may reduce certain penalties if they "think it right because of special circumstances". The concept of special reduction applies to the following penalty regimes:

- FA07/SCH24 - inaccuracy penalties;

- FA08/SCH41 - failure to notify and VAT and Excise wrongdoing penalties;

- FA09/SCH55 - failure to make a return;

- FA09/SCH56 - failure to make payment on time;

- FA 2016/SCH22 - asset-based penalties for offshore inaccuracies and failures.

It is important to note that there is no statutory definition of "special circumstances", although the law outlines certain situations which do not constitute "special circumstances", see below.

Application of the provisions can result in HMRC "staying" a penalty (where HMRC stop or postponement enforcement) or "agreeing a compromise" (foregoing all or part of a penalty). Where a relevant penalty regime, as noted above, applies, HMRC must consider applying a special reduction.

Although, in theory, the special reduction provisions are good news for clients, they are dependent on HMRC's discretion (or a favourable decision at the tribunal). Ultimately, each case must be determined on the facts and circumstances.

What are not special circumstances?

The penalty regimes noted above provide that "special circumstances" do not include the ability to pay, or the fact that a potential loss of revenue from one taxpayer is balanced by a potential over-payment by another.

What is HMRC's view?

HMRC's guidance on this subject is found in the Compliance Handbook (at CH170100 to CH175200). HMRC's view is that special circumstances are either:

- Uncommon or exceptional; or
- Where the strict application of the penalty law produces a result that is contrary to the clear compliance intention of that penalty law.

The guidance notes that any other factors that might remove or reduce the penalty should be considered first. This would include, in a case involving a failure to notify, for example, considering whether there is a reasonable excuse.

HMRC consider that the following do not constitute special circumstances:

- Point covered by some other point of law;
- Items balanced out in other accounting periods;
- Where the behaviour is deliberate;
- Size of penalty;
- Proportionality.

HMRC is less expressive when it comes to stating what might be special circumstances. The guidance provides three examples (at CH 170800) of what might be accepted.

What might be special circumstances?

The HMRC guidance on what might be special circumstances do not greatly assist in considering this matter. Advisers should consider all relevant facts relating to their client's circumstances, which might include the following:

- What caused the inaccuracy?
- What caused the client not to take reasonable care?
- What caused the client to make a disclosure that was prompted rather than unprompted?
- Procedural errors by the client

- Mistakes by HMRC, including failure to follow normal working practices
- Lack of contact from HMRC
- Mental health issues
- Life events

Special reduction at the tribunal

There isn't a right of appeal in relation to a special reduction, but the client's remedy is an appeal against the penalty charged by HMRC, or, as appropriate, the level of that penalty. The appeal can include a hearing at the tribunal, although the tribunal's options are somewhat limited. The tribunal may either affirm HMRC's decision on special reduction, or substitute their decision on special reduction for HMRC's decision (but only if the tribunal considers that HMRC's decision was flawed). In this context, a flawed decision has the same meaning as for judicial review (which might include where HMRC has considered irrelevant facts).

Hardy v HMRC [2011] UKFTT 592 (TC) (careless error)

White v HMRC [2012] UKFTT 364 (TC) (careless error)

Klein [2017] UKFTT 0088 (TC) (late filing penalties)

Practical considerations

Advisers should consider other penalty mitigation options before focusing on special reduction. If it can be established that an error in a return has arisen despite the client taking reasonable care, a penalty will not be charged by HMRC. In such a case it will not be necessary to consider whether there are any special circumstances. Similarly, when it can be established that the error arises from careless behaviour, it would normally be preferable to seek suspension of the penalty, if applicable, before pursuing special circumstances.

Where HMRC do not decide to allow a special reduction, advisers should check that HMRC had at least considered whether special circumstances existed. A special reduction may be possible on appeal, if HMRC has not done so, or does not provide an explanation for its decision. This will depend on the facts of the case.

The adviser should determine all relevant facts relating to the offence leading to the penalty and collate any supporting documentation. Reference should be made to any relevant tribunal decisions, to establish whether there are any similar cases. As each case is determined on its own particulars, consideration of tribunal decisions will only provide an indication of how the tribunal might view your client's position. Advisers should consider seeking specialist advice, including whether to help establish the relevant facts, or in making representations to HMRC.

Contributed by Phil Berwick (Director, Berwick Tax)

Deadlines

1 May 2022

- Corporation tax for periods ended 31 July 2021 for SMEs not paying by instalments
- New VAT fuel scale charges apply

3 May 2022

- Filing date for printed form P46(Car) for quarter ended 5 April 2022

7 May 2022

- Electronic filing and payment of VAT liability for quarter ended 31 March 2022

19 May 2022

- PAYE/NICs/CIS/student loan payments for month to 5 May 2022 (non electronic)
- File monthly construction industry scheme return

21 May 2022

- Monthly EC sales list for a business based in Northern Ireland selling goods
- Supplementary intrastat declarations for April 2022 for arrivals and despatch for a business in Northern Ireland.

22 May 2022

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

31 May 2022

- P60s to employees at 5 April 2022
- Companies House should have received accounts of:
  - private companies with a 31 August 2021 year end
  - public limited companies with a 31 November 2021 year end
- CTSA returns for companies with periods ended 31 May 2021

News

Homes for Ukrainians

On 31 March 2022, the Financial Secretary to the Treasury issued a written statement clarifying how the government will legislate to ensure that sponsorship under the Homes for Ukraine scheme will be tax-free.

Income tax and national insurance

The government will legislate within Finance Bill 2022-23 to ensure that the Homes for Ukraine Sponsorship Payments, made by Local Authorities to sponsors under the Homes for Ukraine Scheme will:

- be exempt from income tax, corporation tax and national insurance;
- will be applied retrospectively;
- disregarded when calculating income for tax credits purposes.

With payments being treated as non-taxable income, any expenses that could otherwise have been offset against taxable income will not be allowable as a tax deduction.

ATED and SDLT

Companies that currently qualify for the existing reliefs available from the Annual Tax on Enveloped Dwellings (ATED) and the 15% rate of Stamp Duty Land Tax (SDLT) for dwellings used in a property development or property trading business or let on a commercial basis will continue to be able to claim the relief while the dwellings are being used under the Homes for Ukraine Scheme.

Where a company purchases a property for a purpose that would otherwise be relievable from the 15% rate of SDLT, relief will continue to be available if the property is to be temporarily used under the Homes for Ukraine Scheme.

Where a dwelling does not currently qualify for relief from ATED, before the property is included in the Homes for Ukraine Scheme, ATED relief will be available from the point of occupation where the entire dwelling is used under the Homes for Ukraine Scheme.

https://questions-statements.parliament.uk/written-statements/detail/2022-03-31/hlws740

Business Taxation

Property development income (Lecture B1311 – 15.34 minutes)

Summary - A self-employed property developer had undeclared income and gains, with the Tribunal confirming that HMRC's calculations were valid.

Tom Nash registered with HMRC as self-employed in December 2006, describing his business as that of 'property developer'. He submitted tax returns for 2006/07 onwards declaring small profits or losses each year.

In September 2015, HMRC opened an enquiry into Tom Nash's 2013/14 tax return, requesting copies of business records, details of rental income since 5 April 2008 and details of all property transactions since 5 April 2008.

HMRC closed the enquiry in March 2017, making a number of adjustments covering all years.

- HMRC calculated his turnover for 2005/06 to 2013/14 as 2.5 times expenses claimed. HMRC argued that he was unlikely to have understated the expenses in his tax returns. They applied a multiple of 2.5 to these expenses, based on internal analysis of data from other similar traders. They argued that it was reasonable to believe that the same understatement of turnover applied to earlier years,

- Income from the sale of a property referred to as 19RHL was added to turnover for 2007/08 as income from property development;

- Funds received from his brother-in-law were treated as self-employment income due to lack of alternative evidence;

- A gain on disposal of land to the rear of properties 147TR and 149TR was liable to capital gains tax in 2011/12 (no main residence relief was available and mortgage interest costs were not deductible);

Discovery assessments were issued for 2005/06 to 2012/13 and penalties were charged for all years.

On 28 February 2018, Tom Nash appealed to the First Tier Tribunal.

Decision

The First Tier Tribunal did not accept Tom Nash's argument that:

- he earned little or nothing from being self-employed;

- the property purchases and renovations were funded by inheritances and re-mortgaging.

The First Tier Tribunal accepted the manner in which HMRC had arrived at their adjustments.

His appeals against the assessments and penalties were dismissed

Mr Tom Nash v HMRC (TC)8422)

Gross Payment Status removed (Lecture B1311 – 15.34 minutes)

Summary – HMRC were correct to remove Gross Payment Status based on compliance failures that happened eight years earlier.

RMF Construction Services Limited filed its Corporation Tax return for 2010 late as well as a number of other compliance failures including submitting late construction industry scheme returns and a late P35 return.

HMRC accepted that the company had a reasonable excuse for failing to submit contractor's monthly returns on time but did not accept that this was true for the other compliance failures. As a result, HMRC sought to cancel the company's gross payment status under the Construction Industry Scheme.

In December 2012, RMF Construction Services Limited appealed to the First Tier Tribunal but HMRC requested the appeal be stayed behind *JP Whitter (Water Well Engineers) Limited v HMRC*. RMF Construction Services Limited accepted that the compliance failures back in 2012 had taken place but that withdrawing gross payment status eight years later, in 2020, was wrong. The company argued that if it were to apply for gross payment status now it would be granted as the company had been fully compliant for a number of years.

The First Tier Tribunal allowed the company's appeal, finding that the eight-year delay in withdrawing CIS gross status would be disproportionate. The Tribunal stated that the objective of the CIS compliance system was to encourage compliance, and not to punish non-compliance. The threat of withdrawal had achieved the desired result as the company was now fully compliant and if it was to reapply now it was likely that gross status would be granted.

HMRC appealed to the Upper Tribunal.

Decision

The Upper Tribunal found that in 2012, the company's compliance failures gave HMRC grounds to cancel their registration. The eight year delay was not relevant. The aim of the legislation was to ensure that everyone was treated in the same way, irrespective of whether they appealed their position or not. Under the scheme, penalties are issued for non-compliance. Being able to avoid penalties by subsequent compliance during the appeal process would undermine the system.

Further, the First Tier Tribunal had erred by taking into account the risk that the company might fail as a result of removing gross payment status. This too is not relevant to the CIS gross scheme.

HMRC's appeal was allowed.

HMRC v RMF Construction Services Limited [2022] UKUT 00067 (TCC)

Gas cavities not plant (Lecture B1311 – 15.34 minutes)

Summary – The Court of Appeal found that underground gas storage cavities were not plant, meaning they were ineligible for plant and machinery capital allowances.

The companies' businesses involved the generation and supply of energy. They built underground cavities for the storage of gas from the national transmission system (NTS). The cavities allowed the removal of the gas to the NTS to enable its owners to profit from gas price volatility. They were created by a leaching process which involved drilling a borehole into salt rock into which water is pumped to dissolve the rock. The cavity is converted to gas storage by exchanging the resulting salt water with gas through boreholes (debrining).

The companies claimed capital allowances on the expenditure incurred on leaching and debrining but both the First Tier and Upper Tribunals dismissed their appeal.

The companies appealed to the Court of Appeal.

Decision

The Court of Appeal said it could find no legal error in the lower tribunals' decisions. The companies argued that the cavities were plant, but the judge said there was a 'fundamental preliminary hurdle in the path' of that argument. No man-made structure or equipment was put into the cavities – they were not artificially lined.

The only element introduced into the debrined cavities was the cushion gas and this was to prevent the cavity collapsing. It had the same effect as a beam or brace giving stability to a structure. The land was not in its 'natural state' but the alterations were to carry out the taxpayers' stock-in-trade.

Even assuming that hurdle was surmountable, any plant-like function was 'not only incidental' to the way the cavities were created but was also outside the taxpayers' control and not a common use. The cavities were 'little more than receptacles' in which gas could be stored at high pressure.

The taxpayers' appeals were dismissed.

Cheshire Cavity Storage 1 Limited and EDF Energy (Gas Storage Hole House) Limited v HMRC [2022] EWCA Civ 305

Adapted from the case summary in Taxation 24 March 2022

Allowable deductions for grant of share options

Summary – Accounting debits relating to the grant of employee share options were a deductible expense for corporation tax purposes.

The taxpayers were members of a group of companies whose parent, Smith & Williamson Holdings Ltd (SWHL), established an employee benefit trust that gave employees the right to acquire shares in SWHL. When the trust granted share options, the taxpayers paid SWHL an amount equivalent to the value of the option. That obligation was reflected in an inter-company balance owed by the taxpayers to SWHL and was settled each month.

The taxpayers prepared their accounts under IFRS 2 which required them to recognise an accounting credit on the balance sheet and treat it as a capital contribution from the parent company.

The taxpayers claimed deductions against trading profits corresponding to accounting debits in their income statement for the grant of share options to their employees. HMRC said these were not deductible.

The First Tier Tribunal, the Upper Tribunal and the Court of Appeal rejected HMRC's arguments.

The matter progressed to the Supreme Court.

Decision

Lord Hamblen and Lady Rose delivered the judgment with which Lord Reed, Lord Briggs and Lord Sales agreed.

The court said no law required the companies to adjust their financial accounts so as to exclude the debits from the computation of profits. Case law had established that the profit of a taxpayer's trade is to be determined in accordance with 'ordinary principles of commercial accountancy'. This was reflected in s.46(1) which requires that profits must be calculated in accordance with generally accepted accounting practice. Further, a company's balance sheet and profit and loss account were not separate and severable as HMRC suggested, because entries on one may affect entries on the other in order that overall they give a true and fair view of the financial state of the company.

On whether the deduction was disallowed by s.54(1)(a), the judges noted this provision states that no deduction should be made for 'expenses not incurred wholly and exclusively for the purposes of the trade'. They saw no reason to challenge the First Tier Tribunal's finding of fact that the debits were incurred for the purposes of the companies' trades.

Next, looking at whether the debits were capital in nature and therefore disallowed by s 53, the court agreed with the First Tier Tribunal that the debits had a revenue, rather than capital, nature. The fact that the matching credit entry was a capital contribution did not change this.

Finally, on the effect of s.1290 on the debits, the judges said this placed restrictions on deductions that would otherwise be allowable when calculating a company's profits, if that deduction was in respect of 'employee benefit contributions'. The court said the critical part of the definition in s.1291 was that property had to be 'held … under an employee benefit scheme'. It held that this case did not involve any property being held in that way, so the provision did not apply.

HMRC's appeal was dismissed.

HMRC v NCL Investments Ltd and another [2022] UKSC 9

Adapted from the case summary in Taxation (31 March 2022)

Freedom of establishment restricting group loss relief

Summary –The restriction to the group relief provisions that infringed the EU Freedom of Establishment were justified as a matter of public interest.

The taxpayers were UK resident members of a group company whose ultimate parent was based in the Netherlands. They claimed consortium relief for the years ending 31 December 2007, 2008 and 2009 against losses by the UK permanent establishment of one of the Dutch group companies.

HMRC refused the claims on the basis that the profits were available to be offset against non-UK profits and indeed some of the losses had been offset against Dutch profits.

The First Tier Tribunal allowed the taxpayers' appeal that s.403D ICAT 1988 breached the EU principle of freedom of establishment in a manner that was not justifiable or proportionate.

HMRC appealed to the Upper Tribunal.

Decision

The Upper Tribunal held that the UK's rules on cross-border group relief – in force at the relevant time – were not compatible with the EU principle of freedom of establishment. However, rather than disapply the UK rules in their entirety, the Upper Tribunal decided to adopt a conforming construction. As a result, the losses of the UK permanent establishment which had been set off against profits taxable in the Netherlands, were not also available to be surrendered as group relief in the UK.

The Upper Tribunal remade the First Tier Tribunal's decision and allowed HMRC's appeal. However, the case was remitted to the lower tribunal to decide how that interpretation should be applied to the facts of the case.

HMRC v Volkerrail Plant Ltd and others [2022] UKUT 00078 (TCC)

Adapted from the case summary in Taxation (31 March 2022)

Family shares and rent a room (Lecture B1312 – 10.17 minutes)

Transferring shares around family members has always had its benefits. Income is often moved around to maximise the use of personal allowances and tax rates bands and alphabet shares have been used to help fund children through university.

In 2022, with increasing household costs, alphabet shares now have further possibilities. We could pay dividends to our children who are over 18 and living at home, who then use that income to pay rent, with parents claiming rent-a-room relief to avoid paying tax on that income.

Reclassifying shares

Alphabet shares are best set up when the company is first formed but it is feasible to issue them during a company’s trading life.

We could engage the services of a company secretarial agency to reclassify ordinary shares that are currently in issue to become ‘A’ shares with the same full voting and capital rights as they had before reclassification. The difference is that dividends are now independent of all other class of shares. The secretarial agency would then create a new class of ‘B’ shares and schedule a bonus issue of these shares to the parents. These shares would have full voting and capital rights but independent dividend entitlement from any other class of shares. The B shares are then gifted to the children who are 18 or over with any gain covered by gift relief as this is a gift of shares in an unquoted trading company.

Typically, the fee charged by the secretarial agency would be in the region of £250 to £300.

Example

Andy and Jane each own 50 ordinary £1 shares in their trading company and are both directors of the company. Each draws a salary of £12,500 and take dividends of £37,500 per annum (£3,125 per month). The couple could withdraw more money from the company but are keen to avoid higher rates of tax. They are also aware that their child benefit for their 14 year old twins would be reduced if they had income in excess of £50,000.

Their third child, Rob, is 18, and about to start an apprenticeship at a local plumbing company.

A secretarial agency is appointed to redesignate the existing ordinary shares into ordinary ‘A’ shares. A new class of ‘B’ shares is created, with both ‘A’ and ‘B’ shares ranking equally in respect of votes and capital rights. Dividends can be declared independently of each class of share. A 1 for 2 bonus issue of ‘B’ shares is made.

After the bonus issue both Andy and Jane each own 50 ‘A’ shares and 25 ‘B’ shares. They both gift 5 of their ‘B’ shares to their 18 year old son, Rob.

The couple are aiming to pay £6,000 to Rob so that he can pay £4,000 into a Lifetime ISA. The remaining £2,000 will help him pay his rent of £275 per month for living at home.

For Rob to receive an annual dividend of £6,000, the ‘B’ shares must pay a dividend of £600 per share. Andy and Jane would then also receive £12,000 each so they would need to reduce their ‘A’ dividends from £37,500 to £25,500 to stay within the basic rate band.

Practicalities

A gift claim is prepared (HS295) for each gift of shares by Andy and Jane, for the parties to sign. This gift will be declared on their Self Assessment return.

Using Rent-a-room relief, qualifying rental income is tax free up to £7,500. Rob’s rent is well below this and so is tax free income for his parents. Andy and Jane could charge more rent and it would still be tax free. They could consider using this in the future for their twins.

Rob has an annual dividend of £6,000 per annum, of which £4,000 would be taxed at 8.75%. Remember the first £2,000 is covered by the dividend allowance. However, he has £5,000 per annum building up in his Lifetime ISA. That is the £4,000 plus the £1,000 government bonus.

Settlements legislation

The settlements legislation is in point where there is a bounteous gift of income and the settlor still has an interest in this income.

In our example, Andy and Jane do have an interest in this income as some of the dividend is paid back to them as rent. However, as the shares have capital and voting rights, it would be difficult for HMRC to argue that pure income has been shifted. The gift that was made was of capital and income. If we stripped the shares f capital and voting rights, there could be an issue.

Article contributed by Dean Wootten

Tax reconciliations **(Lecture B1313 – 22.49 minutes)**

FRS 102 and IFRS requires a reconciliation between:

1. The applicable rate of tax multiplied by accounting profit before tax; and
2. Total tax expense.

For a UK company, the applicable rate would normally be the current rate of corporation tax for the accounting period. But if the company derives substantial profits from other countries, it is permitted (but not required) to use a weighted average rate instead.

The reconciliation can be in currency terms (e.g. £s) and/or in percentage terms.

A reconciliation is not required if a company is using the small company provisions in Section 1A of FRS 102. However, it is worth considering producing a reconciliation in any case as a control to ensure the tax expense in the P&L is correct.

Normally deferred tax would not feature in the reconciliation as it seeks to equalise the tax expense in P&L, but changes where different tax rates are used for deferred tax (see the article on this in a previous session), the differential from the corporation tax rate of the current period will be a reconciling item.

Permanent differences

Deferred tax is not booked on permanent differences. They are items that only affect accounting profits or only affect taxable profits and will always feature in the tax reconciliation.

Examples include:

- Non-staff entertaining;
- Abortive asset acquisition costs;
- Fines and penalties;
- The 130% SME R&D enhancement;
- 30% of the 130% super-deduction (if the assets will not be disposed of before 1 April 2023);
- Gains eligible for substantial shareholding exemption;
- Dividends received.

Example

In its year ended 31 December 2021 a company makes a profit before tax of £150,000. This includes customer entertainment expenses of £22,000 and accrued pension costs of £10,000 which were paid in January 2022.

Show the total tax expense under FRS 102 and the tax reconciliation.

Analysis

Current tax

- Adjusted profit (150,000 + 22,000 + 10,000) = £182,000
- Current tax @ 19% = £34,580

Deferred tax

- Timing difference on pension costs accrued
  - Deferred tax asset/tax credit (P&L)
  - 19%* x £10,000 = (£1,900)
- *reverses in y/e 31.12.22

Total tax expense £32,680

Effective rate (32,680 ÷ 150,000) = 21.79%

Profit before tax multiplied by applicable rate (150,000 x 19%)	28,500	19.00%
Disallowed expense (22,000 x 19%)	4,180	2.79%
Total tax expense	32,680	21.79%

Deferred tax does not feature in the tax reconciliation unless there are using a different tax rate to calculate it.

Example – change in rate of tax

A company with a December year-end accrued a December 2021 deferred bonus of £70,000 (leaving it with an accounting profit of £300,000). This will be paid in mid-January 2023 when it will become tax-deductible.

Calculate the total tax expense in the P&L and produce a tax reconciliation.

Analysis

Profit before tax	**300,000**
Current tax expense (19% on £370,000)	70,300
Deferred tax (timing difference £70,000 @ *23.5%)	(16,450)
Total tax expense	**53,850**
Profit after tax	246,150
Effective tax rate on PBT	***17.95%***

* Expected tax rate for y/e 31 December 2023 (19% x 3/12 + 25% x 9/12)

Tax reconciliation	£	%
Profit before tax multiplied by 19%	57,000	19.00%
Deferred tax calculated at future rates	(3,150)	(1.05%)*
(70,000 x [23.5% - 19%])		
Total tax expense	53,850	17.95%

*3,150 ÷ 300,000

Common items in a tax reconciliation

- Permanent differences;
- Deferred tax assets not recognised (losses and tax credits carried forward);
- Foreign income taxed at higher rates than the UK CT rate;
- Foreign income taxed at lower rates than the UK CT rate if exempt from UK tax;
  - E.g. foreign branch profits where branch exemption claimed, profits of foreign subsidiaries in group accounts, foreign income exempt under the terms of a double tax agreement;
- Using future tax rates in calculating deferred tax;
- Adjustments made this year to prior year CT liabilities:
  - But does this indicate lack of controls over accurate calculation of CT?
  - Or material judgements when calculating CT?

- Other taxes on profits chargeable, e.g.
  - Diverted profits tax
  - Residential property development tax
  - Petroleum revenue tax and/or supplementary charge

Comprehensive example

Your client, XYZ Limited has prepared its draft financial statements in accordance with FRS 102 for the year ended 31 December 2021. It is not a member of a group.

This shows a profit before tax of £845,000.

The draft CT600 shows the following adjustments to this profit:

Profit before tax	£845,000
a) Entertaining expenses	£25,400
b) Legal and professional fees relating to an abortive asset purchase	£18,200
c) Depreciation – buildings (acquired 10 years ago)	£6,240
d) Depreciation – plant and machinery	£12,470
e) Capital allowances – 130% super-deduction	(£31,850)
f) Capital allowances – 18% WDA	(£4,124)
g) R&D enhancement – 130%	(£18,100)
h) Deferred bonuses – 50% payable in January 2023, 50% in January 2024	£60,000*
	£913,236
Corporation tax provision in the accounts (19%)	£173,515

*includes the associated NIC and social care levy costs.

The draft notes to the balance sheet shows the following carrying values:

	Land & buildings	**Plant & machinery**
Cost:		
At 1 January 2021	£542,000	£122,520
Additions	-	£24,500
At 31 December 2021	£542,000	£147,020

Accumulated depreciation

At 1 January 2021	£56,160	£34,790
Depreciation	£6,240	£12,470
At 31 December 2021	£62,400	£47,260
Carrying value at 31 December 2021	£479,600	£99,760
Carrying value at 31 December 2020	£485,840	£87,730

Assume that future depreciation will be charged on a straight line basis to depreciate the carrying value of plant and machinery to nil over the next 5 years.

The capital allowances computation has been prepared by a colleague of yours:

	Super-deduction	**General pool**	**Total**
At 1 January 2021		£22,911	
Additions	£24,500 x 130%		£31,850
WDA (18%)		(£4,124)	£4,124
Tax written down carried forward		£18,787	£35,974

The audited financial statements for the year ended 31 December 2020 showed a deferred tax liability of £12,316. The notes to those financial statements disclose only one source of timing difference – accelerated capital allowances.

The audit file shows the calculation of this deferred tax liability as:

Carrying value of plant and machinery	£87,730
Tax written down value	£22,911
Timing difference	£64,819
Deferred tax at 19%	£12,316

Requirements:

1. Calculate the deferred tax assets and liabilities in respect of the timing differences at 31 December 2021 and explain the extent to which they will be netted against each other in the financial statements.

2. Calculate the deferred tax expense (credit) for the year ended 31 December 2021, the total tax expense and the effective tax rate.

3. Prepare a tax reconciliation for the year ended 31 December 2021.

Analysis

1 Calculation of deferred tax assets and liabilities

Accelerated capital allowances:

At 31 December 2021:		
Book value of plant and machinery		99,760
Tax written down value		18,787
		80,973

Future depreciation is expected to be :			
Year ended 31 December 2022	(99,760 ÷ 5 years)	19,952	
Year ended 31 December 2023		19,952	
Later accounting periods		59,856	*
		99,760	

* balance to reduce carrying amount of 99760 to zero

Future WDAs are expected to be:		
Balance 31 December 2021		18,787
Year ended 31 December 2022	18%	3,382
		15,405
Year ended 31 December 2023	18%	2,773
Later accounting periods		12,632

Timing difference are therefore expected to reverse as follows:

	Year ended 31 December				
	2022	**2023**	**2024 onwards**		
Depreciation	19,952	19,952	59,856		
WDAs	3,382	2,773	12,632		
	16,570	17,179	47,224	Total	80,973
Tax rate	19%	23.50%	25%		
Deferred tax liability	**3,148**	**4,037**	**11,806**	**Total**	**£18,991**

Deferred bonuses

These will be tax deductible when paid as they are not payable within 9 months of the end of the accounting period

Deferred tax asset arises, calculated as:			**DT asset**
Bonuses payable in year ended 31 December 2023	30,000	23.5%	7,050
Bonuses payable in year ended 31 December 2024	30,000	25%	7,500
	60,000		**£14,550**

The DT asset must be netted against the DT liability as they relate to tax payable and recoverable in the same jurisdiction.

The net deferred tax liability at 31 December 2021 should be **£4,441**

2 Deferred tax (credit) in the income statement will be the change in the defered tax liability:

At 1 January 2021	£12,316
At 31 December 2021	£4,441
DT credit in P&L	**(7,875)**

Total tax expense:	
Current tax expense	£173,515
Deferred tax credit	(7,875)
Total tax expense:	**£165,640**

Effective tax rate **19.60%**
(tax expense ÷ profit before tax)

Profit before tax	845,000

3 Tax reconciliation

	£	**%**
Profit before tax multiplied by applicable tax rate (19%)	160,550	19.00%
Expenses disallowed for corporation tax purposes (25,400+18,200+6,240)	9,470	1.12%
Capital allowances super-deduction (30% x 24,500 x 19%)	(1,397)	(0.17%)
R&D enhancement relief (18,100 x 19%)	(3,439)	(0.41%)
Effect of change in tax rates on deferred tax*	456	0.05%
Total tax expense in income statement	165,641	19.60%

*Capital allowance timing difference reversals

2023	17,179	(23.5% - 19%)	773
2024+	47,224	(25% - 19%)	2,833

Deferred bonus timing differences

2023	30,000	(23.5% - 19%)	(1,350)
2024	30,000	(25% - 19%)	(1,800)
			456

Contributed by Malcolm Greenbaum

VAT and indirect taxes

Nursing agency had no legitimate expectation (Lecture B1311 – 15.34 minutes)

Summary - The VAT concession that allows employment agencies to exempt supplies of medical staff to third parties could not be relied on retrospectively.

First Alternative Medical Staffing Ltd and Delta Nursing Agency Ltd were companies that provided nurses and other medical staff on a temporary basis to both hospitals and care homes.

Both companies charged clients by the hour, with the hourly rate covering the wage payable to the nursing and medical staff plus a commission element payable for providing the staff. VAT was charged on the commission element only, on the basis that they were acting as agents.

Subsequently, HMRC raised VAT assessments on the companies for £2.1 million for the periods between 2013 and 2016, on the basis that the companies were in fact acting as principals, meaning that VAT was due on the full charge made to clients.

The companies acknowledged that they were principals but argued that a letter from HMRC sent in 2004 gave rise to a legitimate expectation. This letter confirmed that it was correct to charge and account for VAT on the commission element only because it was acting as an agent.

The High Court agreed the 2004 letter had been capable of giving rise to a legitimate expectation. However, by 2013, as a result of subsequent HMRC public statements, the companies could no longer rely on that legitimate expectation. In 2010, HMRC had published Revenue and Customs Brief 12/10 on 'Nursing Agencies Concession' allowing employment agencies to exempt the supply of nursing and health care staff to third parties where specific requirements are met. However, the companies had previously been relying on their 2004 letter and so could not now rely on this Brief retrospectively.

Decision

There was confusion over whether HMRC had accepted that the companies had met the conditions of the concession. However, the Court of Appeal proceeded on the assumption that the conditions were met as this was, in any case, a moot point given the conclusions that would follow.

The Court of Appeal stated that the companies had to choose whether or not to rely upon the 'Nursing Agencies Concession' and the question in this case was whether that choice had to be made prior to the relevant supply or could it be made retrospectively.

Agreeing with the High Court, the Court of Appeal found that the 'Nursing Agencies Concession' could not be relied on retrospectively. Under UK law, there was no 'legitimate expectation' inherent within the wording of the concession as there was nothing that the 'ordinarily sophisticated taxpayer' would understand to mean the concession could be applied retrospectively. It found that the concession would be understood by the 'ordinarily sophisticated taxpayer' to require a choice to be made in relation to each supply by the time that the client was invoiced. At the time the companies raised their invoices, they had not considered this concession as they were relying on the 2004 letter instead.

The companies' appeal was dismissed.

NOTE: The companies have also contended that their services were exempted from VAT as supplies of medical services under Schedule 9, Group 7, item 1, VATA 1994. HMRC disagree and this point is pending appeal to the First Tier Tribunal, having been stayed awaiting the outcome of this judicial review.

First Alternative Medical Staffing Ltd and Delta Nursing Agency Ltd v HMRC [2022] EWCA CIV 249

Unexplained banking deposits

Summary – A company provided sufficient evidence to prove that a discrepancy between the value on invoices and the amount credited to the bank were not unrecorded taxable supplies.

Starz Traders Limited contracted with four shipping agents to collect consignments arriving in the UK from Pakistan and, from its warehouse, break down the consignment into the individual client boxes. From here, the company would arrange for the boxes to be delivered to the customers by Parcelforce and DPD.

Starz Traders Limited's invoices for their work done were given to the shipping agent to pay.

To avoid issues of foreign-exchange remittance restrictions in Pakistan, when directed by the manufacturer in Pakistan, payments were also made by the end customers to Starz Traders Limited's UK bank accounts. The company would credit payments made either by the shipping agent or by the customers to its outstanding invoices with the relevant shipping agent. Payments were allocated to the earliest outstanding invoices.

In April 2019 HMRC opened an enquiry into Starz Traders Limited's VAT position and sought information about cash deposited in the company's bank account (including loans), the source of payments, and the validity of the sales invoices.

By October 2019, HMRC still had a number of concerns including that the number and volume of cash banked was not supported by sales invoices. For four periods to June 2019, the company had declared sales of £262,346 on its VAT returns but banked £422,308 into its business bank account. HMRC did not accept the company's explanation of how their business operated and that it was actually selling imported goods which in turn was creating the banking difference. Consequently, HMRC treated the difference as standard-rated sales and assessed output tax accordingly.

Starz Traders Limited appealed claiming that it provided a service to manufacturers of goods who were based in Pakistan and so no output tax was due.

The company explained that the banking discrepancy arose as a result of:

- an adjustment for debtors where sales from the previous period were now being paid;
- injections of money from the director;
- a loan from an associated company; and
- advance payments made by customers.

Decision

The First Tier Tribunal found that the evidence produced did confirm that the extra deposits mainly related to a loan as well as capital introduced by the director.

Unlike HMRC, the First Tier Tribunal found the company's business model to be 'thoroughly credible'. The Tribunal were satisfied that the evidence presented by Starz Traders Limited provided a coherent explanation of the source of funds making up the difference between the value of the sales invoices and the amounts credited to the bank account.

The appeal was allowed.

Starz Traders Limited v HMRC (TC08420/V)

Parking penalties **(Lecture B1311 – 15.34 minutes)**

Summary – Penalties charged by a car park operator represented additional consideration for the 'excessive use' of the car park.

Apcoa Parking Danmark A/S operated car parks on private land under agreements with site owners. Similar arrangements are quite common in the UK, where supermarkets might engage an operator to oversee and fix the rules for parking at their stores.

The company set the conditions for using the car parks and imposed a €69 'control fee' if drivers did not comply with them, for example by exceeding the permitted parking time or parking across multiple bays.

Decision

The CJEU considered the facts of the agreements and concluded that such fees were subject to VAT. There was a requirement to pay the control fees as part of a legal relationship created between the company and the driver when they decided to park their vehicles on the site. In other words, the driver had to comply with the general terms and conditions for using the car park.

The court decided that the penalties represented additional consideration for the 'excessive use' of the car park. There was a link between the control fees and the provision of parking.

Apcoa Parking Danmark A/S v Skatteministeriet (Case C-90/20), Court of Justice of the EU

Adapted from the case summary in taxation (24 March 2022)

Revenue and Customs Brief 7 (2022)

On 27 October 2021 it was announced that the import of dental prostheses would be VAT exempt when imported by, or behalf of, dentists or dental care professionals.

This measure was backdated to 1 January 2021 and included in Finance Act 2022. Affected importers can now reclaim overpaid import VAT on imports in the period 1 January 2021 to 27 October 2021.

HMRC have published Revenue & Customs Brief 7 (2022): 'Claiming a repayment of overpaid import VAT on the importation of dental prostheses into the UK'.

https://www.gov.uk/government/publications/revenue-and-customs-brief-7-2022-claiming-a-repayment-of-overpaid-import-vat-on-the-importation-of-dental-prostheses-into-the-uk

One Stop Shop VAT Return – updated guidance

HMRC has added a new section to its guidance entitled 'what not to include in your OSS VAT Return'.

This section explains that businesses must not include distance sales of goods that are zero-rated or exempt from VAT Return. Such sales should be reported in box 6 of their UK VAT Return.

Further, businesses must not report supplies of digital services to consumers in the EU on their OSS VAT Return.

https://www.gov.uk/guidance/completing-a-one-stop-shop-vat-return#what-not-to-include-in-your-oss-vat-return

Exported goods were zero-rated (Lecture B1311 – 15.34 minutes)

Summary – The taxpayers had sufficient evidence to support the zero-rating of their exports to China.

Junjie Liu and Zhe Li bought and sold clothes and accessories. They had one customer in China who bought a lot of their goods.

In 2016, due to a lack of export evidence, HMRC raised an assessment treating the exported goods as supplied in the UK. HMRC argued that the evidence provided did not satisfy the requirements of VAT Notice 703 para 3.3 which stated that 'vague descriptions of goods, quantities or values' were not acceptable. Parcelforce documents referred to the category of exports as 'personal effects', 'clothes' as the description of the items and £100 as the total value on every shipment.

Junjie Liu and Zhe Li claimed that the evidence that they had provided was sufficient proof for zero rating. The reason that they had used vague descriptions and a low value was to avoid theft of the goods while in transit to China.

Decision

The First Tier Tribunal accepted the need to use vague descriptions and a fixed value of £100 as the value on every shipment.

Referring to HMRC v Arkeley Ltd (in liquidation) [2014] STC 309, the First Tier Tribunal found that evidence must be 'taken as a whole' rather than by looking at each document separately.

While the taxpayers' packing lists did not include their VAT number and were not VAT invoices, they did describe in detail each item to be exported in the parcel, the value per item and the Parcelforce or Royal Mail tracking code for the parcel in which they were exported. They were able to cross refer each item on a sample packing list to the client's order, retail sales receipt for the goods ordered.

There was no suggestion that the value of £100 entered for each shipment should be treated as the value of the supply for VAT purposes. The Tribunal accepted that the value of the goods exported was the value clearly set out in the packing lists.

The First Tier Tribunal found that *Junjie Liu and Zhe Li* had satisfied them that they:

- held sufficient evidence to prove that the exports of goods to China took place; and
- had supplied suitable evidence that clearly identified the goods with an accurate value, such that the conditions for the zero-rating the exports were met.

The appeal was allowed.

Junjie Liu and Zhe Li (TC08396/V)

Transfer of residency relief not available

Summary – A couple returning to live in the UK were liable to customs duty and VAT on moving their possession from France back to the UK .

The taxpayer and his wife moved to France in 1991 but decided to return to the UK in 2016 because of concerns about healthcare and Brexit. They moved into rented accommodation in the UK and put their French property up for sale. Eventually, in 2019, a binding sale of the French house was agreed. However, it was not possible to ship their furniture back to the UK until after 31 December 2020 by which time the UK had left the EU and free movement of goods had ended.

The couple's haulage agent told them that customs duty and VAT were payable on their possessions, subject to any transfer of residency relief. The taxpayer applied for relief but HMRC refused, on the grounds the taxpayer became UK resident in 2016 so the application was too late.

Transfer of residency relief is available for a person's own goods as long as they imported within 12 months of the date of the person becoming resident in the UK. The taxpayer explained that he and his wife returned to the UK in 2016 only in the 'technical sense' because their only home was in France. It had taken a few years to sell their French property

because the market was slow. Therefore the circumstances were exceptional and the relief should be due.

Decision

The First Tier Tribunal said: 'Had anyone suggested to Mr and Mrs Brooks, British citizens returning to the UK after many years in France, that they would have to pay customs duty and VAT when bringing their household goods to the UK they may well have felt that was surprising and possibly unfair ... That charge, however, is a direct consequence of Brexit, and is the unhappy result in this transfer of residency relief appeal.'

Although sympathetic with the taxpayer's predicament, the judge concluded from the evidence that the taxpayer and his wife returned to the UK in 2016 and became resident from then. The couple registered with a GP and joined the electoral roll. They returned only occasionally to France to maintain the house while it was on the market. They left the house furnished to help make it more attractive to future buyers. Although they did all they could to encourage a sale, they were in breach of the 12-month rule for transfer of residency relief.

On exceptional circumstances, the tribunal said the changes in the law after Brexit were not exceptional but were a 'direct and foreseeable consequence of the UK's departure from the EU and the ending of free movement'. The duty was therefore due.

The taxpayer's appeal was dismissed.

J Brooks v HMRC (TC08333)

*Adapted from the case summary in Taxation (*10 March 2022)

Tour operator margin scheme (Lecture B1314 – 12.06 minutes)

Introduction

The Tour Operator Margin Scheme (TOMS) applies to businesses that buy in and resell transport, accommodation etc without material alteration, selling them on as a package.

VAT Notice 709/5 provides full details of how the scheme operates. Here we provide you with an overview of how the scheme works.

How it works

This is a mandatory scheme whereby businesses must account for output tax on their margin relating to bought in supplies. There is no input tax recovery on their bought in supplies but other input tax relating to accountancy fees, property costs, telephone, advertising etc. is recoverable.

In 2020 the EU margin was standard rated meaning that 1/6 VAT was due on EU margins. The non-EU margin was zero rated. However, leaving the EU has meant that from 1 January 2021, VAT on travel outside the UK is now all zero rated.

Example

A holiday is sold for £3,000 with total bought in costs of that holiday being:

	£
Flights	800
Accommodation including VAT	1,500
Airport transfers including VAT	100
Total costs	2,400

The margin on the holiday is £600 (3,000 – 2,400).

If the holiday was:

- in the UK, the output VAT is £100 (£600 x 1/6);
- outside the UK, the margin is zero rated.

The actual mechanics

The actual TOMS calculations are performed for the accounting year and include holidays with departure dates that occurred in that year.

Provisional output tax payments are made throughout the year, which are based on last year's standard rated margin percentage.

At the end of the year, provisional payment amounts are deducted from the annual TOMS calculation, with the difference in output tax accounted for in the first VAT return ending after the accounting year.

In order to give them the longest time to prepare their annual TOMS calculations, businesses usually align their VAT quarters with their accounting year end.

Example 2 – year to 31 March 2022

A tour operator sells holidays in the year totalling £900,000.

The cost of bought in supplies are:

	£
UK holidays (VAT inclusive)	200,000
Non-UK holidays (VAT inclusive)	620,000
Total cost of bought in supplies	820,000

The margin for the year is £80,000 (900,000 – 820,000) and the UK margin is calculated as £19,512 (80,000 x 200,000/820,000).

Output VAT payable is £3,252 (£19,512/6).

If we assume provisional payments were £2,700, VAT due is £552 (£3,252 – 2,700) which will be accounted for on the VAT return to 30 June 2022.

Provisional percentage for year to 31 March 2023

The provisional percentage for year to 31 March 2023 is calculated using last year's UK margin of £19,512 divided last year's total sales of £900,000 times 100. This gives as 2.168%.

If total sales in the quarter to 30 June 2022 are £300,000, the provisional output VAT payable to HMRC would be £1,084 (£300,000 x 2.168% x 1/6).

TOMS supplies

Certain supplies will always fall within TOMS when bought in and resold without material alteration. These are:

- Accommodation;
- Passenger transport;
- Hire of means of transport;
- Trips or excursions;
- Services of tour guides;
- Use of special lounges at airports.

Other supplies can fall within TOMS when provided with the services above. These include catering, admission tickets and sports facilities.

Who uses TOMS?

TOMS can apply within any business. So for example, a client might have normal activity with a small element of TOMS supplies. In this situation, we would have normal VAT accounting as well as TOMS within the VAT calculation.

Created from the seminar presented by Dean Wootten.

VAT transfer of a going concern (Lecture B1315 – 22.10 minutes)

Introduction

When a VAT registered taxpayer sells their trade and assets to a VAT registered buyer, the sale is normally a treated as the transfer of a going concern and so is outside the scope of VAT.

This treatment would extend to partial sales of their business where the part sold is capable of separate operation (so for example the sale of one of two shops owned).

If VAT is incorrectly charged by the seller and the buyer pays it, input tax recovery by the buyer is not permitted. In this situation, recourse would be to the seller and not HMRC.

Capital goods scheme

Property costing more than £250,000 is subject to the capital goods scheme rules with the rules applying for a ten year period.

Where the seller has been operating the capital goods scheme on property that is transferred as part of the sale, the buyer must continue with that scheme, inheriting the remaining capital goods scheme periods. These can be adjusted to the buyer's year-end but only after discussion with HMRC.

This issue must be addressed in the sale contract as the buyer will need all of the historical information relating to the capital goods scheme calculations and adjustment up to the date of sale. This will then enable them to continue these calculations in their books.

Buyer obligations

After the sale, the business must be carried on by the buyer post sale. This fact is normally warranted in sales contracts and is fundamental to securing the transfer of a going concern treatment.

The purchaser must be VAT registered. Some buyers believe they have the choice of whether to register for VAT, as they may regard themselves as a start-up. They often overlook that they will inherit the turnover of the seller. Where a seller is compulsorily VAT registered, the buyer will also be compulsorily registered from the date of purchase. They would not have the option of not registering and paying VAT on the purchase.

If the seller was voluntarily VAT registered, the buyer could of course choose not to register and may well do so if they are dealing with the public (i.e. non-registered customers).

However, they must bear in mind that they will inherit the seller's turnover which could affect their position. Assuming that the buyer is still below the VAT registration threshold, they can choose not to register. By not registering, the transfer of a going concern conditions are breached and VAT will be charged on sale.

The buyer will need to continue to monitor their turnover level on a monthly basis. If and when they exceed the VAT registration threshold of £85,000, they will need to register for VAT at that time. If the buyer registers within 4 years of the trade and asset purchase, and still holds the assets purchased at that point, VAT on the purchase could be recovered as pre-registration input VAT.

Standard rated property

If there is a standard rated property within the assets transferred (e.g. a new freehold commercial or an opted to tax property), this will be treated in one of two ways.

If the buyer chooses not to opt to tax, the property will be transferred outside of the transfer of a going concern and will be standard rated. Buying a property standard rated will increase the cash flow requirement including the effect of higher SDLT payable on the VAT inclusive price. It will also trigger a new 10 year cycle for the capital goods scheme when the property is £250,000 plus VAT or more as a standard rated transaction is treated as a new asset capital goods scheme asset.

On the other hand, if the buyer opted to tax the property, it would be transferred within the transfer of a going concern and as such would be outside the scope of VAT. To be effective, the buyer would need to opt to tax pre-completion to ensure the property falls within the transfer of a going concern rules. Their option to tax must be confirmed to the seller and the buyer must confirm that there will be no disapplication of the option to tax. This is normally covered within the sale and purchase agreements. This would reduce the cash flow requirement including the SDLT payable. It would also reduce the exposure to the capital goods scheme as the buyer simply inherits the remaining capital goods scheme intervals from the seller.

Tenanted property

Tenanted properties are regarded as a business in themselves and are therefore within the transfer of a going concern provisions. The purchasing landlord would be best advised to opt to tax when buying a tenanted commercial property from a landlord that has exercised their option to tax. This would secure the transfer of a going concern treatment making the transfer outside the scope. Rent charged to tenants would be standard rated rather than exempt

Landlord selling to the tenant

However, when the tenant buys the property from the landlord, this cannot be a transfer of a going concern as the property is owner occupied post-purchase rather than tenanted. VAT would normally be charged on such purchases as the landlord is likely to have opted to tax the commercial property. This will cause cashflow issues and will increase the SDLT payable.

The simple solution is to contact the seller's solicitors and ask how long ago the landlord opted to tax the property. If this was more than 20 years ago, the option to tax could be revoked prior to sale by the seller completing Form 1614J, sending it to HMRC, informing them of their revocation of the option to tax. The property sale then becomes an exempt transaction. The input tax suffered by the seller on professional fees relating to the sale should be deductible under the partial exemption de minimis rules.

Where 20 years has not passed since the option to tax was made, revocation of the option to tax is not possible. In this situation it is worth considering buying the property in the individual shareholders' names to be able to obtain the transfer of going concern treatment. They would need to register for VAT and opt to tax the property at the same time, sending the relevant forms to the VAT registration unit. The individuals would then rent the property to their trading company, charging standard rated rent. Note that if the tenant company is partially exempt, making more than 20% exempt supplies, then the option to tax will be disapplied under anti avoidance rules.

Selling to one of two tenants

A landlord owns a property that is being rented to two tenants who are currently paying standard rated rent on the property as it has been opted to tax.

If the landlord sells the property to one of the tenants, the sale will be standard rated unless the tenant has opted to tax the property by the completion date. By opting to tax in this way, they secure the transfer as a going concern treatment, meaning that the sale is outside the scope of VAT. Rent payable by the second tenant to the new tenant-buyer is standard rated. In summary, the sale of a partly tenanted property falls within the transfer of a going concern rules and is outside the scope of VAT. It is still a tenanted property, albeit partly tenanted.

Contributed by Dean Wootten