Tolley®CPD

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Personal Taxes

Whether failure to pay NICs not due to failure to exercise due care and diligence

Summary – The FTT found that a contributor was not entitled to make voluntary NICs for an extended period because he had not shown that his ignorance or error in failing to make timely contributions was not due to his failure to exercise due care and diligence.

Mr McKinnon (M) lived in the UK until September 1980. At the age of 25 he left to live and work in Italy. He returned to the UK temporarily in the summers of 1981 and 1982 to work in a language school, when he also claimed unemployment benefit. Thereafter he worked only in Italy.

He was initially employed in Italy but became self employed in June 1991. Prior to leaving the UK the appellant had been employed for around three years following completion of his university education and teaching qualification. Later M discovered that it was possible to pay voluntary NICs. Under the normal rules he was allowed to make voluntary contributions for 1996–97 onwards.

HMRC refused to allow the appellant to make voluntary contributions for earlier periods because although they accepted that the failure to make contributions was attributable to the appellant's ignorance or error, they did not accept that his ignorance or error was not the result of his failure to exercise due care and diligence.

The appellant appealed, submitting that he had exercised due care and diligence and in particular:

1. He had voluntarily contacted the Inland Revenue in 1982 to inform them that he was living and working in Italy and had sent them payslips.
2. When he left the UK he had no experience of being self-employed, his knowledge of NICs was very superficial and he thought the Inland Revenue were responsible for NICs and that the DHSS was only relevant for matters such as unemployment benefit.
3. He had relied heavily on his father for advice and given that his father was the head of pensions and salaries at a large UK company, it was reasonable to rely on that advice and not to seek other advice.
4. The fact that the appellant had followed his father's advice and taken out endowment policies in the early 1990s, and the fact that the appellant also took other professional advice from firms in Italy, showed the level of care and diligence he exercised.
5. He was not alone in his ignorance, and more should have been done to promote the opportunity of paying voluntary NICs.

Decision:

The FTT did not find its decision a straightforward one. Applying the principles laid down in Kearney in 2010 it concluded that the appellant had not shown that his ignorance or error was not due to a failure to exercise due care and diligence.

In particular the FTT noted that:

1. The appellant clearly knew of the existence of the NICs system, the concept of contributory benefits and the DHSS.

2. It did not accept that it was reasonable for the appellant, who was an educated person, to have assumed that the Inland Revenue dealt with all NICs matters and that contacting the Inland Revenue sufficed.

3. In the contact the appellant had with the Inland Revenue, his father, his Italian employer and professional firms in Italy he did not raise any a particular query in respect of NICs or his State pension position. His reliance on his father was somewhat passive and did not go quite as far as statute required (these points distinguished this case from *Kearney* and *Schonfield* in 2013.

4. It was clear that the concept of due care and diligence in most cases requires some kind of positive step to be taken to make enquiries.

Comments - This case provides a useful reminder that paying voluntary NICs can be useful in protecting a person's entitlement to some state benefits. It also stresses the fact that based on the Kearney decision when deciding whether reliance on advice from another person can amount to exercising due care and diligence the test to be applied is a strict one.

McKinnon v HMRC TC 05393

Voluntary class 3 NICs

Summary - The Upper Tribunal upheld the FTT decision, finding that Mr Garland was not allowed to pay voluntary NICs for periods while he was living outside the UK.

Mr Garland was born in Dublin in 1928. He had been employed in Great Britain from January 1949 to July 1950 before moving to Kenya, where he remained until 1963. He then lived in several countries (all outside the EU), before moving back to Ireland where he lived from 1984 to 1994. He then settled in the Isle of Man. Mr Garland contended that he had been entitled to pay voluntary class 3 NICs for the entire period from his move to Kenya to his 65th birthday (the pensionable age). The relevant rules at the time Mr Garland had reached 65 were contained in s44 and Sch 3 SSCBA 1992.

The contributions Mr Garland had made into the British scheme in the 18 month period between 1949 and 1950, when he was living and working in Great Britain, fell short of the 11 year requirement. However, the voluntary NICs he had paid during his second period of Irish residence had enabled him to receive 28% of the amount he would have received if he had had a full contributions record. Mr Garland's aim was to secure a full, or at least greater, pension by paying further voluntary NICs.

Mr Garland accepted that he did not satisfy the requirements of the UK legislative provisions, but he claimed that these provisions were incompatible with EU law. In particular, he contended that Council Regulation 1408/71/EEC ('the 1971 regulation') compelled HMRC to aggregate the contributions he had made in Ireland with those he had made in the UK.

Decision:

The UT found, however, that the 1971 regulation did not permit Mr Garland to add his period of residence in Ireland between 1928 and 1948 to his 19 months in Great Britain in order to meet the residence requirement. In any event, that regulation did not have retroactive effect and so could not apply to most of the relevant years.

Comments - It is worth noting that although in 2009 HMRC allowed Mr Garland to pay backdated voluntary Class 3 NICs for the years in which he lived in the Ireland (1984–85 until 1992–93), in this UT hearing HMRC said they were mistaken and, as a matter of law, Mr Garland was not entitled to make these contributions. HMRC did not however seek to go back on their concession.

J A Garland v HMRC Upper Tribunal

Wrong application of statutory maternity pay

Summary – The FTT decided that HMRC had been correct not to allow an offset of employer NICs

The taxpayer paid statutory maternity pay (SMP) to an employee and off-set the amount against its class 1 National Insurance liability. HMRC said the employee had not been entitled to SMP because she had not met the qualifying threshold set by the lower earnings limit for SMP. There had therefore been no entitlement to an off-set and an underpayment had arisen. HMRC also imposed a penalty on the ground the company had acted carelessly, although it later agreed to suspend it.

The director of the company appealed. He said HMRC's decision to collect the underpaid National Insurance was unreasonable and, as a public body, it had failed to exercise discretion. Further, the company dealt with its tax affairs honestly and kept its records in good order. It employed an adviser to deal with its tax and, if the adviser could make a mistake calculating the SMP, 'how could a small employer get it right?'

Decision:

The First-tier Tribunal found that HMRC had applied the law correctly when deciding that the company was not entitled to an off-set and that there was no statutory provision for HMRC to exercise the kind of discretion requested by the appellant.

The taxpayer's case was that HMRC's decision to collect the underpayment was unreasonable; that, as a public body, it had failed to exercise discretion; and that the decision was 'unfair and unjust and infringes the principle of proportionality'. The judge said these were grounds for judicial review, for which the First-tier Tribunal had no general powers.

There was no prospect of the appeal succeeding, so HMRC's application to have it struck out was agreed.

Comments - The FTT noted that it had 'great sympathy for the appellant's plight', in that it had been caught out trying to do the right thing, and additionally was having to make additional payments during a period of financial hardship as the business had been forced to close due to flooding.

The FTT also advised the taxpayer company that any judicial review claim was unlikely to succeed given that the original error was the company's. It was also suggested during the hearing that the 'SMP' paid to the employee might be eligible for deduction as part of staff costs, against the appellant's profits.

Jon Stewart & Co v HMRC TC5355

Applying EU law principles to individuals working in Switzerland

Summary - The CJEU found that the agreement between the EU and Switzerland precluded legislation excluding from its benefit German teachers working in Switzerland.

The European Community and the Swiss Confederation had entered into seven agreements, one of which provided for the free movement of persons on the basis of the rules applying in the European Community. Under German law, the income of a part-time lecturer who carried out his activities on behalf of a public entity established in the European Union or in the European Economic Area was exempt from tax up to a threshold.

Mr Radgen, who was tax resident in Germany, taught on a part-time basis in Switzerland under an employment contract. The German tax authorities had refused to apply the exemption on the ground that it did not apply outside the European Union and the European Economic Area.

Decision:

The CJEU found that the difference in treatment was likely to deter German teachers from teaching in Switzerland; and that German teachers employed on a part-time basis in Swiss territory were in a comparable situation to German teachers teaching in Germany. Furthermore, that different treatment could not be justified by the public interest in the promotion of education, research and development.

Comments - This case is an important reminder that European law principles apply outside the European Union under the jurisdiction of the CJEU. This will be particularly relevant in the Brexit era.

P and L Radgen v Finanzamt Ettlingen (Case C-478/15)

Sanctions for unauthorised payments

Summary – The FTT found in favour of the taxpayer in respect of penalties for potential unauthorised payments.

Sippchoice Ltd operated a self-invested personal pension scheme (SIPP), Sippchoice Bespoke SIPP. HMRC alleged that it was used as a pension liberation vehicle by allowing members to invest their funds in Imperium Enterprises Ltd, which then allowed members to access the funds indirectly in the form of loans before they reached the age of 55.

HMRC argued that the loans were unauthorised member payments for the purposes of s160(2) FA 2004. It imposed an unauthorised payments charge under s 208 on the scheme members and scheme sanction charges on the taxpayer.

The taxpayer appealed on the basis that it reasonably believed that no unauthorised payments had been made. It said it had no knowledge of the fact that loans had been made to individuals in connection with the investment of funds in shares in Imperium until 4 August 2011. It was then that an investor in Imperium emailed Sippchoice voicing concerns and accepted no further new business from Imperium. The taxpayer had before then carried out enquiries of Imperium and found no evidence of loans to scheme members made from the invested pension funds.

HMRC said the taxpayer had not taken adequate steps to ensure that the pension scheme was not being abused.

Decision:

The First-tier Tribunal accepted the taxpayer's assertion that it had raised concerns with Imperium about pension liberation, but these had been 'laid to rest by misinformation deliberately given' to it by Imperium. Further, Sippchoice had shown that it reasonably believed no unauthorised payment had been made (s 268(7)(a)).

The taxpayer's appeal was allowed.

Comments – This case is another demonstration of the importance of evidence. The potential set of two penalties which were applicable were defeated because the taxpayer was able to prove to the Tribunal that adequate steps had been taken contrary to HMRC's assertions.

Sippchoice v HMRC TC5217

Non-UK residents and the new dividend rules? (Lecture P981 – 3.35 minutes)

In the same way as there is little detail in FA 2016 in relation to the tax treatment of dividends in the hands of trustees on or after 6 April 2016, the recent legislation is equally uninformative on the subject of non-UK residents who are in receipt of dividend income.

In the past, non-UK residents who received dividends from UK companies were treated as having paid tax at the dividend ordinary rate and any liability above this rate was deemed to originate from 'disregarded income' with the result that no further tax was due.

Given that no amendment has been made in FA 2016, this continues to be the case for non-UK residents in receipt of UK dividend income on or after 6 April 2016. Such individuals will see no change in the treatment of their UK dividends. They did not have a UK tax liability before the legislation brought in by FA 2016 and they still do not have one for 2016/17 onwards.

Contributed by Robert Jamieson

Optimum use of the personal allowance in 2016/17 **(Lecture P982 – 14.01 minutes)**

It is well known that, for many years, an individual's personal allowance has been set against his various sources of income in the following order:

- non-savings income (salary, business profits, pensions and property income); then
- interest; and finally
- dividends

This was on the grounds that this normally produced the most tax-efficient end result. For reference, you should note S25(2) ITA 2007 which states:

> 'Deduct the reliefs and allowances in the way which will result in the greatest reduction in the taxpayer's liability to income tax.'

However, with the introduction of both the personal savings allowance and the dividend tax allowance in FA 2016, this is no longer the case.

Personal savings allowance

The details of the personal savings allowance can be found in S4 FA 2016.

This stands at £1,000 for basic rate taxpayers, but falls to £500 in the event that the individual has any income that is charged at the higher rate (or its dividend equivalent). If the individual has any income that is charged at the additional rate (or its dividend equivalent), the personal savings allowance is zero.

The personal savings allowance can only be used for interest and certain other categories of 'savings income' as defined in S18 ITA 2007.

It operates alongside the 0% starting rate – see S7 ITA 2007. It is important to appreciate that the personal savings allowance does not reduce the taxpayer's total or taxable income. Savings income covered by the personal savings allowance might be better described as being subject to a nil rate band.

Dividend tax allowance

The legislation for the £5,000 dividend tax allowance is set out in S5 FA 2016. This allowance can only be used for dividends – never for interest and other forms of savings income.

Unlike the personal savings allowance, it has been set at £5,000 for everyone. It too does not reduce an individual's total or taxable income (and therefore has to be taken into account when determining whether an individual is classified as a higher or additional rate taxpayer for personal savings allowance purposes).

Illustration

Edward has the following sources of income for 2016/17:

	£
Self-employed business profits	7,200
Interest from gilt-edged securities	6,500
UK dividends received	6,800

On the assumption that his personal allowance of £11,000 is set first against his self-employed earnings and then against his interest, Edward's income tax position is:

	£
Self-employed business profits	7,200
Less: PA (part)	7,200
	£Nil
Interest	6,500
Less: PA (balance)	3,800
	2,700

Given that no part of Edward's non-savings income is taxable, he is entitled to the 0% starting rate of up to £5,000 on his interest. In this case, all his remaining interest of £2,700 is therefore zero-rated.

Edward's dividend income of £6,800 is covered by his £5,000 dividend tax allowance, leaving £1,800 in the charge to tax at the dividend ordinary rate of 7.5%. This gives rise to a total income tax liability for 2016/17 of £135 (1,800 @ 7.5%)

However, this calculation does not produce the greatest reduction in Edward's liability to income tax. If, as an alternative, the personal allowance is set against the earned income (as before), but then only partly against the interest and partly against the dividends in order to maximise the benefit of the:

- 0% starting rate for savings income; and
- personal savings allowance,

Edward's tax position changes. His business profits are still tax-free, but, instead of using the balance of the personal allowance against Edward's interest, only £500 of the personal allowance is set against his interest.

Thus:

	£
Interest	6,500
Less: PA (part)	500
	6,000

This balance is then extinguished by a combination of the £5,000 0% starting rate and the personal savings allowance of £1,000.

Edward's dividend position is:

	£
Dividends	6,800
Less: PA (balance)	3,300
	3,500

The remaining dividend income is covered by his dividend tax allowance, leaving a nil income tax liability. This procedure has saved Edward £135 of tax.

Contributed by Robert Jamieson

Tenant's deposit scheme (Lecture P983 – 11.06 minutes)

Overview

Landlords must put their tenant's deposits in a government-backed tenancy deposit scheme if they rent their property on an assured shorthold tenancy that started after 6 April 2007.

Holding deposits are not included in this scheme until the tenant signs the tenancy agreement and the holding deposit becomes a deposit.

In England and Wales the deposit can be registered with:

- Deposit Protection Service (Custodial and Insured)
- MyDeposits
- Tenancy Deposit Scheme (Custodial and Insured)

If the property is not let on an assured shorthold tenancy, the landlord can accept valuable items (eg a car or watch) as a deposit instead of money. The items won't be protected by a scheme.

The tenant deposit schemes ensure that the tenants will get their deposits back if they:

- meet the terms of their tenancy agreement
- do not damage the property
- pay their rent and bills

The landlord or letting agent must put the tenants deposit in the scheme within 30 days of getting receiving the deposit.

The landlord must return the tenant's deposit within 10 days of them agreeing how much is repayable.

If there is a dispute between landlord and tenant, then the deposit will be protected in the tenants deposit protection scheme until the issue is sorted out.

Information landlords must give to tenants

Once the landlord has received the deposit, they have 30 days to tell the tenant:

- the address of the rented property
- how much deposit the tenant has paid
- how the deposit is protected
- the name and contact details of the tenancy deposit protection scheme and its dispute resolution service
- the landlord (or the letting agency's) name and contact details
- the name and contact details of any third party that has paid the deposit
- why the landlord would keep some or all of the deposit
- how to apply to get the deposit back
- what to do if the tenant cannot get hold of the landlord at the end of the tenancy
- what to do if there's a dispute over the deposit

If the landlord does not protect the deposit

The tenant can contact a tenancy deposit scheme if they are not sure whether their deposit has been protected.

The tenant can apply to their local county court if they think their landlord has not used a tenants deposit protection scheme when they should have.

If the court finds that the landlord has not protected the tenants deposit, it can order the person holding the deposit to either:

- repay it to the tenant
- pay it into a custodial tenants deposit protection scheme's bank account within 14 days

The court may also order the landlord to pay the tenant up to 3 times the deposit within 14 days of making the order.

At the end of a tenancy the court may decide that the tenant does not have to leave the property if the landlord has not used a protection scheme when they should have.

Disputes and problems

The tenancy deposit protection scheme offers a free dispute resolution service if the tenant disagrees with their landlord about how much deposit should be returned.

The resolution service does not have to be used but if you do, both the tenant and the landlord have to agree to it. The landlord and the tenant will both be asked to provide evidence, and the decision made about the deposit will be final.

The tenant can also 'raise a dispute' to get their deposit back if they cannot contact their landlord and the deposit is held by one of the approved protection schemes. The protection scheme will refund the deposit if the dispute resolution service agrees.

Distributions in a winding up (Lecture P984 – 20.43 minutes)

S35 FA 2016 introduces a targeted anti-avoidance rule (TAAR) which will apply to certain company distributions in respect of share capital on a winding up made on or after 6 April 2016. This TAAR comes in the form of a new S396B ITTOIA 2005 and specifically treats a distribution on a winding up as an income distribution, but only where certain conditions are met. The legislation is aimed at what is known as 'phoenixism': this is when a profitable company enters into a members' voluntary liquidation and a new business is set up to replace the old one and to carry on the same (or substantially the same) activities. In this case, the shareholders receive all the value of the company in a capital form while the trade continues (albeit now in the new structure) exactly as before.

Although there is no provision for a statutory clearance in this new measure (which seeks to extend the 'transaction in securities' legislation), HMRC are beginning to receive clearance applications from taxpayers and their advisers. In an effort to clarify the situation, they have recently written to the CIOT with a standard reply which they are now using in response to these requests. A copy of this letter can be found on the CIOT's website (www.tax.org.uk). The letter includes a number of examples, but these should not be seen as a substitute for the detailed guidance on which HMRC are still working and which should hopefully be published before the end of the year.

HMRC's letter restates the four conditions which must be present in order for the TAAR to apply:

(i) the individual receiving the distribution in respect of a winding up must hold an interest of at least 5% in the company;

(ii) the company must either be a close company when it is wound up or have been a close company at some point in the two years before the start of the winding up;

(iii) within a period of two years from the date on which the distribution was made, the individual is involved in a similar trade or activity – for this purpose, he may carry on the new business in his own name, through a partnership, through another company in which he has at least a 5% interest or through a person with whom he is connected (working as an employee for a spouse or some other connected person will meet this condition); and

(iv) it is reasonable to assume, having regard to all the circumstances, that the main purpose (or one of the main purposes) of the arrangements is the avoidance or reduction of an income tax liability.

HMRC's view is that the last condition will narrow the application of the TAAR to 'circumstances where, when considered as a whole, the arrangements appear to have a tax advantage as one of the main purposes'. There then follow three examples which seek to illustrate this last point.

The first example looks at Mr A who had been the sole shareholder of a landscape gardening company for 10 years. He has recently liquidated his company and retired. In order to subsidise his pension, he continues to do a small amount of gardening for people in his local village on a self-employed basis. Clearly, the conditions set out in (i) – (iii) above have been met – gardening for his neighbours is a similar trade to the landscape gardening activities which his former company carried on. However, when viewed as a whole, these arrangements do not appear to have tax avoidance as a main purpose. It was natural for Mr A to have wound up his company, given that it was no longer needed once his main trade had ceased. HMRC confirm that Mr A's distribution in the winding up would still be treated as capital.

The next example involves Mrs B, an IT contractor. Whenever she receives a new contract, she sets up a limited company to carry out the work. When the contract is completed and the client has paid her bill, Mrs B liquidates the company and takes out the profits as capital. Here, too, the conditions in (i) – (iii) above have been met, given that Mrs B's latest company is carrying on a similar trade to the previous one. However, in HMRC's view, these arrangements have a different outcome. They say:

'It looks like there is a main purpose of obtaining a tax advantage. All of the contracts could have been operated through the same company and, apart from the tax savings, it would seem that would have been the most sensible option for Mrs B. Where the distribution from the winding up is made on or after 6 April 2016, (it) will be treated as a dividend and subject to income tax.'

This is a more controversial decision. Does this view depend on the type of trade which Mrs B carries on? If, for instance, she had been a property developer where it has long been the customary practice for each new development to be undertaken through a separate company which is closed down when the project is completed, would HMRC have been of the same opinion?

The final example concerns Mrs C who has been running her accountancy practice through a limited company for the last three years. She decides that the risk involved in operating her own business is not worth the effort and so she decides to accept a job at her brother's established accountancy firm as an employee. Mrs C winds up the company and begins life as an employee. The conditions in (i) – (iii) above are again met because Mrs C is continuing a similar activity to the business carried on by her company. Note that she is doing so as an employee of a connected party – if the firm which she joined did not belong to a close relative, the TAAR would not be invoked. With reference to this example, HMRC state:

'Looking at the arrangements as a whole, it is not reasonable to assume that they have a tax advantage as a main purpose and so (the condition in (iv) above) will not be met. Mrs C's company was incorporated and wound up for commercial, not tax, reasons. Although she works for a connected party, it is clear that the other business was not set up to facilitate a tax advantage, (given that) it had been operating for some time. In these circumstances, the distribution from the winding up will continue to be treated as capital.'

We await HMRC's detailed guidance with interest.

Contributed by Robert Jamieson

Capital Taxes

Challenge to Entrepreneurs' relief on own share purchases (Lecture P985 – 25.15 minutes)

Nowadays there is a significant difference between the rates of CGT – especially where entrepreneurs' relief is in point – and the higher rates of income tax. This encourages shareholder directors to extract value from their companies in the form of a capital gain rather than as a dividend or salary.

When a shareholder sells shares back to his company under an own share purchase arrangement, the proceeds are prima facie taxed as an income distribution. However, CGT treatment is available provided that all of the following conditions are satisfied:

(i) the vendor has held the shares for at least the last five years;

(ii) the vendor is resident in the UK;

(iii) the purchase by the company has been made for the benefit of its trade (and was not part of any tax avoidance arrangements);

(iv) the company is an unquoted trading company or an unquoted holding company of a trading group;

(v) the vendor's shareholding (including associates' holdings) has been substantially reduced – or eliminated – by the own share purchase; and

(vi) the vendor and his associates are not connected with the company immediately after the own share purchase.

In these circumstances, the company can apply to HMRC in advance of the purchase of own shares for a formal clearance that the sale proceeds will be subject to CGT rather than to income tax.

If the company has sufficient financial resources to pay the shareholder in full, the own share purchase can go ahead without further complications. However, where the company cannot afford to meet the agreed purchase price, it is now customary to settle the required payment in tranches spread over a number of years. These so-called 'multiple completion contracts' are seen as an increasingly useful solution to this corporate dilemma. The company enters into a single unconditional sale contract with the vendor, with legal completion of the buy-back taking place on a series of dates in the future in respect of separate tranches of shares within the agreement. The vendor must give up his beneficial interest in the repurchased shares on entering into the contract and so he cannot subsequently take dividends or exercise voting rights over the shares. If he was a director of the company, he would normally resign his position at this stage. As far as CGT is concerned, the disposal of the entire beneficial interest in the shareholding takes place at the date of the contract.

The vendor therefore needs to ensure that he has the means with which to meet the full tax liability by the 31 January following the tax year in which the multiple completion contract is made. It is understood that HMRC accept that a multiple completion contract is a valid arrangement provided, of course, that beneficial ownership passes at the contract date – see ICAEW TR745.

Unfortunately, HMRC have recently started raising an objection to vendors making an entrepreneurs' relief claim in respect of that part of the sale proceeds which relates to the subsequent tranches. Their position appears to be based on the argument that a company does not 'acquire' the shares from the vendor shareholder given that, with a private company, it must normally cancel the shares returned to it under such an arrangement. As a result, the provision in S28 TCGA 1992, which fixes the CGT disposal date as the exchange date of the contract, does not apply. HMRC go on to say that the payments received for the subsequent tranches represent lump sums derived from an asset and are therefore subject to the legislation found in S22 TCGA 1992. Applying this section, the gain is taxed at the time when the proceeds are received, and not at the contract exchange date. If HMRC are correct in pursuing this line, entrepreneurs' relief will not apply to that part of the gain applicable to the shares disposed of in tranches in view of the fact that the vendor will no longer be a director of the company.

It is worth emphasising that, when an own share purchase clearance is obtained under S1044 CTA 2010, this simply confirms that the transaction is not treated as a distribution. It does *not* provide confirmation that entrepreneurs' relief is available. So the fact that the taxpayer has received his clearance is of no real comfort in this regard.

One expert commentator has stated:

'HMRC's potential argument goes against the currently accepted technical analysis, as demonstrated by every learned article on multiple completion purchases of own shares. I do not see that there is a "nice" legal point on the concept of "acquisition" in the context of (such transactions). Indeed, we would rely on this very point when it comes to claiming a capital loss on a purchase of own shares – since there is no acquisition, the connected party loss rules should not apply.

In my view, multiple completion purchases of own shares do not involve any form of tax avoidance. The arrangements simply enable the company to defer part of the purchase consideration in a Companies Act-compliant manner. In fact, under conventional analysis, all the CGT is paid up front on the basis of the contract date per S28 TCGA 1992 (see (c) above) – so where is the mischief in that?

So what we have here is HMRC taking a very literal approach to the operation of S28 TCGA 1992 in a way that was never even contemplated by the draftsman or indeed Parliament. I strongly suspect that the reason why this point is being taken has something to do with the denial of 10% CGT entrepreneurs' relief to some "innocent" taxpayer.'

Reference was made earlier to ICAEW TR745 which dates back to April 1989. To the best of one's belief, HMRC have never retracted their agreement to this technical release and so, if necessary, there must be a proper 'legitimate expectation' argument to be run in relation to multiple completion contracts which have already taken place.

The same commentator continues:

'If this point was ever (argued at) an appellate tribunal, I do hope that it would take a reasonable balanced – and purposive – view of what is going on here: an apparent u-turn in HMRC's tax treatment of entirely legitimate purchase of own share transactions just to deny entrepreneurs' relief.'

Should HMRC ever succeed with this contention, one suspects that tax practitioners will increasingly be advising vending shareholders to retain a 5% 'sentimental' stake in their companies, as well as thinking up a good reason for them to stay on for the time being as a part-time employee in some capacity! But, hopefully, it will never come to this.

Contributed by Robert Jamieson

Legacy to a non-UK charity

Summary – The Court of Appeal decided that a legacy in a Will to a non-UK charity did not benefit from the s23 IHTA 1984 exemption

In her will, Beryl Coulter had left her residuary estate on trust for the purpose of building homes for elderly residents of the parish of St Ouen in Jersey or, in default, to assist with the capital expenditure required by an organisation called Jersey Hospice Care.

The trust was established under and subject to Jersey law and as such was not a charity under s989 ITA 2007. It also followed that the Will had not effected a transfer to 'a trust established for charitable purposes only' because s23 IHTA 1984 required it to be established in the UK.

HMRC said the executors were therefore liable for inheritance tax of £600,000. The matter proceeded to the High Court which found for HMRC.

The executors appealed.

The appeal raised two issues. The first was whether the residuary estate of Mrs Coulter was given to charities for the purposes of s 23 and was therefore exempt from inheritance tax.

The second was that, if it was accepted that s 23 should be construed as contended by HMRC, it would constitute an unlawful restriction on the free movement of capital between member states and third countries within the meaning of Art 63 of the Treaty on the Functioning of the EU.

Decision:

On the first issue, the Court of Appeal ruled that the first limb of s 23 required the charity to be established under UK law. The second had to be seen in the context of the whole provision and it was a requirement of the phrase 'held on trust for charitable purposes only' that the trust was governed by UK law and subject to the jurisdiction of the courts here. The determination was confirmed therefore.

However, the court invited the parties to propose directions for the second part of the executors' appeal, which would be heard separately.

Comments - The definition of 'charity' in s989 has since been replaced by a new definition now found in Sch 6 FA 2010 which includes charities established in the EU and other specified territories. In this case the legislation could not be read in a way to allow exemption from IHT in relation to gifts to non-UK charities. Donors should be reminded of this restriction when choosing the charities they wish to benefit under their will.

Peter Routier and Christine Venables (as executors of the late Beryl Coulter) v CRC, Court of Appeal

Circumstantial evidence is not enough

Summary – The FTT found that share loss relief was not available where the appellant could not produce sufficient evidence that shares had been issued to him.

The taxpayer entered into a business venture with a partner, JP. It involved buying a specialist food snacks and drinks business in financial difficulties from a company in administration and then running the business. The business was incorporated and both became directors.

The taxpayer paid £250,000 into the company. But the business proved unsuccessful, administrators were appointed and the company was dissolved. The taxpayer claimed share loss relief (s131 ITA 2007).

The issue before the First-tier Tribunal was whether the company had issued shares to the taxpayer in consideration of the £250,000 he had invested in it. Each director already held one share, so he was, in any event, a 50% shareholder.

The taxpayer could not recall whether he had seen a register of members of the company or share certificates, but he remembered signing all the documents sent to him when the company was set up. He had not taken copies of the documents because he did not realise that it would be important to have paper evidence of his shareholding.

Decision:

The tribunal said the burden of proof lay with the taxpayer. The judge was not prepared to accept that 'the fact that solicitors based in the City of London produced a draft agreement for certain things to be done means that, on the balance of probabilities, those things were done'.

It concluded the shareholders' agreement was never finalised and the shares not issued.

The taxpayer was an equity investor as the holder of one share, but the judge said it did not follow that the company issued additional shares when he made the £250,000 investment. Share loss relief was not available.

The taxpayer's appeal was dismissed.

Comments - The FTT accepted that the appellant, as the holder of one share, was an equity investor, that the further injection of £250,000 enhanced his equity investment, and that he had suffered a commercial loss of £250,000.

Unfortunately, as the conditions in s131 ITA 2007 had not been satisfied, they were obliged to dismiss his appeal. This case therefore demonstrates once again the need to ensure that all necessary legal formalities are complied with. Entrepreneurs who invest in their companies need to always ensure that their investment is properly documented - it will enable them to obtain the relevant reliefs.

R Alberg v HMRC TC5357

Share loss relief claim

Summary – The First-tier Tribunal found that an individual had subscribed for shares where another person subscribed for them on his behalf.

The taxpayer claimed loss relief on his investment in Geezer Telecom Ltd because the shares had become worthless when the company had entered into administration.

He said it was agreed with G, the sole shareholder, that he would invest in the company and receive 225 shares in return.

HMRC accepted that the taxpayer had made payments to the company between June 2011 and May 2012 but said the company did not issue any shares to him. Instead 100 £1 shares were subdivided into 1,000 10p shares. In July 2011, G transferred 225 shares to the taxpayer for a nil consideration. In May 2012, the taxpayer transferred those shares to G also for a nil consideration. As a result, said HMRC, the taxpayer must have lent the money to Geezer. He paid nothing for the shares and received nothing for them when he sold them.

Decision:

The First-tier Tribunal found that the taxpayer had an agreement with G that he would invest £272,000 by way of subscription for shares. Further the draft accounts of the company, prepared by a qualified accountant, showed a share premium account. The judge concluded that the share subdivision had taken place to enable the agreed number of shares to be transferred to the taxpayer. There was evidence that G intended to transfer shares and held the relevant shares as nominee for the taxpayer until they could be registered in his name. The tribunal found that, as a result, the taxpayer did not acquire beneficial ownership of the shares from G because he had held the beneficial ownership since the subdivision.

The taxpayer had therefore subscribed for the shares within the meaning of ITA 2007, s 135(2). His appeal was allowed.

Comments - Interestingly the only question that had to be determined was whether the appellant had subscribed for the shares for the purposes of s131(3). This was successful.

S Murray-Hession v HMRC TC5348

IHT scheme successful

Summary - The First-tier Tribunal found that the transfer of a reversionary interest was not a transfer of value because it did not diminish the transferor's estate.

Mr Salinger had entered into tax planning arrangements to reduce the amount of IHT payable on his death. The arrangements had involved the transfer of a reversionary interest he held in an Isle of Man trust to the Donald Salinger Family Trust ('the DSFT') of which Mr Salinger's children, M L Salinger and J L Kirby were the trustees. Mr Salinger had died on 27 February 2011 and M L Salinger and J L Kirby had been appointed executors of his estate.

HMRC had issued a determination on the basis that IHT was due in relation to the transfer of the reversionary interest. The executors contended that the reversionary interest was excluded property because no consideration had been given for its acquisition by Mr Salinger; and, in any event, there had been no transfer of value when it had been transferred to the DSFT.

Decision:

Under s48(1)IHTA 1984, 'a reversionary interest is excluded property unless it has at any time been acquired ... for a consideration in money or money's worth'. The FTT found that Mr Salinger had acquired the reversionary interest as part of a package of rights for which he had paid consideration of £890,000. The reversionary interest was therefore not excluded property. It had, however, been an 'empty shell', similarly to the B shares in *Arrowtown* [2003] HKCFA 46.

Furthermore, there had been no loss to Mr Salinger's estate as a result of the transfer, which had therefore not been a transfer of value. In particular, the transfer of the reversionary interest had not prevented Mr Salinger from accessing the trust fund as a matter of right, as he had remained the only income beneficiary.

Comments - The avoidance arrangements undertaken in this case would now no longer succeed because of anti-avoidance legislation introduced by Finance Act 2012, found in ss 74A-74C IHTA 1984, which would treat the reduction in value of Mr Salinger's estate in consequence of the arrangements as a transfer of value that was not a potentially exempt transfer.

M L Salinger and J L Kirby v HMRC TC5407

Value of transaction disputed

Summary – On the facts the FTT found against the taxpayer based on the value of the property

The taxpayer bought a property in September 2007. The relevant stamp duty land tax return was submitted by his solicitor showing consideration paid of £274,950 and tax due at 1%. The payment was made, but the correct rate should have been 3% and HMRC said the additional tax was due. The taxpayer said the property cost less than £250,000 and no further tax was due.

At the First-tier Tribunal hearing, the taxpayer produced a summary which he had received from his solicitor. This showed the purchase price as £274,950 with a mortgage obtained for £247,425.

It also showed that stamp duty land tax had been paid at 3%. Further, the paper showed that, at completion, the taxpayer paid £235,539.

The taxpayer said he had paid £235,539. HMRC said it was likely that a deposit was paid and tax was due on the £274,950. The taxpayer said he had not paid a deposit. He later opened a complaint about the solicitor.

Decision:

The tribunal found the taxpayer to be an honest witness, but said the evidence pointed to the purchase price being higher than £250,000.. Further 'HMRC appeared to treat the Legal Complaints Service (LCS) as [his] new agent (which was incorrect, but did not appear to be corrected by the LCS).' There was then a four-year period when HMRC appeared to have made no contact with the taxpayer at all, which was 'extremely poor service'. Regardless of this, no evidence was produced to support the transaction price being anything other than £274,950.

The taxpayer's appeal was dismissed.

Comments – The decision is self-explanatory. The judge had a 'great deal of sympathy' for him and said he had received 'poor service at the very least from his agent'. HMRC did not cover themselves in glory either.

Dr J Kissi v HMRC TC5343

Administration

Duty of confidentiality owed by HMRC to taxpayers

Summary – The Supreme Court has confirmed that HMRC owes a duty of confidentiality to each and every taxpayer and their affairs should not form the subject of “off the record” background briefings to the media.'

In July 2012 Dave Hartnett, then HMRC permanent secretary for tax, met two reporters from *The Times*. He believed he was off the record and claimed a financial services provider had marketed avoidance schemes. The newspaper published the allegations.

The company sought judicial review on the ground that the department had breached s18 Revenue and Customs Act 2005 (confidentiality). The application was dismissed by the High Court and Court of Appeal.

Decision:

In the Supreme Court, Lord Toulson said the case should be approached from the perspective of the common law of confidentiality. Under this law, it was a well-established principle that, when information of a personal or confidential nature is obtained 'in the exercise of a legal power or in furtherance of a public duty, the recipient will in general owe a duty to the person from whom the information was received or it relates'. The tax affairs of individual taxpayers are matters between HMRC and the taxpayer, and confidentiality is a vital element in the working of the system.

Lord Toulson said: 'The information supplied by Mr Hartnett to the journalists about Mr McKenna and Ingenious Media was confidential in nature, in respect of which HMRC owed a duty of confidentiality under s 18(1)'.

The desire to foster good relations with the media and to publicise HMRC's view about tax avoidance schemes and speculation that the journalists may have later told Mr Hartnett about other tax avoidance schemes could not justify the disclosures.

Further, the fact that he 'did not anticipate his comments being reported is not a justification for making them'. The whole idea of HMRC officials giving confidential information about individuals to the media on a non-attributable basis was 'a matter of serious concern'. The disclosures were not justified under s 18(2)(a). The Supreme Court unanimously allowed the appeal.

Comments - An Ingenious spokesperson said: 'This was never about restricting HMRC's ability to collect taxes, nor was it about preventing the press from investigating public interest stories. Consistent with HMRC's own guidelines, this was simply about upholding the basic legal principle that HMRC owes a duty of confidentiality to each and every taxpayer and their affairs should not form the subject of “off the record” background briefings to the media.'

R (on the application of Ingenious Media Holdings plc and another) v CRC, Supreme Court

Penalty for late payment of tax

Summary – The FTT found against an elderly taxpayer because age could not constitute a reasonable excuse

The taxpayer filed his self-assessment tax return online before the deadline. The tax due was £5,185 but, at 3 March 2016, £2,945 remained unpaid. The sum was paid in full on 30 June 2016 but HMRC imposed a penalty for late payment. The taxpayer appealed. He said: 'To the best of my memory (I am 70) this is the first time that I have requested paperless reminders. Because I am always expecting a letter through the post I have not been vigilant in opening all my emails. Naturally I will be more careful in future.'

Decision:

The First-tier Tribunal said this could not constitute a reasonable excuse and dismissed the taxpayer's appeal. However, the judge said the tribunal had 'not been provided with information to clearly demonstrate that the amount outstanding at the penalty date was £2,945'. There appeared to be several adjustments and reductions, which suggested the amount outstanding might be less than that. As a result, the tribunal could not verify the accuracy of the calculation of the penalty. He suggested that the outstanding tax should be agreed and the penalty revised if necessary.

Comments – With all the changes that are about to occur with MTD taxpayers such as this will be at a disadvantage and we may well see more cases like this. However the FTT took a pragmatic approach.

D Ludzker v HMRC TC5398

Penalties for late EC sales lists

Summary – Penalties were upheld in respect of late EC Sales Lists.

The company was charged penalties of £500 and £780 for submitting late EC sales lists for September and December 2014. It appealed, saying it had posted the returns before the due dates and, as soon as it realised HMRC had not received them, it resubmitted them.

Decision:

The First-tier Tribunal said 'the mere claim' of posting the forms was not enough. It was the taxpayer's responsibility to show the forms had been submitted in time. In this case, the company provided no documentary evidence to prove they had been posted or that there were problems with the postal service. The tribunal said it was 'highly improbable' that the post 'should fail to deliver on two consecutive occasions'.

The taxpayer's claim that the penalty was 'extortionate' also failed. The penalties were not disproportionate, particularly in view of the capping of the penalty to a maximum 100 days, and the scaling of the daily rate from £5, to £10, and to £15 in proportion to the number of defaults in a rolling 12-month penalty period.

The appeal was dismissed and the penalties were upheld.

Comments - Neil Warren, independent VAT consultant, commented: 'The legislation on ESL penalties is quite generous compared with other parts of the tax system (VATA 1994, s 66), and HMRC must always issue a penalty liability notice before a penalty for a late return — the yellow card, in footballing speak. The main learning point from this case is that online returns are the safest bet rather than paper formats. If a postal return is submitted late or not received, the taxpayer must be able to prove to HMRC that he posted it in good time and correctly, which can often be difficult if normal post was used.'

AGC Customs Ltd v HMRC TC5267

Penalties for late filed employer return

Summary – There being no plausible argument the Tribunal dismissed the appeal

The taxpayer received late filing penalties amounting to £1,200 because it had not submitted its 2009-10 employer annual return. It appealed, saying it had twice tried to file a paper return because it had not received an authorisation code for online filing in time for the May deadline.

Decision:

The First-tier Tribunal said a taxpayer wishing to comply with its obligations would have applied for an authorisation code in time to meet the filing deadline. By law the form had to be filed electronically and therefore the tribunal had to 'discount the actions of the appellant in seeking to file the returns by hand'. Further it seemed strange that the paper return was filed more than a year late and after the authorisation code had been received.

The taxpayer did not have a reasonable excuse and its appeal was dismissed.

Comments – The decision is self-explanatory

Oasis Church Trust v HMRC TC5360

Failure to notify chargeability

Summary – The case demonstrates the power of the NCA by reference to tax

In 1996, the taxpayer was charged with drug offences connected with a night club with which he was involved. He absconded to Cyprus before his trial.

In 2005 he attempted to transfer £1.5m from a Cypriot bank account to one in Thailand. But the payment was routed through London and intercepted. In 2009, he was arrested, returned to the UK, convicted and sentenced to five years in prison. After serving his sentence he was extradited to Cyprus for property fraud and was sentenced to 11 months in prison for illegal use of land.

In March 2012, the Serious and Organised Crime Agency (SOCA) (now the National Crime Agency (NCA)) was successful in its civil recovery action against the taxpayer in relation to the £1.5m. The agency then notified HMRC under the Proceeds of Crime Act 2002, s 317(2) that it would be taking over the general revenue functions for the taxpayer's income tax, National Insurance and capital gains tax for 1993-94 to 2005-06. It raised assessments on the taxpayer and imposed penalties on the basis that he had received between £5,000 and £10,000 from ventures in Cyprus but never paid tax. He appealed.

Decision:

The First-tier Tribunal decided that, based on information provided to the authorities while in prison in the UK, the taxpayer had been entitled to the income assessed. He had failed to notify HMRC and was unable to provide figures to prove those assessed were excessive. The assessments and penalties were confirmed. The taxpayer's appeal was dismissed.

Comments - Donald Toon, director of the NCA's economic crime command, said:

> 'The NCA is tenacious in using every legal avenue available to hit crooks where it hurts. In this case we have used our unique tax powers under part 6 of the Proceeds of Crime Act to pursue [the taxpayer] for his profits. It might seem unusual that a drug dealer can be penalised for not paying tax and interest on his earnings but this is a powerful and important tool to reduce the funds which can otherwise be diverted into supporting further criminality.'

G Robb v HMRC TC5374

Reasonable excuse for late payment of VAT

Summary – The Upper Tribunal upheld a 5% default surcharge as the company lacked a reasonable excuse in relation to insufficiency of funds to pay VAT.

The taxpayer, ETB, had been registered for VAT since 1973. It changed to a group registration in 2013 and, in more than 20 years of trading, had paid £3.5m in VAT without incurring any penalties. T was a director of the company until it was sold in December 2014.

The company failed to pay the VAT due for accounting period 12/14 on time and HMRC imposed a default surcharge under VATA 1994, s 59. The taxpayer claimed it had a reasonable excuse for the late payment because it did not have enough funds. This had been caused by the sale of the business and T's illness.

The First-tier Tribunal dismissed the appeal and the case proceeded to the Upper Tribunal.

Decision:

The Upper Tribunal found that, on the facts, the First-tier Tribunal had failed to address the circumstances leading up to the default relied upon by ETB. Nor had it analysed whether these could provide a reasonable excuse, as explained by the Court of Appeal in *CCE v Steptoe* [1992] STC 757.

In addition, it had not considered the effect of the sale of the assets and goodwill of the business, the fact that the company no longer had any staff from that date, the illness of T and that T had realised how much VAT would be due only when preparing the return. This was a flaw in the tribunal's reasoning and an error of law. As a result, the Upper Tribunal was entitled to set aside that decision and remake it.

After looking at the facts, the Upper Tribunal decided it could not be said that the sale of the business and the consequences that followed were capable of constituting a reasonable excuse. ETB had failed to show that the lack of funds was not reasonably avoidable — indeed it should have been 'blindingly obvious' that VAT would be due.

On T's illness, the taxpayer had not established that his ill health rendered an insufficiency of funds unavoidable. T had undoubtedly suffered bouts of illness but there was no evidence to show that this had prevented him dealing with ETB's lack of funds by raising alternative funding — as he eventually did — or contacting HMRC.

Even taking the sale and illness together, these could not constitute a reasonable excuse.

The taxpayer's appeal against the decision of the First-tier Tribunal was allowed and the decision set aside. It was remade and the appeal dismissed.

Comments - HMRC have the burden of proving that the taxpayer failed to pay the VAT on time and is liable to pay the default surcharge. The onus then passes to the taxpayer to prove that he had a reasonable excuse for his failure to pay on time. Although insufficiency of funds can never of itself constitute a reasonable excuse, the cause of that insufficiency might do so.

ETB (2014) Ltd v CRC, Upper Tribunal

Identifying appealable decisions

Summary - The FTT considered its jurisdiction to hear an appeal regarding a late registration.

HMRC had decided that NTJ (which became NT ADA) should be registered for VAT and informed the company by letter dated 29 October 2012. NTJ contended, however, that the letter did not fall within either VATA 1994 s 83(1) (a) or s 83(1)(b), as it had not been in relation to actual registration but only to the threat of registration and there had been no decision on the amount chargeable. This was therefore not an 'appealable' decision.

Decision:

The FTT found that the issue between the parties was whether, as stated in the letter, NTJ should be registered. This issue, stated in writing, was not 'in the abstract or on a hypothetical basis'; it was sufficiently crystallised to constitute a decision 'in respect to' the registration of NTJ within s 83(1)(a). Similarly, the issue of a registration certificate on 29 February 2016 (and the subsequent issue of its cancellation) were appealable decisions. This was irrespective of the fact that the certificate had originally been sent to the wrong address, as notification was not a prerequisite to VAT registration.

The position was, however, different in relation to the penalty imposed by HMRC, notification of which had also been sent to the wrong address. S76(4) VATA 1994 contained a requirement to notify penalties. However, following *Grunwick* in 1986, although not enforceable, the penalty could be valid and therefore an appealable decision within s 83(1)(q). The penalty was nonetheless invalid because the notification letter had indicated that the appellant could 'ask for a review', when it should have said that the appellant had the statutory right to a review. The appeal was therefore struck out against the s 67 penalty.

Comments – Normally, HMRC apply for an appeal to be struck out, but in this case HMRC argued that the FTT has jurisdiction to determine the appeals.

NT ADA v HMRC TC5375

Reasonable grounds for believing tax was overcharged

Summary – The First-tier Tribunal held that there were reasonable grounds for believing that the taxpayer was overcharged to tax for the purposes of an application to postpone payment of corporation tax pending determination of an appeal

The taxpayer applied for the postponement of corporation tax of £516,721. It had arisen as a result of a consequential amendment by HMRC disallowing a claim for intangibles relief of £2m. The relief related to the amortisation of goodwill acquired by the taxpayer on the transfer of the business to it from Spring Salmon & Seafood Ltd.

In essence, HMRC refused the claim because, in an earlier First-tier Tribunal decision (TC4273) concerning the goodwill, the judge had concluded that the company was not entitled to relief. HMRC interpreted this as implying the judge had given consideration to Sch 29 Para 92 FA 2002 (transfers between company and related party treated as being at market value) and para 118 (application of the schedule to assets created or acquired after commencement). The taxpayer said the judge had not considered these provisions.

Decision:

The First-tier Tribunal agreed that, because neither paragraph was 'specifically addressed in the decision', there was a 'reasonable, as opposed to fanciful, argument' that they could apply to the appeal against HMRC's consequential amendment.

The taxpayer's application for postponement of tax was allowed.

Comments – The FTT confirmed that, in relation to determining whether there are reasonable grounds for believing that a taxpayer is overcharged to tax for the purposes of an application to postpone payment of corporation tax pending determination of an appeal, it is not necessary for the tribunal to conduct a 'mini-trial' of the issues that will be aired at the full hearing of the appeal. All that is necessary is to show that there are reasonable grounds for making an argument

Spring Capital v HMRC TC5382

Non-compliance with Money Laundering Regulations

Summary - The FTT dismissed a taxpayer company's appeal against a penalty for non compliance with the anti-money laundering rules, but reduced the penalty because HMRC had not followed their penalty policy framework.

The Regulations implement the UK's obligations under Directive 2005/10/EC, which relates to the prevention of the use of the financial system for the purpose of money laundering and terrorist financing. HMRC is the supervisory authority for auditors, external accountants and tax advisers which are not supervised by any other specified body. Under the Regulations, a person to whom the Regulations apply must apply 'customer due diligence', conduct 'ongoing monitoring' of its business relationships and apply 'enhanced ongoing monitoring' on a 'risk sensitive basis'.

N Bevan operated a small accountancy business with about 75 clients. It provided end of year accounts preparation and assistance with self-assessment, corporation tax, PAYE and VAT returns.

Decision:

The FTT noted that N Bevan had been unable to provide HMRC and the tribunal with evidence that it complied with its obligations under the Regulations.

The FTT accepted that N Bevan had a limited client base and may know its clients and how they operated; however, it was unable to demonstrate that this was the case. A penalty was therefore due. Under the Regulations, the maximum penalty was 10% of N Bevan's gross profit. HMRC had mitigated this by 50%, as the failure had not been deliberate.

The FTT found, however, that HMRC had been too generous, as the company had failed to cooperate with HMRC during its various visits so that a 20% mitigation was appropriate. The penalty imposed by the FTT was, however, lower than that originally imposed by HMRC, as it accepted N Bevan's evidence as to the level of its gross profits.

Comments - In this case, the FTT accepted that the taxpayer may have known its clients and how they operated and, in relation to its corporate clients, who their beneficial owners were and what influence they exerted over the business. But as it was unable to demonstrate this to HMRC (its anti-money laundering supervisory body), and had been given time to rectify its processes and record keeping and had not done so, it was right that it was penalised.

N Bevan v HMRC TC5404

Tribunal's jurisdiction in relation to HMRC conduct

Summary – The complaints were outside the jurisdiction of the Tribunal.

HMRC assessed two unauthorised payments charges on the taxpayer. These had arisen from two loans made by an approved occupational pension scheme to the taxpayer who was the sponsoring employer of the scheme.

The taxpayer appealed. He also complained that HMRC had abused its powers and behaved inappropriately.

Decision:

The First-tier Tribunal considered only the preliminary issue in relation to HMRC's conduct. In essence, the taxpayer argued that the department had failed to return calls or provide copies of documents, had ignored the business's agent and had not provided notes of a meeting.

The judge said the tribunal had no general supervisory jurisdiction to consider a taxpayer's claims based on public law concepts of fairness or inappropriate behaviour by HMRC. He said the taxpayer's allegations about the department's conduct did not relate to the statutory requirements governing the raising of assessments.

He concluded that the complaints about HMRC's conduct were 'properly for judicial review proceedings and/or the HMRC adjudicator'. They were outside the jurisdiction of the First-tier Tribunal. These arguments were struck out under rule 8(2)(a) of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009, but the judge confirmed the appeal concerning the charges was unaffected by this decision.

Comments – The decision is self-explanatory.

Eden Consulting Services (Richmond) Ltd v HMRC TC5399

HMRC News

Deadline Dates

1 November 2016

- Payment of corporation tax liabilities for periods ended 31 January 2016 for small and medium-sized companies not liable to pay by instalments are due by this date

2 November 2016

- Filing date for form P46 (Car) for quarter ended 5 October 2016.

5 November 2016

- Deadline for specified employment intermediaries to file return for quarter to 5 October 2016.

7 November 2016

- Due date for VAT returns and payment for 30 September 2016 quarter (electronic payment).

14 November 2016

- Due date for quarterly corporation tax instalment for large companies depending on accounting year end.
- Due date for Monthly EC sales list if paper return used.

19 November 2016

- Pay PAYE, NIC, CIS and student loan liabilities for month ended 5 November 2016 if not paying electronically by this date.
- File monthly construction industry scheme return by this date.

21 November 2016

- File online monthly EC sales list by this date.
- Submit supplementary intrastat declarations for October 2016 by this date.

22 November 2016

- PAYE, NIC, CIS, student loan liabilities should have cleared into HMRC bank account.

23 November 2016

- Autumn Statement

30 November 2016

- Companies House should have received accounts of private companies with 28 February 2016 year end by this date.
- Companies House should have received accounts of public limited companies with 31 May 2016 year end by this date.
- HMRC should have received CTSA returns for companies with accounting periods ended 30 November 2015 by this date.

Exceptions to the limiting of the individual Child Element of Child Tax Credit and the Child Element of Universal Credit to a maximum of two children - Consultation

The Welfare Reform and Work Act 2016 restricts the number of children or qualifying young persons in respect of whom the Child Element in Universal Credit and the Child Element in Child Tax Credit is payable to a maximum of two.

At the Summer Budget 2015 when the Chancellor announced the policy and during the passage of the legislation through Parliament four exceptions to this policy were announced (https://www.gov.uk/government/topical-events/budget-july-2015)

This consultation seeks further evidence and views to inform the detailed design of the exceptions and their implementation.

The Government is keen to hear views from all parties with relevant knowledge or experience, including charities and support groups, medical, health, social work and education professionals and affected individuals.

The consultation seeks views and evidence in relation to the detailed design and implementation of the exceptions to the policy to limit the Individual Child Element of Child Tax Credit and the Child Element of Universal Credit to a maximum of two children. It is not a consultation on the policy itself.

The exceptions being consulted upon in this document apply to both Child Tax Credit and Universal Credit. Universal Credit extends across Great Britain and Child Tax Credit across the United Kingdom.

The consultation period begins on 21st October 2016 and runs until 27th November 2016.

Jim Harra appointed as HMRC's new Tax Assurance Commissioner

Following organisational changes within HMRC, Jim Harra CB has today been appointed as HMRC's Tax Assurance Commissioner. Jim takes over from Edward Troup who is relinquishing the tax assurance role now that he is Executive Chair with wider responsibility for HMRC.

With his wealth of tax expertise and experience, Jim is well placed to oversee the assurance and dispute governance arrangements that allow Parliament and the public to be confident that HMRC secures the right tax under the law when resolving tax disputes. Jim does not directly engage with taxpayers to discuss their specific tax liabilities, nor is he responsible for the HMRC operational units that manage taxpayers' compliance.

The tax assurance role was one of the changes introduced in 2012 to strengthen HMRC's governance and assurance of tax disputes.

HMRC protects more than £900 million through 10th win against NT Advisors

HM Revenue and Customs has won its tenth successive win against tax avoidance schemes promoted by NT Advisors.

This means that HMRC's court successes against the serial avoidance promoter have now protected £916 million in tax. Previous successes include the defeat of the controversial Working Wheels scheme, where participants claimed to be second-hand car dealers.

The Court of Appeal has ruled that NT Advisors' latest scheme consisted of a series of circular payments designed purely to generate tax deductions with no genuine commercial purpose. No tax relief is therefore due. The latest ruling covers 304 users and will protect £143 million for the UK.

Jane Ellison, Financial Secretary to the Treasury, said:

> HMRC are working hard for the majority of taxpayers who play by the rules. Tax avoidance is unacceptable and HMRC has been given the tools to tackle it.
>
> Changes to the law have also ensured that any future schemes of this kind won't work as a way of avoiding tax.

Jennie Granger, HMRC's Director General of Enforcement and Compliance, said:

> HMRC has a 100% success record against NT Advisors in the courts. If you are currently using one of their schemes, or any other avoidance scheme, we will help you get out if you get in touch with us.

HMRC's dedicated helpline for people who have engaged in tax avoidance is 03000 530 435. Further information can also be found on GOV.UK.

In addition to the 10 litigation wins, HMRC has also successfully defended a Judicial Review brought by NT Advisors, which challenged the issue of Schedule 36 notices to obtain information on avoidance schemes.

HMRC announced that it has collected £3 billion from users of tax avoidance schemes in the last two years under its "accelerated payments" programme, which collects disputed tax up front. It is also consulting on tough new penalties for accountants, tax planners and advisers who provide advice on how to avoid tax.

Consultation on Penalty for participating in VAT Fraud

Publication date: 28 September 2016 Closing date for comments: 11 November 2016

This consultation, announced at Budget 2016, seeks your views on the introduction of a new penalty for businesses that participate in VAT fraud.

The vast majority of customers meet their obligations in full and on time. Penalties are only applied to a small minority of taxpayers. However we need to penalise those that seek to cheat the system to protect honest taxpayers.

Organised VAT fraud presents a significant risk to the public revenue. It commonly involves supply chains which seek to distance those behind the fraudulent evasion of VAT from the parties and supplies in the chain. The proceeds of the fraud are typically realised through a VAT repayment further along the chain. This new penalty is designed to penalise those that participate in VAT fraud and increase the downsides from engaging in this type of activity. Those affected are businesses and company officers that know or should know that their transactions are connected with a fraudulent default along the transaction chain.

If the government proceeds, HMRC will be able to levy the new penalty at the same time as they take action to address the primary fraud issue.

This will improve the effectiveness of HMRC's response to VAT fraud cases ensuring that those that facilitate fraud are penalised in a timely and efficient manner.

Calculating the 2014-15 tax gap

The tax gap in 2014/15 is estimated to have been £36bn, representing some 6.5% of the total tax and duties due to HMRC. The estimate announced for the previous year (2013/14) has been revised upwards from £34bn to an actual figure of £37bn (from 6.4% to 6.9% of the total dues).

1. What is the tax gap?
The tax gap is the difference between the amount of tax due and the amount collected. It is impossible to collect every penny theoretically owed in tax, so a 'tax gap' will always exist. For example, we cannot legally collect taxes from companies that owe tax and are insolvent.

1.1 Tax gap and percentage of liabilities: tax year 2005 to 2006, to tax year 2014 to 2015

This graph shows the tax gap totals between the tax years 2005 to 2006, and 2014 to 2015. It also shows what percentage each tax gap was of the total amount of tax owed.

When comparing over time, the tax gap as a percentage of liabilities is a more meaningful measure because it is not as affected by rate changes or changes in the size of the economy.

2. Why we measure it
The tax gap is an official statistic. We estimate the tax gap, because it provides a useful tool for understanding the relative size and nature of non-compliance.

Tax gap calculations cannot be used for precise performance management for a variety of reasons. For example, some components take a long time to calculate, the estimates are not accurate enough and they are updated when new data becomes available. We publish tax gap figures every year to show broad trends in compliance and because we want to be transparent in our thinking on this important issue of public interest.

3. Latest calculations

We estimate the 2014 to 2015 tax gap was 6.5% of total tax and duties due to HMRC – a reduction from 6.9% in 2013 to 2014.

This equates to £36 billion, after we deduct the money we bring in through our compliance activities. This indicates that more than 93% of tax due was paid in the tax year 2014 to 2015. There is an overall downward trend from 8.3% in the tax year 2005 to 2006 to 6.5% in the tax year 2014 to 2015, although the tax gap has levelled out in recent years.

The current tax gap estimate of £36 billion is £11 billion lower than it would have been if the percentage tax gap had remained at the 2005 to 2006 level of 8.3%. The adjustment in the figures for 2013 to 2014 from £34 billion to £37 billion largely result from two factors:

- projected information has been replaced by actual data
- improved data analysis arising from an upgrade in the way HMRC identifies risk

3.1 PAYE tax gap and percentage of liabilities: tax year 2005 to 2006, to tax year 2014 to 2015

Introducing Real Time Information (RTI) for Pay As You Earn (PAYE) in 2013 is likely to have made a significant contribution towards a large reduction in the PAYE tax gap to £2.8 billion (1.1%) in 2014 to 2015, compared to £4 billion (1.6%) the year before.

Its introduction has fundamentally reformed the PAYE system, allowing employers to send tax information at the time, or before, they make payment to their employees.

RTI has led to information on payroll taxes being recorded more accurately and on a more frequent basis. This has speeded up the collection of money we estimate we are owed by employers. It is allowing us to identify debts and take action at an earlier stage than previously – reducing the risk of the debt becoming uncollectable and having to be written off.

The VAT gap is at its lowest level of 10.3% (£12.7 billion) for 2014 to 2015, compared to 11.4% (£13.5 billion) the year before. The VAT gap is reducing due to the combined effect of a number of our measures, including:

- putting pressure on organised crime, particularly where fraudsters charge VAT and then go missing before paying it over to the Exchequer, which is known as Missing Trader Intra-Community Fraud, (MTIC). We have responded to new risks by amending our operational processes, as well as sharing information with other countries
- taking VAT online, including online filing of VAT returns and VAT registration - this has removed opportunities for people to make basic errors, for example, the introduction of the Notification of Vehicle arrivals (NOVA) service has removed the opportunity for VAT fraud on cars entering the UK
- introducing legislation that has had a major impact on VAT avoidance, which along with a change in the general climate has made aggressive tax planning less acceptable

The tobacco duty tax gap is made up of the illicit market in cigarettes and hand-rolling tobacco and is estimated to be £1.4 billion (12.8%) in 2014 to 2015, compared to £1.9 billion (16.6%) for the year before.

4. Quality of the calculations

Tax gap calculations are a complex series of measurements; this is partly why very few countries produce a tax gap estimate and the estimates themselves are subject to constant revision.

We have access to data that covers most tax sources, and use experimental statistics in a consistent way where limited evidence is available. Because we have had our calculations reviewed and endorsed by the International Monetary Fund, we are confident that our calculations are as accurate as they can be. We publish our methods and set out clearly any changes we make.

To put the £36 billion tax gap in context, we collected £517.7 billion in tax during 2014 to 2015. The figures, combined with our own customer research, show the vast majority of UK taxpayers pay what they owe, with only a small minority choosing to bend or break the rules.

5. Our approach to tackling the tax gap

Calculating the tax gap and its different component parts means we can focus in a more targeted way on the non-compliance that exists within our different customer groups.

We are well underway in implementing our 'promote, prevent, respond' approach to non-compliance. We aim to make paying tax simple and efficient for the compliant majority, through promoting good compliance and preventing errors when they deal with HMRC. This allows us to target and respond in a more robust way with the small minority intent on cheating the tax system.

Through significant new powers to tackle tax avoidance, we have made it far less attractive for individuals and companies to try to bend the tax rules to their own advantage.

In the two years since we introduced Accelerated Payment Notices, which require those who have entered into tax avoidance schemes under HMRC investigation to pay the disputed tax upfront within 90 days, we have secured more than £3 billion in disputed tax. By the end of 2016, we expect to have issued 64,000 notices – securing £5.5 billion in tax for the UK by March 2020.

Outstanding debt forms part of the tax gap and we give people who have tax or tax credits debt every opportunity to pay, including Time to Pay arrangements. For the small minority who refuse to comply, and after applying rigorous checks first, we use 'direct recovery of debt' powers to recover the money owed from their bank and building society accounts.

We continue to close the net on hidden wealth offshore through voluntary disclosure facilities that have attracted more than 57,000 disclosures and raised more than £1.6 billion since 2007. We also launched more than 100 taskforces aimed at employment sectors at high-risk of non-compliance since May 2011, bringing in more than £404 million and continue to enforce strict controls on wholesalers in the alcohol sector, to prevent excise fraud.

Making it easier, more efficient and cost-effective for customers to deal with HMRC drives compliant behaviour and is fundamental to how we tackle the tax gap. We are already introducing digital services that are transforming the way individuals and businesses pay what they owe and claim entitlements.

By 2020 customers will be able to see all their tax affairs in near real-time, in one place, with overpayments offset against liabilities. They will not need to provide information that HMRC already holds, whether directly from customers or from third parties. Prompts built into digital tools will eliminate common errors, giving businesses greater certainty that they've got their tax right first time. Targeted guidance and tailored alerts will make businesses more aware of relevant obligations, entitlements and reliefs.

More than five million individuals have already signed up for Personal Tax Accounts where customers can check their records and manage their dealings with HMRC. Small businesses are benefitting from support across a range of digital channels, including webinars, YouTube video tutorials and e-learning packages.

The full report - Measuring tax gaps - contains detailed information about the tax gap and how we measure it.

HMRC are considering the tax status of 100 BBC presenters

HMRC are investigating around 100 BBC presenters over claims they used personal service companies (PSCs) in a bid to reduce the amount of tax they paid when working as staff at the organisation. This is according to evidence presented to a First-tier Tribunal (FTT) in Paya Ltd[2016] TC 05386 which dealt with a procedural issue about whether the BBC could supply evidence in the substantive appeal. This substantive tribunal is considering an appeal by two BBC news presenters, Tim Willcox and Joanna Gosling, over whether their PSC arrangements met the requirements of IR35.

In the event, the FTT looking at the procedural question decided against allowing the BBC to submit an application to give evidence. However, the documents provided show that in July last year, HMRC were in the process of working through a list of 469 people who had been engaged by the BBC via PSCs, to establish whether further investigations should be initiated. By the autumn, HMRC were considering opening inquiries into the tax affairs of 100 individuals described as 'on-air talent'.

The BBC's argument to the tribunal was that this was an industry-wide issue which should be dealt with on that basis, rather than by seeking to reclaim income tax and National Insurance contributions from individuals.

In a statement, the BBC said the arrangements under discussion were made during the period 2006 to early 2013, and the corporation has since developed new guidance on the use of PSCs for staff members.

OECD publishes BEPS mutual agreement procedure peer review documents

The OECD has released a group of documents that will form the basis of the Mutual Agreement Procedure (MAP) peer review and monitoring process under Action 14 of the BEPS Action Plan. The MAP is the framework for resolving tax-treaty related disputes.

On 20 October 2016 OECD released key documents, approved by the Inclusive Framework on BEPS, that will form the basis of the Mutual Agreement Procedure (MAP) peer review and monitoring process under Action 14 of the BEPS Action Plan.

The Action Plan on Base Erosion and Profit Shifting identified 15 actions to address BEPS in a comprehensive manner. Recognising that the actions to counter BEPS must be complemented with actions that ensure certainty and predictability for business, Action 14 calls for effective dispute resolution mechanisms to resolve tax treaty-related disputes. The BEPS package endorsed by the G20 Finance Ministers in October 2015 contains the report on Action 14 (Making Dispute Resolution Mechanisms More Effective), which outlines the minimum standards and best practices for resolving treaty-related disputes under the Mutual Agreement Procedure (MAP).

The documents released today form the basis on which this process will be moving forward. The compilation includes the Terms of Reference which translate the minimum standard approved in the final Action 14 report into a basis for peer review; the Assessment Methodology for the peer review and monitoring process and the MAP statistics reporting framework which reflects the collaborative approach competent authorities will take to resolve MAP cases and will ensure greater transparency on statistical information relating to the inventory, types and outcome of MAP cases through common reporting of MAP cases going forward and Guidance on information and documentation to be submitted with a MAP request.

Through rigorous peer reviews and continual collection of data, the Action 14 BEPS deliverables seek to eliminate taxation not in accordance with treaty provisions and help resolve any tax-treaty related disputes in a timely and efficient manner. The involvement of the Inclusive Framework throughout the peer review process ensures that the effort to streamline MAP incorporates the experience of both developing and developed countries. The peer review and monitoring process will be conducted by the FTA MAP Forum, with all members participating on an equal footing.

The review will take place on the basis of the existing treaties and there is no requirement for jurisdictions to negotiate any new treaties. Furthermore, the methodology released today contains the possibility for developing countries to defer the peer review, recognising their capacity constraints and often relatively small MAP pipeline.

Consistent with its efforts to enhance transparency, the OECD will also publish updated MAP profiles of all members of the Inclusive Framework, which contain information about each member's Competent Authorities' contact details, domestic guidelines for MAP and other useful information for both tax authorities and taxpayers. The actual peer reviews will be conducted in batches, with the first batch commencing in December 2016. We will be seeking taxpayer input before the launch of these reviews and a questionnaire for taxpayer input seeking such input will be published shortly, together with a schedule for review.

Business Taxation

Nature of statutory interest payable to creditors

Summary – The HIgh Court found that the statutory interest to be paid under reg 2.88(7) was not yearly interest within the scope and meaning of s874 ITA 2007, and no obligation to deduct tax arose.

Lehman Brothers International (Europe) had been in administration since September 2008. There was a substantial surplus in the administration that was to be used to pay statutory interest to creditors under Insolvency Rules SI 1986/1925, reg 2.88 para 7. The value of that interest was estimated to be £5bn.

The question arose as to whether the interest would be yearly interest for the purposes of s874 ITA 2007 as contended by HMRC. If it did, the administrators would be required to deduct income tax from the payments made and account for it to HMRC.

Decision:

Mr Justice Hildyard in the High Court said the statutory right to interest arose only if a surplus was established. It did not accrue over the period between the beginning of the administration and the payment of dividend or dividends on the proved debts.

He said: 'Accrual signifies that a sum certain is being added over time, so that at any given time the amount accrued may be ascertained. The exercise in reverse engineering posited by HMRC in seeking to characterise as "accruing" a sum which, it is common ground, does not in fact become payable unless and until a right arises "at the end of the day" is not justified.'

The judge said HMRC had not recognised the particular nature of the statutory interest payable out of surplus. Although it was interest for the purposes of tax legislation, it was of a 'very different nature from that payable on contractual debts, judgment debts of other analogous debts'.

The right to payment out of a surplus of statutory interest was in the nature of an arrangement statutorily imposed on the creditors for the equitable distribution of surplus. This was different from a case where a payment or commitment to pay interest had been determined to be in the nature of yearly interest.

He said: 'There is no loan; no investment; no judgment; no period of accrual; no right unless and until a surplus is established; no quality or capability of recurrence; there is only a moratorium and a scheme of distribution mandated by the statute and the rules.'

The judge concluded: 'The legislation had manifestly created a right which did not have the quality of yearly interest and was not subject to any deduction obligation.' The statutory interest to be paid under reg 2.88(7) was not yearly interest within the scope and meaning of s874 ITA 2007, and no obligation to deduct tax arose.

Comments - For readers with an interest in tax history, the judgment includes at the end a brief history of the deduction of yearly interest. The sums involved were huge.

The joint administrators estimated the value of statutory interest calculated from the date of administration to the date of the final dividend to be in the region of £5bn. The issue was of great importance for HMRC as many of the creditors entitled to interest were non-resident and therefore cannot be charged to tax in relation to UK source interest beyond any amount deducted at source .

Re Lehman Brothers International (in administration); Lomas and others v CRC, Chancery Division, Companies Court

Claim for capital allowances on the purchase of caravans

Summary – The FTT found that caravans occupied by a Caravan Club warden in the performance of his employment duties did not qualify as plant for capital allowances purposes because they played no part in the carrying on of those duties, but were merely the place within which the duties were carried on.

The taxpayer and his wife were employed by the Caravan Club as assistant wardens at various locations. They were required to be on site 24 hours a day and, although the club would have provided accommodation, they used their own caravans. The taxpayer claimed capital allowances on the purchase of two caravans. This was on the basis that he carried on a qualifying activity and owned them for that purpose.

HMRC said plant and machinery allowances were due only if the caravan was 'necessarily provided for use in the performance of the duties of employment or office' (s15(1)(i) CAA 2001). It was not enough that it was relevant to the duties.

Decision:

The First-tier Tribunal referred to the functional test in *Benson v Yard Arm Club* in 1979. The judge asked whether the caravan was 'something by means of which he carried out the duties of his employment, or merely the place (or part of the place) within which those duties were carried out'. This led to a consideration of the ambit of the taxpayer's duties as an assistant warden.

The tribunal concluded that the Caravan Club's requirement that an assistant warden must live on site throughout their employment was not enough to make the assistant warden's caravan 'something by means of which he carried out the duties of his employment'. Although, realistically, he could not have performed his duties without the use of the caravans, they did not pass the functionality test and could not be regarded as plant.

Despite the caravans being used as shelter and living accommodation in the performance of the employment duties, they played no part in carrying them out.

The taxpayer's appeal was dismissed.

Comments - The FTT clearly had some sympathy for the taxpayer in this case, but even though it accepted that the taxpayer could not legally or realistically have performed his job without the use of the caravans they were not something by means of which those duties were carried on, and therefore capital allowances could not be claimed.

P Telfer v HMRC TC5350

Under-declaration of trading income

Summary – The taxpayer's appeal was allowed in part against penalties for under-declaration of income.

The taxpayer was an events organiser. After an enquiry into her 2010-11 tax return, HMRC concluded that the taxpayer had understated her income because of unidentified deposits in her bank account.

It issued an assessment and imposed a penalty on the basis that the under-declaration had been deliberate. The taxpayer appealed.

Decision:

The First-tier Tribunal noted that neither the taxpayer — nor her husband — could provide documentary evidence to identify the income. However, the judge did accept that a couple of entries were the result of an insurance claim and a wedding present and he ruled that the assessment should be reduced to take those into account.

On the penalty, the tribunal decided that the under-declaration arose as a result of the taxpayer's disorganised approach to her personal finances rather than a deliberate default. It said the penalty should therefore be reduced from 59.5% to 25.5%.

The taxpayer's appeal was allowed in part.

Comments – The decision by the Tribunal is self-explanatory.

G Scott v HMRC TC5335

Tax credits for unlawful charge to charge on dividends

Summary – The High Court found two issues in favour of the taxpayer and one for HMRC.

Six Continents Overseas Holdings (SCOH) was incorporated in England and Wales in 1991. During the period 1993 to 1997, it received dividends from its wholly-owned subsidiary (SCIH) which was incorporated and resident in the Netherlands.

The dividends formed part of Six Continents' income profits and were chargeable to UK corporation tax under Sch D case V. Six Continents claimed the tax charge was unlawful. The Court of Justice of the European Union decision in *Test Claimants in the FII Group Litigation v CRC* (Case C-35/11) [2013] STC 612 had established the unlawfulness under EU law of the case V charge when applied to dividends paid to a UK holding company by a subsidiary resident in another member state.

Therefore, there was no dispute in the instant case about the unlawfulness of the charge: the only live issues were of a computational nature and the extent of the notional credit for foreign tax to which Six Continents was treated as entitled in calculating the restitution due for the unlawfully levied tax.

Decision:

The first issue was whether Six Continents was entitled to a credit at the Dutch corporation tax rate for the dividends derived from revaluation adjustments. Mr Justice Henderson in the High Court said a revaluation adjustment would be subject to Dutch corporation tax. Therefore, Six Continents was entitled to a tax credit.

The second issue concerned whether the taxpayer was entitled to a credit for the dividends which had arisen from the liquidation of a subsidiary of SCIH. The judge said this was similar to the first issue and, again, Six Continents was entitled to a tax credit because the liquidation profits would be subject to Dutch tax.

The final issue was whether Six Continents was entitled to a credit at the Dutch rate of corporation tax for the dividends derived from the share premium account in a Dutch subsidiary of SCIH. The judge said there were no profits for which EU law required a tax credit at the Dutch nominal rate to be given to Six Continents. In short, the case V charge on the dividends in question was, to that extent, compliant with EU law.

The first and second issues were decided in favour of Six Continents, but the third in favour of the Revenue. Six Continents was entitled to judgment and compound interest on the principal sums of unlawful tax. But each party had the right to apply for revision of this pending the appeal to be heard by the Supreme Court in *Littlewoods*.

Comments - The first and second issues were decided in favour of Six Continents, but the third in favour of the Revenue. Six Continents was entitled to judgment and compound interest on the principal sums of unlawful tax. But each party had the right to apply for revision of this pending the appeal to be heard by the Supreme Court in *Littlewoods*.

Six Continents Ltd and Six Continents Overseas Holdings Ltd v CIR and CRC, Chancery Division

FRS 102 - Tax Effects Of Transition Adjustments (Lecture B981 – 10.12 minutes)

Overview of the new accounting regime

Start dates

The changes are a consequence of the EU Accounting Directive and they affect the small companies regime for APs beginning on/after 1 January 2016 so in most cases you won't be preparing small company accounts under the new standards until early 2017

The full FRS 102 applied to medium and large companies with APs commencing on or after 1st January 2015 (i.e. one year earlier than the small company changes).

Applicable accounting standards

Framework	Applicable accounting standard
Micro-entities regime	FRS 105
Small entities regime	Section 1A Small Entities of FRS 102
FRS 102	FRS 102

Eligibility criteria

A company qualifies if it does not exceed 2 of the following 3 criteria:

	Micro-entities regime	Small entities regime
Turnover	£632,000	£10,200,000
Balance sheet total	£316,000	£5,100,000
No. of employees	10	50

First time adoption of FRS 102

This gives rise to a 'prior period restatement' in the accounts, resulting from a change of accounting basis. FRS 102 must be adopted at the transition date (which is defined as the start of the comparative year), subject to certain exemptions to make transition easier. So, for a medium or large company with a December year-end, the year of adoption is y/e 31 December 2015 and the transition date is 1 January 2014.

A tax adjustment is required, which is treated as a receipt or expense in the year of adoption, unless the special rules for financial instruments apply. The latter, which phase in transition adjustments over ten years in most circumstances, will be covered in a later lecture.

Example

ABC Ltd adopts FRS 102 with effect from its year ended 31 December 2015. The opening P&L reserves at the start of its comparative year (ignoring any tax effects) were as follows:

1 January 2014 – old UK GAAP	£480,000
1 January 2014 – FRS 102	£690,000
Increase in accumulated profits	£210,000

In addition, there is a £45,000 reduction in 2014 profit previously reported because of a leasing adjustment.

Assuming that the adjustments all have tax effects at a 20% rate that are recognised immediately, explain the current and deferred tax implications of adopting FRS 102 in 2015.

Solution

Both the £210,000 increase in reserves and the £45,000 reduction in the comparative year profits will affect the tax calculation for the year ended 31 December 2015. These adjustments to profit will produce a current tax liability in the 2015 tax computation equal to 20% of £165,000 (£210,000 - £45,000) i.e. £33,000.

How will this be reflected in the accounts? The double entry will be

	DR	CR
DR (see below)	£33,000	
CR 2015 Current tax liability		£33,000

There are two schools of thought on the debit:

1. Charge to shareholders' funds but show £9,000 credit in 2014 P&L to match the reduction of revised reported profit.

2. Include in 2015 expenses and use deferred tax to match

The latter is likely to be the preferred accounting treatment. The full double entry for this is:

	DR	CR
DR Opening retained earnings 1 Jan 14 (20% x £210,000)	£42,000	
CR Deferred tax expense 2014 ((20% x 45,000)		£9,000
CR Deferred tax liability 31 Dec 2014		£33,000

In 2015, the deferred tax is reversed out

	DR	CR
DR Deferred tax liability	£33,000	
CR 2015 tax expense		£33,000

Either way, no net 2015 tax expense is shown, as this tax liability, although not arising until 2015 following the adoption of FRS 102, relates to prior year profits.

Contributed by Kevin Read

Streaming of losses (Lecture B982 – 12.29 minutes)

In HMRC v Leekes Ltd (2016), the Upper Tribunal allowed HMRC's appeal against a decision made last year by the First-Tier Tribunal.

In November 2009, the taxpayer company (Leekes Ltd), which runs out of town department stores, had purchased a loss-making company with a similar trade and had then hived that trade up in order to combine it with its own operations.

The trade from the purchased company had given rise to substantial trading losses of over £3,000,000 which were being carried forward and the Upper Tribunal was asked to consider whether these losses could be used against profits from Leekes Ltd's own trade or whether the losses had to be streamed so that they could only be used against profits – when they arose – generated by the trade which had been hived up.

The First-Tier Tribunal had decided that the case hinged on the interpretation of the corporation tax legislation that provided for trading losses to be preserved when the trade was transferred to another company under common ownership. They found that the statute did not specifically require streaming in these circumstances and that streaming presented practical difficulties and was at variance with commercial reality. The Upper Tribunal disagreed. They stated that there was 'no real room for doubt' that what is now CTA 2010 did require streaming. The purpose of the legislation, the Upper Tribunal said, was to allow the losses from the loss-making trade to continue to be used against future profits from that trade. It was never the Government's intention to permit losses to be offset against the profits of someone else's trade.

Although the streaming of losses is not mentioned in so many words in CTA 2010, the Upper Tribunal inferred that this was due to the fact that there was no specific need for this, given that the transferor company's trade could be discretely identified as continuing (albeit as part of a larger operation) and that profits from this trade could be sufficiently identified by careful record-keeping.

This decision restores the position on loss streaming to what has always been the long-established view of HMRC.

Contributed by Robert Jamieson

Set-off of corporation tax loss against income tax profit (Lecture B983 – 11.17 minutes)

Introduction

In English Holdings v HMRC (2016), the First-Tier Tribunal allowed an appeal by a non-UK resident company against HMRC's decision to refuse a claim to offset losses arising in its UK permanent establishment (which would have been subject to corporation tax had it been profitable) against profits earned by its UK property rental business.

Background

English Holdings (EH) is a company registered in the British Virgin Islands. It had a permanent establishment in the UK through which it traded in land. Any profits made by this permanent establishment would have been subject to corporation tax by virtue of Ss5(3) and 19 CTA 2009. However, for the year in question, it had made a trading loss of more than £2,000,000.

The company also owned a number of investment properties in the UK from which it generated rental income. This letting business was not carried out through a permanent establishment and so it was within the charge to income tax on any profits arising – see S264 ITTOIA 2005. The profits for the relevant tax year were in excess of £1,000,000 and would normally have been assessed at 20%. However, EH made a claim to set off the loss incurred by its UK permanent establishment against the profits of the property letting business. The effect of this set-off, if permitted, would be to reduce EH's income tax liability to nil.

HMRC opened an enquiry into the relevant returns and, in due course, issued a closure notice rejecting the claim. EH appealed.

First-Tier Tribunal's decision

The issue before the First-Tier Tribunal was therefore whether a corporation tax loss could be set against an income tax profit.

EH's main argument was that it was entitled to the relief claim on an ordinary reading of the relevant statutory provisions. The company relied on S64 ITA 2007 which states:

'(1) A person may make a claim for trade loss relief against general income if the person:

(a) carries on a trade in a tax year; and

(b) makes a loss in the trade in the tax year.'

HMRC accepted that the company had carried on a trade and made a loss in the relevant year. However, they did not accept that the relief was due, given that S5 ITA 2007 provides:

'S3 CTA 2009 disapplies the provisions of the Income Tax Acts relating to the charge to income tax in relation to income of a company . . . if:

(a) the company is UK-resident; or

(b) the company is non-UK resident and the income is within its chargeable profits as defined in S19 CTA 2009.'

HMRC therefore argued that S3 CTA 2009 disapplied the income tax provisions – including the calculation of losses – if profits from the trade were chargeable to corporation tax.

The First-Tier Tribunal was not persuaded by this argument. Although the legislation limits the scope of the charge to tax in circumstances where profits are taxed, the relevant provision makes no mention of losses. In the Tribunal's opinion, the loss relief legislation in S64 ITA 2007 could, on a literal interpretation, be utilised by the taxpayer to offset income tax profits.

HMRC raised a further point in connection with EH's claim to set off its trading loss against profits of the same or preceding tax year. They argued that there was no basis period for income tax purposes and thus no loss capable of set-off. This view was also rejected by the Tribunal. Since the trade had not been started or discontinued in the tax year, the basis period was – by default – the accounting period ended in the tax year. This general rule is found in S198 ITTOIA 2005.

The company's appeal was allowed.

This case raises some interesting questions regarding the interaction between income tax and corporation tax in certain circumstances. The legislation, HMRC said, indicated that Parliament had intended the regimes for income tax and corporation tax to be treated as separate and distinct. For example, the time periods are different: tax years versus accounting periods. The Tribunal was not persuaded by this. Parliament could have introduced specific legislation to ensure that corporation tax losses were not set against income tax profits, but, for one reason or another, they had chosen not to do so. It was not therefore necessary to adopt a purposive interpretation of the legislation. It remains to be seen whether HMRC will appeal this decision or whether they will simply seek to have the relevant provisions amended.

Contributed by Robert Jamieson

VAT

Best judgment over ratio of zero-rated and standard-rated sales

Summary – The First-tier Tribunal dismissed the appeal regarding HMRC's assessment of the split between zero-rated and standard-rated takings.

The partnership traded as a café/takeaway pizza business. In November 2012 two HMRC officers visited the premises unannounced. They queried the split between standard and zero-rated sales on past VAT returns. These showed that 75% of sales were zero rated as cold takeaway food.

The taxpayers accepted that they had incorrectly zero rated hot takeaway food and also standard rated items such as bottles of water. HMRC carried out two days of observation in June 2013, which established that only about 26% of sales should have been zero rated and that the daily takings of £514 and £408 were much higher than the daily average of £200 declared by the taxpayers.

HMRC raised an assessment for £28,436 using its powers of 'best judgment' given by VATA 1994, s 73(1). This was based on a zero-rated percentage of 30% and an explanation from the owners that the takings in the two observation days were higher than usual because of sports days at local schools.

The taxpayers appealed.

Decision:

The First-tier Tribunal agreed that HMRC had been fair in all of its calculations and assumptions, and dismissed the view of the taxpayer that two days of observation were too few. The judge said it was for the taxpayers to explain why the assessment was incorrect but they provided no evidence about the zero and standard-rate split. HMRC had made reasoned decisions using the information available to it.

The appeal was allowed for the suppressed takings but dismissed in relation to standard and zero-rated sales.

Comments - Neil Warren, independent VAT consultant, said: 'The weakness in the taxpayers' defence was that they never presented any evidence or records about what the correct split of zero and standard-rated sales should have been. Their only line of attack was to challenge the basis of HMRC's calculations, even though HMRC had been very fair in giving allowances and concessions within the figures. To the cynical observer, this indicates that even a figure of 30% zero-rated sales was probably too high.'

S A Torkizadeh and H Torkizadeh trading as The Granary v HMRC TC5266

VAT exemption available to local authorities providing waste services

Summary – The Upper Tribunal considered an application for judicial review concerning the lawfulness of the VAT treatment being afforded to local authorities carrying out certain trade waste collection and disposal services. In the opinion of TDC, local authorities were in competition with private sector operators and should be bound by the same VAT rules. The UT held that where a local authority makes supplies of trade waste collection services to business customers in the performance of its duties as a public authority, it does not do so as a taxable person. Accordingly, its services are not liable to VAT.

The taxpayer provided commercial waste services and was required to charge VAT on them. Local authorities also provided trade waste collection services in their capacity as public authorities but these were exempt from VAT.

The taxpayer argued that local authorities offering trade waste collection, in competition with private providers, were not doing so as public authorities and should not benefit from exemption. It applied for judicial review of the VAT treatment of local authorities carrying out those services.

Decision:

The Upper Tribunal found that, when a local authority was providing waste collection services to business customers and did so in the performance of its statutory duties, those supplies would be 'activities in which it is engaged as a public authority' under s41A(a) VATA 1994. Whether an authority provided the services under its statutory duties would be a question of fact.

The judge said:

> 'If [the taxpayer] is to succeed on its application for judicial review, it must be on one of the two bases… The first basis is that the competition proviso applies. This would have to be tested as a matter between [the taxpayer] and the [local authorities] in whose areas it operates. The second basis is that there are [local authorities] who are, in fact, operating beyond their powers…'

Comments – The UT decided, in effect, that the status of local authorities providing commercial waste collection services should be determined on the facts of each case, but that such services are normally activities in which the provider was engaged as a public authority with a legal duty to arrange collections and, therefore, are not taxable services for the purposes of VAT. Although this was a preliminary ruling it will be welcomed by affected local authorities, who fear a combined annual loss in revenue of as much as £77m if it was decided that their collection services are subject to VAT.

R (on the application of The Durham Company Ltd (trading as Max Recycle)) v CRC and another, Upper Tribunal

DIY claim for a habitable building

Summary - The FTT dismissed the appeal against HMRC's decision to reject a DIY builder's claim for a VAT refund.

Mr Steynor had acquired three barns, which had been undergoing a conversion into residential accommodation. He had himself continued the works until the issue of a completion certificate.

The issue was whether Mr Steynor had carried out a residential conversion for the purpose of s35 VAT 1994. The FTT pointed out that the 'stumbling block' in s 35 was that the works carried out by the claimant must 'consist' in a residential conversion. The test was not satisfied by reference to his works taken together with those undertaken by others; it was satisfied only by reference to the works undertaken by the claimant. Mr Steynor's works had started after his purchase. At that time, one of the barns had already been adapted for use as a dwelling — although it was not compliant, safe or comfortable.

Decision:

The FTT concluded that s 35 did not apply. The FTT added that this did not contradict HMRC guidance (in VAT leaflet 431C) that in the event that a building is sold before a conversion is complete, the person completing the conversion may claim in respect of the works undertaken. The FTT simply added the proviso that this only applied if, at the time of the purchase, the building could not already be occupied as a dwelling.

Comments - A DIY builder is usually eligible to claim a VAT refund if he buys a building as a 'shell', which is not capable of being described as a dwelling, and fits it out to completion, but Mr Steynor was in a different situation. He did extra work to a converted building, which had been poorly completed before he purchased it.

W Steynor v HMRC TC5380

Careless error penalty in relation to building works

Summary – The FTT decided that HMRC had been correct to disallow a claim for input tax due to insufficient evidence.

The taxpayer traded as a furniture warehouse and claimed input tax of £39,152 for building works to improve the premises. An HMRC officer was not satisfied that the invoices related to a taxable supply received by the taxpayer and refused the claim. The officer also imposed a penalty for careless error. The taxpayer appealed.

Decision:

The First-tier Tribunal was satisfied that the taxpayer had received some supplies but found there was no evidence of negotiations, nor written estimates or agreements. Further, there was insufficient evidence of the cash payments alleged to have been made by the taxpayer.

The tribunal concluded that HMRC was correct to say the invoices were invalid. The judge also agreed that the penalty was appropriate on the basis that the taxpayer had been careless. However, HMRC's decision not to suspend the penalty was flawed because the inaccuracy was due to the taxpayer failing to keep adequate records. But, because of concerns about the authenticity of documents and records that were available, and the fact that work had not been carried out when the taxpayer initially insisted it had, the tribunal decided it was not appropriate to order HMRC to suspend the penalty.

The taxpayer's appeal was dismissed.

Comments - Neil Warren, independent VAT consultant, commented: 'The most interesting aspect of this case was that HMRC refused to suspend the careless error penalty on the basis that the officer did not know what had caused the error in the first place, so it was not possible to set a behavioural condition to avoid it happening again. This seems strange because the problem was clearly caused by poor record-keeping and failing to proper documentation to support input tax claims. But the tribunal supported HMRC and dismissed the appeal on this issue as well.'

G Singh trading as Smethwick Carpet and Furniture Warehouse v HMRC TC5376

Supplies of taxi services to contract customers

Summary – The First-tier Tribunal cancelled HMRC’s decision to compulsorily register the appellant for Value Added Tax on the basis that the appellant was acting as an agent on behalf of drivers in the supply of taxi services to account customers.

The taxpayer traded as a taxi business. He engaged self-employed drivers who had their own cars, kept the cash fares, and paid the taxpayer rent for the use of the base. He was not VAT-registered because the total income earned from the rental payments was below the registration threshold. He also had some account clients whom he invoiced monthly based on cash dockets produced by the drivers which detailed specific journeys.

HMRC said the taxpayer was acting as a principal in relation to the account work. As a result of including the income from those customers, he had traded above the VAT registration threshold since 2009. An assessment was issued as was a late registration penalty.

The taxpayer appealed, claiming this turnover should be ignored from the figures because he was acting as an agent, as he was for the cash work.

Decision:

The First-tier Tribunal noted that the taxpayer made no profit on the account business because he gave 100% of those fares to the drivers. The reason was the drivers would go elsewhere if he did not. HMRC argued that the taxpayer was acting as principal on the basis that:

- he negotiated terms and conditions with each account customer;
- he invoiced the account customers monthly; and
- payment was made into the business bank account by those customers.

The tribunal did not accept HMRC's arguments 'for a moment'. The judge said the features showed there were differences between the account and the cash businesses but the first two were inevitable for account work and the third had a practical purpose. He said:

'Agents habitually negotiate contracts, issue invoices and receive payment. So do principals of course, but those features are not the ones that distinguish a principal from an agent.'

The tribunal said there was no indication whether a bad debt would be charged to the driver or the taxpayer, which had been a consideration in similar cases, including *A Hussain trading as Crossleys Private Cars*(16194). It also noted that the arrangement seemed to meet the definition of an agent in *VAT Notice 700/25*, para 3.4. The tribunal concluded that the taxpayer was acting as an agent — the supplies of services to the account customers was made by the drivers. The taxpayer's appeal was allowed.

Comments - Neil Warren, independent VAT consultant, said: 'The approach of tribunals and HMRC is to treat taxi firms on a case-by-case basis. The two key factors in this instance were that the business owner made no direct profit from account customer journeys and did not appear to have any bad debt risk. The challenge is to weigh up all of the specific trading arrangements between the three parties to arrive at the correct VAT outcome. This is not easy in many situations.'

Khalid Mahmood v HMRC TC5358

Missing trader intra-community fraud

Summary – The Upper Tribunal allowed HMRC’s appeal against the decision of the First-tier Tribunal that the recovery of input tax had been wrongly denied on the basis that there was a connection with fraud.

HMRC claimed that the taxpayer had taken part in a missing trader intra-community (MTIC) fraud. As a result, it denied the company recovery of input VAT on transactions in computer processing units. At the hearing before the First-tier Tribunal, the taxpayer accepted HMRC had proved there had been a fraud and that each of its transactions had been connected with the fraudulent evasion of VAT. The issue was whether it had proved that the taxpayer had known or should have known about the connection to fraud.

Decision:

The First-tier Tribunal held that there was no evidence showing the taxpayer had known about the fraud. The most likely explanation therefore was that the taxpayer was an innocent party who had known nothing about it. HMRC appealed.

The Upper Tribunal said the First-tier Tribunal had given insufficient weight to HMRC's evidence. Further, it had not scrutinised the evidence of the taxpayer's witnesses in light of HMRC's factual evidence. These were errors of law. As a result, the Upper Tribunal ruled that the First-tier Tribunal's decision should be set aside and the matter remitted.

HMRC's appeal was allowed.

CRC v Pacific Computers Ltd, Upper Tribunal

VAT treatment of grant of right to use a stall at a craft fair

Summary – The Upper Tribunal allowed HMRC's appeal against the decision of the First-tier Tribunal, so standard-rating applied to the fees paid for stalls and pitches at craft fairs.

The taxpayer organised craft fairs in Dorset and accounted for output tax on admission fees paid by the public but not on the income she received from pitches sold to stallholders, which she treated as exempt supplies of land.

HMRC said the supply was a standard-rated package of taxable services, intended to give the business the opportunity to trade.

The First-tier Tribunal allowed the taxpayer's appeal, holding that the supply of space to stallholders was an exempt supply of a licence to occupy land.

Decision:

The Upper Tribunal agreed with HMRC that the licence provided by the taxpayer to the stallholder was not only to use a plot of land, but to use a stall or pitch at a specified event to sell items. Under the contract between the taxpayer and the stallholder, the former was obliged to provide a stall at the relevant fair.

Given that it was incumbent on the taxpayer to ensure there was a fair, the question arose whether there was a single supply or multiple supplies. The tribunal judge found there was a single indivisible supply to the stallholder. Further, this was a taxable supply because the taxpayer had 'very real and significant responsibilities beyond the bare provision of an appropriately-sized plot with, potentially, a table and chairs'. The judge accepted HMRC's argument that, in return for the fee, the stallholder gained the right to participate as a seller in a high-quality, well-organised craft fair, of which only one element was the pitch.

The judge concluded that the land exemption did not apply and the fees were subject to VAT.

HMRC's appeal was allowed.

Comments - Craft Carnival organised craft and garden fairs charging an entrance fee to the public and charging stallholders for a space at the fair to exhibit their wares for sale. The UT held that standard-rating, rather than exemption, applied to the fees paid for stalls and pitches at the craft fairs.

CRC v Kati Zombory-Moldovan (trading as Craft Carnival), Upper Tribunal

VAT flat rate scheme for farmers

Summary – The Upper Tribunal asked the ECJ for a ruling on whether the UK may exclude a business from the flat-rate scheme for farmers on the basis that it makes a substantial profit from the scheme.

The taxpayer, a family farming partnership in Northern Ireland, farmed beef cattle.

In May 2004, it joined the VAT flat rate scheme. In October 2012, HMRC cancelled the taxpayer's flat rate scheme certificate on the ground that the partnership obtained a much greater net benefit under the scheme than it would under normal VAT registration (*Notice 700/46*).

The First-tier Tribunal dismissed the taxpayer's appeal and the matter progressed to the Upper Tribunal which had to consider two issues:

- an exclusivity issue — whether Art 296.2 of the Principal VAT Directive, which permits a member state to exclude from the scheme 'certain categories of farmers', provided an exclusive regime as to when taxpayers could be excluded from the flat rate scheme; and
- categories issue — whether the exclusion of the taxpayer could be said to result from the exclusion of a category within the meaning of Art 296.2.

Decision:

The judge decided that both issues should be referred to the Court of Justice of the EU for a preliminary ruling. He felt unable to resolve either issue 'with complete confidence' and said the answer was not *acte clair*. Further, there was no established body of case law that helped and the decision, ultimately, was likely to have 'a potentially significant impact on the compatibility of the UK's flat rate scheme … with the provisions of the directive'.

Comments - The ECJ needs to clarify the law by ruling whether the UK may exclude a business from the Scheme on the basis that the business makes a substantial profit from using it.

Shields & Sons Partnership v CRC, Upper Tribunal

Home delivery of hot meals standard-rated

Summary - The FTT decided that the home delivery of hot meals was therefore standard-rated.

The taxpayer, who traded as meals on wheels, appealed against HMRC's assessments, raised on the basis that he had been making standard-rated hot food sales. He accepted that he supplied hot food; however, he submitted that the supplies fell outside the definition of 'in the course of catering', as they were not for consumption on the premises on which they were made.

Decision:

The FTT noted, however, that the fact that the food was not consumed on the premises where it was prepared had no bearing.

> Note (3)(b) provided: 'a supply of anything in the course of catering includes ... any supply of hot food for consumption off those premises'. The preparation and delivery of hot food to customers in their homes fell within this category.

The FTT also disagreed with the taxpayer's interpretation of Notice 709/1 (which in any event did not have force of law). Putting the various elements of a meal onto a plate did not amount to 'significant' or 'further preparation' (para 2.2.1 of the notice).

The FTT noted finally that the taxpayer was not a charity, a state-regulated private welfare institution or agency, or a public body of welfare services. Its supplies were therefore not exempt under Sch 9 VATA 1994..

Comments - This case is a useful reminder that note 3 is potentially extremely wide ranging**.**

Manifold (t/a Easy Living Meals on Wheels) v HMRC TC5406

Incorrect assessment made to best judgment

Summary - The FTT struck out the taxpayers' appeal as prime assessments, which turned out to be substantially incorrect, had been made to best judgment.

The appellants had failed to submit VAT returns for the five consecutive periods from 09/07 to 09/08 inclusive. HMRC had therefore assessed the VAT for those periods. Some years later, the assessments had been withdrawn, upon receipt by HMRC of the appellants' VAT returns for the relevant periods. There had been an overpayment of VAT of £20,971.51 and a claim for repayment was made. HMRC refused to credit the overpaid amount, on the basis that each of the returns had been submitted more than four years after the end of the prescribed accounting period. The taxpayers appealed and HMRC applied to strike out the appeal.

Decision:

The FTT found that all assessments by HMRC had been made to best judgment in the absence of figures provided by the taxpayers, using centrally stored data relating to the traders' business and tax history, in comparison with the average liability and average taxable turnover of the other traders within the same trade group. Any alleged deficiency in the empirical information available to HMRC was due to the fact that the taxpayers had not submitted returns.

Comments - The FTT commented that 'the appellants could not reasonably complain that HMRC should have considered information which it did not have', due to the appellants' failure to file returns. Furthermore, the fact that the assessments, when compared with the eventual returns, had turned out to be substantially incorrect did not mean that the assessments had been made contrary to best judgment.

P Doherty and another v HMRC TC5408

VAT and Holding Companies (Lecture B984 – 18.38 minutes)

The subject of VAT and holding companies is considered in detail in Tax Digest 153, July 2015. These notes summarise the main points only.

What are the VAT issues?

The key question in most of the cases about HCs is whether they can recover VAT on their expenditure, and if so how much. This can be subdivided into the following four steps.

1. Eligible to register? A HC that does not carry on an economic activity for VAT purposes is not a "taxable person". It is not eligible to register for VAT in its own right and none of the VAT it incurs qualifies as "input tax". It cannot therefore recover any of it.

2. Included in VAT group? A HC may be registered as part of a VAT group with one or more of its subsidiaries, as long as one or more of the companies comprised in the group carries on an economic activity. If so, the result is deemed to be a single taxable entity. VAT incurred by the entity is eligible for credit based on the economic activities of the VAT group, not of the HC or any particular subsidiary.

3. Input tax recovery Those HC disputes that have gone to court are mostly about the recovery of VAT on expenses. Tax authorities in several Member States have refused recovery on a variety of categories of expenditure. Some of the cases and principles are set out in the lecture and summarised in the following notes.

4. Partial exemption The application of the rules of partial exemption to HCs is a secondary issue. If VAT incurred on expenses qualifies as input tax incurred in an economic activity, it may still be irrecoverable if it is attributed to making exempt supplies.

Other issues

There are a number of issues concerning the operation of the VAT grouping rules in VATA 1994 s.43 and following. These are beyond the scope of this lecture.

The cases and other statements referred to in the lecture are summarised as follows.

Recent HMRC guidance

On 25 September 2014, HMRC issued Revenue & Customs Brief 32/2014 to confirm that they had reviewed their policy on recovery of input tax by HCs following the BAA Ltd decision. The Brief said that the policy had not changed, but internal guidance had been updated to clarify how the policy applies. The detail of the guidance suggested that the old policy in News Release 59/93 had changed, even though the Brief denied this.

The guidance at VIT 40500 set out HMRC's views of the functions of a HC and how a HC could recover input tax. The later decision of the CJEU in Larentia + Minerva (below) showed that the guidance was flawed, and a replacement has been awaited for over a year. Until it has been revised, it should be treated with extreme caution.

Polysar

The issue of VAT recovery by HCs came under the spotlight after the 1991 judgment of the CJEU in Polysar Investments Netherlands BV v Inspecteur der Invoerrechten en Accijnzen (Case C-60/90). PIN BV

was an intermediate HC in a large international group. It received dividends from subsidiaries and channelled them up to the ultimate HC in Canada.

The problem for VAT was that the company did nothing else: it merely received dividends and paid dividends. The CJEU ruled that this did not constitute an economic activity – a business, in UK parlance – so it was not entitled to register for VAT or recover input tax incurred on any of its expenses.

Infringement proceedings on grouping

Although Polysar could not join a VAT group registration because its fellow group companies were established in other countries, many Member States permit IHCs and wholly exempt companies to join group registrations. In 2011 the Commission brought infringement proceedings against several Member States, arguing that this was contrary to the PVD. The Commission believed that only companies which were taxable persons in their own right should be allowed to join groups.

The judgment in Commission v Ireland (Case C-85/11) is representative. The Court pointed out that the Commission's view appeared to be based on the wording of the 2nd VAT Directive, which referred to "taxable persons" in this context. The words were removed in drafting the 6th Directive, and the PVD is broader still, referring to "any persons". The Court ruled that the only relevant conditions were those stated in art.11 PVD: the persons should be legally independent but closely bound by economic, financial and organisational links; and they should be established in the territory. If there was scope for abuse, art.11 allowed Member States to introduce rules to counter it.

Cibo

In Cibo Participations SA v Directeur regional des impots du Nord-Pas-de-Calais (Case C-16/00), the CJEU held that the management of subsidiaries could qualify as "economic activity" if it involved "the performance of administrative, financial, commercial or technical services". Costs relating to the purchase of these subsidiaries were therefore overheads of a business rather than being covered by the Polysar principle.

Larentia + Minerva

In Beteiligungsgesellschaft Larentia + Minerva mbH & Co. KG v Finanzamt Nordenham; (C-109/14): Finanzamt Hamburg-Mitte v Marenave Schiffahrts AG (Case C-108/14), the CJEU distinguished between two types of holding company:

- those whose sole purpose is to hold and manage shares in other companies and which do not provide those companies with any services for remuneration and thus do not involve themselves directly or indirectly in the management of other undertakings, other than by exercising their rights as shareholders (Polysar);

- those which have direct or indirect involvement in the management of the companies in which the holding has been acquired, without prejudice to the rights held by the holding company as shareholder (Cibo).

The first are regarded as merely acquiring and holding financial holdings, and are not engaged in economic activity. The second category, referred to as "management holding companies", are economic operators. If a management holding company incurs input tax in relation to the acquisition of a subsidiary to which it will supply taxable management services, no part of that input tax is irrecoverable because of the investment activity of holding the shares – only partial exemption based on making exempt supplies will restrict recovery.

BAA

In Spring 2006 a Spanish company formed a new subsidiary (ADIL) to make a takeover bid in respect of BAA plc. After this bid was successful (July 2006), the new holding company joined BAA's VAT group registration (September 2006). BAA then claimed an input tax deduction for some £6.7m incurred in respect of the costs of making the bid and in refinancing the group operations afterwards. HMRC refused the claim, arguing that there was no direct and immediate link between these inputs and any taxable supplies made or to be made by the group.

The company appealed, contending that the activities of a HC are "economic activity" in European law, and the preliminary activities of the bidder were regarded as such in line with cases going back to Rompelman. The new HC actively managed the acquired business, and obtained finance to fund the group's capital expenditure programme.

The company's appeal succeeded in the First-Tier Tribunal, but the Upper Tribunal ruled against it. The Court of Appeal ruled that the FTT and UT had both been wrong to conclude that the company had carried on an economic activity at the relevant time. The relevant time was when it incurred the liability to pay the VAT; at that point, its only intention was to take over BAA, which was an investment transaction within the principles of the Polysar case, rather than relating to an intention to make taxable supplies of goods or services. The FTT had also been wrong in law to find any connection between the inputs incurred by ADIL and the outputs later made by the BAA group. The inputs were only incurred in connection with the takeover of BAA, and were unconnected with any outward supply that either ADIL or BAA had intended at that time to make.

Norseman Gold/African Consolidated

A UK company appealed against an assessment to claw back £81,000 of input tax recovered in its VAT returns from 10/07 to 01/09. It was a UK registered company, listed on the Alternative Investment Market (AIM). Its operating subsidiaries carry on gold mining activities in Australia. The judge was satisfied that the directors of the HC spent material amounts of time in managing the subsidiaries' activities. In principle, therefore, it was possible that the HC was "active" and making taxable supplies of

management services. However, at the time that the “supplies” were made, no price or payment terms had been agreed. Although the facts of Tolsma (Case C-16/93) were somewhat different, the judge agreed with HMRC that the principle was of assistance: any payment would have been voluntary, and would therefore not have been consideration for a supply.

The agreement of payment terms only finally took place after the last of the disputed periods, and that could not change the correct treatment, which should be based only on the conditions subsisting at the time the claims to input tax were made. The Upper Tribunal confirmed this decision as correct.

BLP

In BLP Group plc v C & E Commrs (Case C-4/94), the CJEU set down a principle that:

costs that are directly attributable (“immediately linked”) to a particular supply cannot be treated as overheads for partial exemption purposes, even if they have a general link to the business as a whole;

costs that are directly attributable to more than one type of output can be treated as residual and apportioned using the rules of partial exemption, but the link to each type of output has to be direct and immediate.

AB SKF

In Skatteverket v AB SKF (Case C-29/08), the CJEU ruled that the sale of shares in a subsidiary is an economic activity and within the scope of VAT. That suggests that it is likely to be an exempt supply. However, the Commission submitted that it could be regarded as the sale of a “totality of assets” (i.e. a TOGC); if so, it would be disregarded and treated as neither a supply of goods nor a supply of services.

The judgment went on to rule that the transaction itself is an exempt supply if it is not a TOGC, but held out the possibility – again for the national court to determine – that there could be “a direct and immediate link between the costs associated with the input services and the overall economic activities of the taxable person”. If this is the case, the costs would be residual, and a fully taxable trader would be able to recover all the input tax (as the exempt supply of the shares would be an incidental financial transaction).

X BV

The CJEU considered the application of AB SKF in Staatssecretaris van Financiën, other party: X BV (Case C-651/11). The circumstances of the present case were quite different, in that the sale only involved 30% of the company. Someone who owned only 30% had only restricted rights over the assets of the company, and this could not be equivalent to a TOGC. Accordingly, the sale of the 30% holding had to be an exempt transaction, and the input tax would not be deductible.

Contributed by Mike Thexton

Year end account -what are the VAT issues? **(Lecture B985 – 12.00 minutes)**

Introduction

I recently got involved with a VAT problem that HMRC identified on a compliance visit, namely a difference in the sales figure on the annual accounts of a business compared to the outputs declared on its VAT returns for the same period. The figure on the accounts was higher by £700,000! You might be wondering why the accountants didn't identify the problem as soon as the first accounts were produced, rather than waiting for it to come to light on an HMRC visit two years later?

And did the discrepancy not produce a creditor balance in the nominal ledger that was much higher than the declared liability on the VAT return? Was this checked? In this session I will consider some practical issues and also two recent First-tier Tribunal (FTT) cases where things went badly wrong for the taxpayers.

Case study

Let us create an imaginary business that has three units in the north west of England trading as a wholesaler of paint and wallpaper. All sales are invoiced to retailers and about 10% of sales are exported. A comparison between the turnover figure on the year end accounts shows sales of £2m compared to outputs of £1.5m on the VAT returns for the same period. What is the solution to this problem?

As an opening comment, I think that a comparison between turnover and outputs is an essential check, and I'll explain why when I consider the FTT case of Wholesale Clearance UK Ltd. I also think it is important to compare the VAT control account balance in the nominal ledger with the liability on the return at the end of each VAT period. A year-end check should be easy because most businesses have VAT periods that coincide with their financial year.

So as a practical challenge, what are the possible reasons why there could be a difference between the accounts and VAT returns of our wallpaper business, which will not result in extra output tax being payable?

- The business might be using the cash accounting scheme which means outputs figures will be based on payments received rather than debtor accounting.
- There could be errors recording zero-rated sales for eg exports which means these sales might be excluded from Box 6 of the VAT returns (eg coded T9 rather than T0 in the Sage world).
- Work-in-progress could be included in the accounts within the sales figure but would not be recorded on VAT returns until a tax point has been created ie when a sales invoice is raised or payment received for the job in question.
- Many businesses forget to include income from overseas services in Box 6 of their VAT returns, which is usually outside the scope under the general B2B (business to business) rule but should still be declared (HMRC Notice 700/12, para 3.7)
- The accounts might contain errors which have resulted in the turnover figure being overstated.

Recent tribunal case

It is always better to nip a problem in the bud before it gets out of control and more difficult to solve with the passing of time. The recent FTT case involving *Wholesale Clearance UK Ltd (TC5027)* highlights this point.

To set the scene, an HMRC officer compared the turnover on the accounts with the declared outputs on VAT returns for the years ending 31 July 2009 to 2011. An assessment was raised for £27,768 because more sales were recorded in the accounts than on the VAT returns.

It was subsequently reduced to £17,614 because only the final quarter of 2009 was in time under the four-year assessment rule. The assessment was raised on the basis of s73(1), VATA1994, which gives officers the power to 'assess the amount of VAT due……to the best of their judgment.'

The accountant was not available to explain the differences to the tribunal because of a 'personal tragedy' and the officer did everything expected of him to produce a fair assessment eg by taking into account the company's zero-rated export sales (about 11% of total sales). The appeal was dismissed.

A key learning point from this case is that it can be very difficult to back pedal and explain differences that happened many years ago. This is the reason for my suggestion that the 'turnover v outputs' check should be carried out each year as a worthwhile habit.

Second tribunal case - basic error

The FTT case of Ppig Ltd (TC4655) was not directly concerned with the figures on the annual accounts but relevant to an error that should have been identified many years before it was discovered by HMRC.

The problem was that the director Mr MacMillan claimed input tax on his UK VAT returns for five successive years in relation to VAT paid in other EU countries, which HMRC rightly disallowed on a compliance visit.

The officer raised an assessment for £67,178 plus interest for the previous four years. The company should have claimed overseas VAT through the EU refund system, where claims must be made within nine months of the end of the previous calendar year. This caused the company a big problem because it was out of time in most cases as far as a potential claim was concerned.

My initial thought was to wonder why Mr MacMillan's accountant did not alert him to the errors. But after a period of reflection, I realise how very different things are in the modern global world when it comes to producing accounts.

A lot of work is now done by electronic communication, a very different approach to the old days of a bundle of records and invoices being brought into the office in a Tesco carrier bag.

VAT objectives

There are three main objectives that are relevant when we try to give a good service to clients. I hope these give food for thought.

1. ***Compliance matters*** – making sure that VAT returns submitted by the business have been correctly calculated ie no errors etc.

2. ***Tax saving opportunities*** – are there opportunities to legitimately reduce a client's VAT payments or help his cash flow? Example – would the flat rate scheme be a winner if the business is eligible to join?

3. ***Future plans*** – is the client doing anything in the future that will affect VAT accounting? Examples - investing in a new business, changing the way he buys vehicles, buying a property where an option to tax might be relevant.

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